Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL ACCOUNTING AT THE ON-SITE INSPECTION AGENCY

Report No. 97-129

April 15, 1997

Department of Defense

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Acronyms

CAFRMS	Centralized Accounting and Financial Resources Management System
CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
DSWA	Defense Special Weapons Agency
OSIA	On-Site Inspection Agency

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

April 15, 1997

MEMORANDUM FOR DIRECTOR, ON-SITE INSPECTION AGENCY

SUBJECT: Audit Report on Financial Accounting at the On-Site Inspection Agency (Report No. 97-129)

We are providing this audit report for review and comment. The audit was performed in response to the Chief Financial Officers Act of 1990 as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report in preparing the final report.

We request additional comments by June 15, 1997, on the potential monetary benefits identified in this report .

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson, Audit Program Director, at (703) 604-9582 (DSN 664-9582) or Mr. Marvin L. Peek, Audit Project Manager, at (703) 604-9587 (DSN 664-9587). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Report No. 97-129
(Project No. 7RD-2001)

April 15, 1997

Financial Accounting at the On-Site Inspection Agency

Executive Summary

Introduction. Public Law 103-356 requires DoD to provide consolidated financial statements for FY 1996 to the Office of Management and Budget. Financial data from the On-Site Inspection Agency (OSIA) will be included in the category "Other Defense Organizations" in the consolidated financial statements for DoD. The OSIA received $68.5 million in direct funding during FY 1996 and reported $120 million in assets to the Defense Finance and Accounting Service for FY 1996.

Audit Objectives. The audit objective was to assess required internal controls and compliance with laws and regulations to produce reliable financial statements required by the Chief Financial Officers Act. Also, we reviewed supporting documentation for FY 1996 account balances that OSIA submitted to the Defense Finance and Accounting Service, and we tested accounting transactions and account balances to validate the effectiveness of accounting operations and controls.

Audit Results. The OSIA accounting records did not contain accurate financial information, and information the OSIA reported to the Defense Finance and Accounting Service for FY 1996 was incorrect. As a result, financial information produced and reported by OSIA could not be relied on to prepare reliable financial statements required by the Chief Financial Officers Act. Also, $1.3 million and additional potential benefits totaling up to $4.4 million from the FYs 1992 through 1996 Operation and Maintenance appropriations could be put to better use when OSIA removes invalid liabilities (and unliquidated obligations) from its accounting records.

Summary of Recommendations. We recommend that OSIA reconcile subsidiary and general ledger records for equipment, make necessary adjustments, and use DoD capitalization criteria; include in the general ledger the cost of real property; validate travel-related liabilities, travel advances, and other accounts payable; use accrual accounting procedures for expenses and liabilities; establish procedures to correctly record and reconcile accrued payroll and annual leave liabilities and expenses; and review general ledger account balances to assure that they are valid and supported by subsidiary records. We also recommend that OSIA tailor management control evaluations to the specific control objectives necessary to correctly account for and report information for required financial statements.

Management Comments. The OSIA concurred with the finding and recommendations and stated that corrective actions have been or would be implemented. See Part III for the complete text of management comments.

Audit Response. We complement OSIA on the aggressive actions initiated to improve financial management. For the final report, we identified $1.3 million that OSIA can put to better use if it removes specific invalid liabilities (and unliquidated obligations) from its accounting records. Also, if OSIA identifies other invalid liabilities (and unliquidated obligations) from the FYs 1992 through 1996 Operation and Maintenance appropriations, OSIA could realize additional potential benefits of up to $4.4 million. We request that OSIA comment on potential monetary benefits by June 15, 1997.

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Part I - Audit Results

Audit Background

The Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576) requires 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. Financial statements for the On-Site Inspection Agency (OSIA) will be included in the consolidated financial statements for DoD. During FY 1996, the OSIA received $68.5 million in direct funding. Also, the OSIA reported $120 million in assets, $16 million in liabilities, and $63 million in operating expenses to the Defense Finance and Accounting Service (DFAS) for FY 1996, for consolidation into the financial statements for "Other Defense Organizations" (a major category of the DoD consolidated financial statements). OSIA submits all financial information used to prepare its financial statements to the DFAS Indianapolis Center.

Accounting System Used by OSIA. OSIA uses the Centralized Accounting and Financial Resources Management System (CAFRMS) to perform general ledger accounting and financial reporting functions. The Defense Special Weapons Agency (DSWA) (formally the Defense Nuclear Agency) owns and uses CAFRMS for its general ledger accounting. CAFRMS is a real-time, on-line, fully integrated, accounting and management information system. It provides for a single point of entry and by linking data bases, updates the general ledger and management resource modules. Each transaction generates a historical record that provides an audit trail to track transactions to source documentation and operating reports. CAFRMS accounts for all transactions by fiscal year and appropriation and produces trial balances by each fiscal year and appropriation.

OSIA employees input all OSIA transactions into CAFRMS. However, OSIA must ask DSWA to make any programming changes. As a result of Inspector General, DoD, Report No. 96-039, "Financial Accounting for the Defense Nuclear Agency," December 1995, DSWA corrected programming errors and made other changes to CAFRMS to help ensure that CAFRMS could produce more reliable information for required financial statements.

Audit Objectives

The audit objective was to assess required internal controls and compliance with laws and regulations to produce reliable financial statements required by the CFO Act. Also, we reviewed supporting documentation for FY 1996 account balances that OSIA submitted to DFAS and tested accounting transactions and account balances to validate the effectiveness of accounting operations and controls. Appendix A discusses the audit scope and methodology and the review of the management control program. Appendix B provides details on related prior audit coverage.

Financial Accounting and Reporting

The OSIA accounting records did not contain accurate financial information, and OSIA information reported to DFAS for FY 1996 financial statements was incorrect. Accountable records and reported information were inaccurate because OSIA:

o did not reconcile the equipment account in the general ledger with property subsidiary records and did not follow DoD capitalization criteria;

o did not record the cost of real property purchased;

o did not validate travel-related liabilities and advances, even though more than $5.4 million was shown in accountable records for prior years;

o had not established procedures to correctly record accrued annual leave payable and annual leave expense, which were overstated by $7.4 million and $4.4 million, respectively;

o did not detect and correct errors in accrued payroll and benefits, which were overstated by a total of $1.1 million;

o did not accrue liabilities and expenses in CAFRMS for commercial accounts payable, and did not correct accounts payable data incorrectly entered into CAFRMS; and

o had not established effective management controls and procedures to review the validity of account balances in the general ledger.

As a result, financial information produced and reported by OSIA could not be relied on to prepare reliable financial statements required by the CFO Act. Also, $1.3 million and additional potential benefits totaling up to $4.4 million from the FYs 1992 through 1996 Operation and Maintenance appropriations could be put to better use when OSIA removes invalid liabilities (unliquidated obligations) from its accounting records.

Reliability and Support for Capitalized Equipment

The OSIA reported to the DFAS Indianapolis Center a capitalized[1] equipment balance of $35.4 million as of September 30, 1996. The balance of $35.4 million was incorrect and could not be supported by subsidiary records. OSIA did not reconcile the equipment balance with subsidiary records, use DoD capitalization criteria, remove equipment transferred to others from the general ledger, and account for Government-owned equipment in the custody of contractors.

Reconciliation with Subsidiary Records. Although reported equipment totaled $35.4 million, property book subsidiary records at OSIA showed only $10.1 million. The OSIA had not established effective procedures to ensure that transactions recorded in the general ledger were also recorded in subsidiary property book records. For example, the Equipment in Use account included a telephone system that cost $1.1 million and a mobile modular laboratory costing $1.4 million that was used in support of the United Nations Special Commission in Iraq. Those items were not in subsidiary property book records. In addition, OSIA field offices maintained separate subsidiary records that did not show the cost of equipment and, therefore, were not useful for financial accounting purposes. Establishing centralized property book records, to include acquisition cost and other information from financial accounting records, will enable OSIA to reconcile property and accounting records.

Use of Capitalization Criteria. Personnel in the OSIA Budget Division determined whether procured equipment should be capitalized or expensed when procurement documents were initially entered into CAFRMS. The February 1996 OSIA Financial Management Handbook (Handbook) incorrectly gave instructions to capitalize any purchase of equipment costing more than $5,000 from Operation and Maintenance funds and costing $50,000 or more from Procurement funds. The Under Secretary of Defense (Comptroller) issued guidance in December 1995 that only assets acquired on or after October 1, 1995, and costing $100,000 or more should be capitalized. The January 1993 Handbook used before the February 1996 edition also contained incorrect information and had not been updated to reflect changes in capitalization criteria made in FYs 1994 and 1995. OSIA issued a January 1997 Handbook that contained updated and correct information on DoD capitalization criteria.

Our review of the Equipment in Use account in the general ledger showed that OSIA incorrectly capitalized $5 million in equipment purchased with Operation

[1]Property purchased is "capitalized" when it is recorded as an asset in financial accounting records. The cost of property not capitalized is recorded as a current operating expense.

and Maintenance funds during FYs 1989 through FY 1996.[2] The cost of equipment purchased with Procurement funds and incorrectly capitalized cannot be determined until OSIA reconciles subsidiary and general ledger records.

Transfer of Capitalized Equipment. Records at OSIA showed that equipment costing $896,000 had been excessed and transferred to educational institutions or other Government agencies. For example, the equipment account included computer workstations costing $156,144 that had been donated to a college in April 1995. Equipment that is transferred or excessed should be removed from the general ledger. However, OSIA had not established procedures for removing such equipment from the general ledger.

Government-Owned Equipment. The OSIA had not established procedures to report in its financial reports to DFAS the Government-owned property furnished to contractors. Part 45 of the Federal Acquisition Regulation requires contractors to maintain the official records of Government assets in the contractors' possession and to annually report the total acquisition cost of those assets. Accordingly, DoD contractors report Government-owned assets (on DD Form 1662) to the Defense Contract Management Command each year as of September 30. The DoD Financial Management Regulation also requires that DoD organizations record the capitalized value of Government-owned equipment furnished to contractors in an Equipment with Contractors account. As of September 30, 1996, OSIA contractors reported $13 million in Government-owned equipment on hand to the Defense Contract Management Command. Because OSIA had not established procedures to report the financial information related to Government-owned equipment furnished to contractors, OSIA did not report that information to the DFAS Indianapolis Center.

Real Property

Review of OSIA accounting records showed that OSIA paid a total of $3.8 million for three designated seismic sites in South Dakota, Oklahoma, and Washington. The U.S. Army Corps of Engineers (Corps) contracted for the construction of the designated seismic sites for OSIA under the Economy Act. The Corps issued DD Form 1354, "Transfer and Acceptance of Military Real Property," to OSIA in February 1992 at the completion of the project. The DoD Financial Management Regulation states that DoD shall record in financial records the dollar value of real property under DoD control, unless there is evidence that the property is recorded in the accounting system of another Federal Agency. However, rather than capitalizing the cost of the real property, as required by the Regulation, OSIA expensed it.

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[2]Assets purchased with Operation and Maintenance funds should not be capitalized because the dollar threshold for capitalizing an asset for accounting purposes is identical to and automatically changes with the funding threshold Congress uses for Procurement (investment) funds.

Travel-Related Liabilities and Travel Advances

Travel-related liabilities and travel advances of $5.4 million shown in CAFRMS were not accurate. Liabilities and advances remained in accounting records long after travel had been completed, and OSIA had not established procedures to review the validity of the liabilities and advances.

Travel-Related Liabilities. Recorded liabilities of $4.9 million as of November 6, 1996, for travel-related expenses from FYs 1992 through 1996 appropriations were overstated because OSIA had not established management controls to review the validity of liabilities accrued for travel. The existence of invalid liabilities (and unliquidated obligations) on accounting records also reduced funds that could have been put to better use.

Invalid Liabilities for Travel. Our judgment sample of 50 travel control numbers with liabilities totaling $508,237 showed that $335,243 in liabilities was not valid. Examples follow.

o For 18 travel control numbers, $174,578 was not valid. Travel was completed, the airline ticket was paid, and disbursements were posted to CAFRMS. However, OSIA had not removed the excess in estimated travel costs over the actual costs for the 18 travel control numbers.

o For 12 travel control numbers, $125,393 was not valid. For the travel orders issued during January 1992 through October 1993, either the individuals did not travel or the travel orders were revoked. At the time of the audit, OSIA improved its controls to ensure that travel orders are revoked when travel plans were canceled. However, OSIA had not reviewed the validity of travel liabilities recorded during prior years.

o For six travel control numbers, $30,884 was not valid. OSIA personnel posted actual disbursements, but had not received billing information from commercial airlines for airline tickets. Even though OSIA had not recorded the costs for airline tickets, when recording disbursements OSIA personnel should have eliminated estimates for accrual of per diem and other travel expenses unrelated to airline tickets.

Other Liabilities for Travel. We could not determine the validity of the remaining $172,994 in recorded liabilities in our sample, because travel documents had not been received, were not posted, or were lost. Examples follow.

o OSIA did not have completed travel vouchers for eight travel control numbers with recorded liabilities of $90,045. Seven of the travel control numbers were for travel that took place during FY 1992. Performing research on the missing travel vouchers will be time consuming, because the personnel no longer work for OSIA. Establishing management controls to promptly validate the status of outstanding travel liabilities after completion of travel will make research easier and will help ensure that recorded liabilities are valid.

o OSIA personnel posted travel payments to three travel control numbers. However, OSIA personnel could not find copies of the posted travel payments. Consequently, we were unable to determine the validity of the remaining $26,681 in accrued liabilities.

Recording and Control Procedures. OSIA accounting personnel posted obligations and accrued travel expenses and liabilities in the CAFRMS general ledger upon receipt of travel orders, which showed estimates of expected travel costs. OSIA accounting personnel recorded disbursements for completed travel upon receipt of paid travel vouchers or airline tickets. That procedure reduced unliquidated obligations and liabilities. However, travel-related liabilities remained in accounting records long after completion of travel. Such liabilities should alert management to potential problems. However, OSIA had not established management controls to promptly or periodically review the status of recorded travel liabilities and to make adjustments as required. Also, OSIA had not established written procedures for accounting technicians to ensure that excess accruals were zeroed out when final travel vouchers and airline tickets were paid.

Funds Put to Better Use. We identified $335,243 in invalid liabilities from the sample of travel-related liabilities (and unliquidated obligations) totaling $508,237. If identified by OSIA, the $335,243 could have been put to better use. Based on the results of our judgment sample and the lack of management controls to review and adjust travel-related liabilities (unliquidated obligations), we doubt the validity of the majority of the remaining $4.4 million in travel-related liabilities from FYs 1992 through 1996 Operation and Maintenance appropriations. If OSIA removes invalid liabilities and obligations from its accounting records, those funds could be put to better use.

Travel Advances. Travel advances shown in CAFRMS were not accurate because OSIA had not established procedures to validate outstanding travel advances. As of October 29, 1996, travel advance accounts in CAFRMS for FYs 1992 through 1996 showed $482,687 in outstanding travel advances and $194,679 in travel advances with negative balances, resulting in a net of $288,008. Of the $288,008 in net travel advances, $209,071 related to travel advances issued during FYs 1992 through 1995.

Outstanding Travel Advances. We selected a judgment sample of 11 travel advances of at least $2,500 each that were issued during FYs 1992 through 1995. The 11 travel advances totaled $97,635 of which $39,517 was not valid due to posting errors. We could not determine the validity of the remaining $58,118 due to lack of documentation. Examples follow.

o CAFRMS showed a $15,000 travel advance issued in September 1994. The OSIA travel system did not show any record of that travel advance, and OSIA did not have a travel voucher to show that travel had been completed.

o CAFRMS showed travel advances totaling $11,000 issued to a traveler in FY 1992. The OSIA travel system indicated that the travel voucher

had been paid at Travis Air Force Base. We could not determine whether any travel advance remained to be collected because OSIA accounting personnel did not have a copy of the paid travel voucher.

o OSIA posted an advance of $9,291 in November 1995 to a traveler's record after a final travel voucher had been posted. We believe the advance was posted to the wrong individual. However, OSIA personnel could not find the documentation to support the posting, so we were unable to determine its validity.

Travel Advances with Negative Balances. The existence of a negative balance for a travel advance indicates an abnormality that should be investigated. However, because OSIA had not established procedures to review outstanding travel advances, OSIA did not review negative balances. Of the $194,697 in negative balances, our sample of four travel advances totaling $32,875 showed that OSIA personnel made posting errors that caused the negative amounts. When we pointed out the errors, OSIA accounting personnel corrected and zeroed them out. OSIA will need to review the remaining negative travel advances to correct probable posting errors.

Accounts Payable

Recognition of Accounts Payable. As of November 18, 1996, OSIA had a total of $486,550 in invoices awaiting payment that were not recorded in the CAFRMS general ledger. Except for payroll and travel-related liabilities, OSIA did not record liabilities in the CAFRMS general ledger until OSIA disbursed the funds. CAFRMS automatically accrued expenses and liabilities when disbursements were made. This procedure understated liabilities and violated Key Accounting Requirement No. 5,[3] "Accrual Accounting." In accordance with that requirement, expenses and liabilities must be recorded when they occur (or records maybe adjusted to the accrual basis at the end of each month).

Other Accounts Payable. Even though OSIA did not normally accrue liabilities and expenses for commercial accounts payable until funds were disbursed, our review of the general ledger showed $625,733 in accounts payable from FYs 1991 through 1993 Operation and Maintenance appropriations. Our review of five liabilities, of more than $25,000 each and totaling $492,956, showed that none was valid. For example, a liability of $45,831 was created in August 1992 when OSIA accounting personnel transferred a disbursement posting from the FY 1991 appropriation to the FY 1992 appropriation. However, OSIA did not reverse the incorrect accrual

[3]Thirteen key accounting requirements are in the DoD Financial Management Regulation, volume 1. Key accounting requirements are a composite of General Accounting Office, Office of Management and Budget, Department of the Treasury, and DoD requirements. All DoD accounting systems must comply with the key accounting requirements.

in the FY 1991 appropriation when the payment was made with FY 1992 funds. Because OSIA had not established procedures or management controls to review the validity of liabilities in CAFRMS, OSIA personnel did not correct this error that occurred in August 1992.

Funds Put to Better Use. Of the $492,956 in invalid liabilities identified, $357,769 was from FYs 1992 and 1993 Operation and Maintenance appropriations that were not closed as of FY 1997. If OSIA removes those invalid liabilities (and unliquidated obligations) from accounting records, $357,769 can be put to better use.

Liability and Expense for Annual Leave

Accrued unfunded annual leave payable at the end of FY 1996 and annual leave expense for FY 1996 were overstated by $7.4 million and $4.4 million, respectively, because OSIA did not have correct procedures to record the liability and corresponding expense. At the end of each fiscal year, OSIA recorded as a liability and expense the amount of annual and sick leave reported by the DFAS Charleston Center for OSIA employees. That procedure overstated both the liability and expense.

Accrued Unfunded Annual Leave Payable. The $8.6 million reported liability for annual leave as of September 30, 1996, was overstated because the $8.6 million incorrectly included $3.1 million in sick leave that, by definition, should not be included in the accrued annual leave liability. The annual leave liability was also overstated by $3.8 million because OSIA accounting personnel did not correctly reverse out the recorded liability for FY 1995. In addition, the annual leave liability was overstated by $0.5 million due to other posting errors that OSIA did not detect. Therefore, the annual leave liability was overstated by a total of $7.4 million.

The annual leave liability was also understated for the accrued leave for the 21 OSIA employees in field offices not paid by the DFAS Charleston Center. OSIA accounting personnel did not have that information at the time of our audit. Accounting personnel should obtain and record that liability with the annual leave liability for the FY 1997 trial balance.

Annual Leave Expense. The reported annual leave expense of $4.5 million was overstated by $4.4 million because accounting personnel recorded the total liability for FY 1996 as an expense, rather than recording the net amount of annual leave earned in FY 1996 as an expense. Accounting personnel stated that OSIA had not established procedures on how to record annual leave and expenses.

Liabilities for Accrued Payroll and Benefits

Errors in the accrued payroll and benefits accounts in the CAFRMS general ledger caused account balances totaling $1.8 million to be overstated by $1.1 million as of September 30, 1996. Included in the $1.1 million in overstated payroll liabilities were unliquidated obligations of $570,179 for FYs 1992 and 1993 Operation and Maintenance appropriations. If OSIA removes of those invalid payroll liabilities (and unliquidated obligations) $570,179 could be put to better use.

o The general ledger included $1.0 million in erroneous accrued payroll liabilities for FYs 1991 through 1995. Those liabilities resulted primarily from computer programming errors in prior years and failure of OSIA accounting personnel to ensure that excess accruals were removed after the final payroll for each fiscal year was processed. Although DSWA personnel concluded that programming errors that caused erroneous balances in the accounts had been corrected, OSIA accounting personnel did not make necessary corrections to the account balances after DSWA corrected the programming errors.

o Accrued payroll and payroll benefits in subsidiary records totaled $190,232 more than the general ledger accounts as of September 30, 1996. The discrepancy was caused by an incorrect adjustment DSWA personnel made at the end of FY 1996 to correct an error found in the CAFRMS computer program.

o As of September 30, 1996, the unpaid payroll and related benefits for OSIA civilians paid by DFAS Charleston Center totaled $673,917. However, OSIA subsidiary records showed that $927,382 had been accrued. The excess in the amount accrued was caused primarily because OSIA accounting personnel did not record the correct accrual for the last payroll for FY 1996.

Review of General Ledger Trial Balances

OSIA accounting personnel made posting errors in other accounts. Accounting personnel did not detect errors in monthly and annual trial balances because OSIA had no procedures to review general ledger trial balances for accuracy. As a result, the trial balances contained errors that were not corrected.

o Since FY 1989, the post-closing trial balances included $280,000 in a revenue account (General Fund Sales of Property) that had been originally recorded in August 1989. Programmers for CAFRMS corrected an error in FY 1994 to ensure that annual revenues were closed into the fund equity (Appropriated Capital) account, but OSIA had not manually closed that revenue account, which had been established before the programing change. As a result, OSIA overstated the revenues reported to DFAS for FY 1996 by $280,000.

o The FYs 1995 and 1996 post-closing trial balances incorrectly showed a negative balance of $233,576 in expenses from the FY 1990 Procurement appropriation. OSIA personnel posted an adjustment to an expense summary account in April 1995 instead of adjusting the proper account, which would have been closed at the end of the fiscal year. As a result, OSIA understated total expenses reported to DFAS for FY 1996.

o Income from miscellaneous reimbursements for FY 1996 was understated by $2.0 million. The $2.0 million was composed of transactions posted to the accounts receivable and miscellaneous reimbursements accounts during FYs 1990 through 1993. However, in July 1993, the Under Secretary of Defense (Comptroller) determined that the services provided to the former Soviet Union should not be considered as accounts receivable. As a result, accounting personnel reversed the original transactions in September 1996 rather than charging the $2.0 million in income to prior period adjustments or to Appropriated Capital. If accounting personnel had reviewed the general ledger after the incorrect adjusting entries were made, accounting personnel would have seen negative balances in the Miscellaneous Reimbursement accounts for FYs 1990 through 1993 appropriations and would have been able to correct the understatement before reporting the FY 1996 trial balance to DFAS.

o As of September 30, 1996, the Accounts Receivable-Government and Accounts Receivable-Public accounts for FYs 1991 and 1992 appropriations showed a positive and a negative balance of $204,983, respectively, thereby canceling each other out and netting to zero. OSIA had not corrected posting errors made in previous years. Even though the net effect of those errors resulted in no accounts receivable for the appropriations, the trial balance sent to DFAS was incorrect.

Management Controls

As part of the OSIA management control program, the OSIA manager identified the same material weaknesses the audit identified in procedures and systems to account for and record property and equipment and in the lack of routine close-out procedures on unliquidated obligations. However, the audit identified another material weakness in the procedures to evaluate the validity of general ledger account balances.

Accounting for Recording for Capitalized Property. OSIA took an important first step in its FY 1996 Annual Statement of Assurance in recognizing as a material weakness its lack of procedures and systems to account for and record property and equipment in accounting records. Recognition of that problem and implementing the recommendations in the audit report will improve management controls related to accounting for and reporting capitalized property.

Invalid Liabilities and Unliquidated Obligations. Because OSIA did not continually review the validity of liabilities (and unliquidated obligations) at

least $1.3 million ($335,243 in travel-related liabilities, 357,769 in other accounts payable, and 570,179 in accrued payroll liabilities) in Operation and Maintenance appropriations was not put to better use. Also, up to $4.4 million (additional unliquidated obligations for travel-related liabilities) could be put to better use when OSIA reviews and removes the travel-related liabilities determined to be invalid.

OSIA had established an Internal Review and Quality Assurance Office (Office) to perform periodic quality assurance reviews of various financial management operations and to conduct reviews of financial problem areas. As a result of reviews in May 1995 and April 1996, the Office recommended that unliquidated travel obligations in CAFRMS be reconciled quarterly to the data in the travel data base. However, OSIA management had not implemented the recommendation.

Procedures to Validate General Ledger Account Balances. According to the OSIA Organizations and Functions Manual, January 1996, the Office also conducts reviews of the OSIA financial statements before submission to DFAS. The Office also recommended in April 1996 that accounting personnel reconcile subsidiary records to at least a few general ledger accounts every quarter. However, OSIA management has not yet established procedures to review the reliability of account balances shown in monthly reports produced by CAFRMS.

The general ledger contained incorrect and unsupportable balances in equipment; travel-related liabilities and advances; accrued leave liabilities and expenses; payroll-related liabilities; and other revenue, expense, and receivable accounts. OSIA management could have detected and corrected many of the problems identified during the audit if OSIA management had established procedures to review the validity of account balances on monthly and annual trial balances and in other reports produced by CAFRMS. Management control reviews included the reliability of the general ledger. However, the reviews did not include sufficient questions and control objectives to evaluate the validity of general ledger account balances. The absence of management controls to verify account balances is a material management control weakness. Procedures should be established to review the validity and supportability of general ledger trial balances each month. Also, the management control reviews of finance and accounting personnel should include procedures and controls for verifying the accuracy of account balances in the CAFRMS general ledger.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, On-Site Inspection Agency:

1. Make a one-time adjustment to the Equipment in Use account in the general ledger based on results of physical inventories, reconciliations with subsidiary property records, and use of DoD capitalization criteria.

2. Establish subsidiary ledgers for Equipment in Use that include the cost of the equipment and other information so that equipment can be traced easily to specific equipment in the general ledger.

3. Establish procedures to:

a. Periodically reconcile the equipment account in the general ledger with subsidiary property records for capitalized equipment.

b. Remove equipment transferred to others from the general ledger.

c. Record balances of Government-owned equipment in the custody of contractors in the general ledger.

4. Adjust the general ledger to include the cost of real property in the custody of the On-Site Inspection Agency.

5. Validate travel-related liabilities, travel advances, other accounts payable, and unliquidated obligations, and:

a. Remove balances that are not supportable.

b. Establish procedures to remove excess accrual estimates when payments are recorded for completed travel vouchers.

c. Periodically validate the accuracy of those accounts in the general ledger.

6. Record expenses and liabilities when goods and services are received and supported by documentary evidence, as required by Key Accounting Requirement No. 5, "Accrual Accounting," in the Financial Management Regulation.

7. Establish procedures to ensure that accrued payroll and annual leave liabilities and expenses in the general ledger are correctly recorded, adequately supported, and periodically reviewed. Specifically:

a. Discontinue including sick leave in the annual leave liability.

b. Reverse prior year annual leave liabilities at the beginning of each fiscal year.

c. Include in annual leave expense only the net expenses for the period rather than the annual leave liability.

d. Include the annual leave liability for the On-Site Inspection Agency personnel whose payroll is not processed by the Defense Finance and Accounting Service Charleston Center.

e. Reconcile accrued payroll with subsidiary records.

f. Investigate the validity of any accrued payroll liability for prior years that remains in the general ledger after the final payroll is processed for each fiscal year.

8. Establish procedures to review the validity of revenue, expenses, assets, and liabilities shown in the general ledger to assure that they are valid, supported by subsidiary records, and recorded in accordance with accounting policies prescribed in the Financial Management Regulation.

9. Tailor management control evaluations for the Finance and Accounting assessable unit to include specific questions and management control objectives necessary for assessing the accuracy and reliability of general ledger account balances.

Management Comments. The Director, OSIA, concurred with the finding and recommendations and stated that corrective actions have been or would be implemented to correct identified problems.

Audit Response. The Director's comments reflect aggressive actions to improve financial management. In response to the final report, we request that the Director, OSIA, comment on the $1.3 million in potential benefits related to invalid liabilities (unliquidated obligations) and additional potential benefits totaling up to $4.4 million from FYs 1992 through 1996 Operation and Maintenance appropriations.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed the OSIA trial balance produced by CAFRMS as of September 30, 1996, and verified that OSIA submitted those account balances to the DFAS Indianapolis Center for FY 1996. The trial balance showed $120 million in assets, $16 million in liabilities, $61 million in revenues, and $64 million in operating expenses. We compared general ledger account balances to subsidiary records within CAFRMS and other supporting records. We performed limited reviews of the validity of selected asset, liability, revenue, and expense accounts to determine the reliability of financial data in CAFRMS. Because CAFRMS is a real-time system and subsidiary information is available only for the current account balance, the dates of account balances we reviewed, as shown in the report, vary from October through November 1996.

We performed limited reviews of transactions and selected account balances and took the following judgment samples.

o We reviewed six purchases, totaling $3.0 million, recorded in the Equipment in Use account to determine whether the equipment should have been capitalized and whether it was recorded in subsidiary property book records.

o We reviewed 50 travel-related liabilities of more than $5,000 each and totaling $508,237 as of November 9, 1996, from FYs 1992 through 1996 appropriations, to determine the validity of the liabilities. Recorded travel-related liabilities for FYs 1991 through 1996 funds as of November 6, 1996, totaled $5 million.

o We reviewed 11 outstanding travel advances totaling $97,635 and 4 travel advances with negative balances totaling $32,875 to determine the validity of reported travel advances. As of October 29, 1996, subsidiary records supporting the general ledger showed net travel advances of $288,008 ($482,687 minus the $194,679 in total negative balances).

o We reviewed the five accounts payable of more than $25,000 each and totaling $492,956 shown in the general ledger subsidiary records as of November 6, 1996, to determine whether the liabilities were valid.

We reviewed management controls used to produce required, supportable financial information necessary for financial statements required by the CFO Act. Because this audit was not intended to provide an overall opinion on the reported balances in financial reports, we did not perform comprehensive

reviews or statistical sampling of transactions supporting the balances in CAFRMS. Also we did not project the results of our judgment sampling of account balances.

Use of Computer-Processed Data. We did not perform a review of the CAFRMS general and application controls. However, our review of account balances and supporting documentation showed that financial data in CAFRMS were unreliable. The data were unreliable because OSIA had not established management controls and procedures to review data in the CAFRMS general ledgers.

Audit Period and Standards. We performed this financial-related audit from October 1996 through January 1997. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, based on the objectives of the audit and the limitations in the scope described in this appendix.

Audit Contacts. With the exception of visits to DSWA, Alexandria, Virginia, all audit work was performed at Headquarters, OSIA, Dulles International Airport, Virginia.

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 Management Control Program. We reviewed the adequacy of OSIA controls over recording and reporting information in financial accounting records. Specifically, we evaluated OSIA procedures to record financial information in accountable records and the adequacy of accounting controls to ensure reliability of financial information. On a limited basis, we evaluated the validity of documentation supporting reported information. In addition, we evaluated the effectiveness of OSIA managers' self-assessments of controls for financial reporting.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Directive 5010.38, for OSIA. The OSIA had not established adequate controls to ensure that accounting records accurately reflected its financial position and results of operations. Also, the accountability, control, and reporting of equipment was not sufficient to provide reasonable assurance that primary control objectives were met. Recommendations 2., 3., 5., 7., 8., and 9., if implemented, will improve management controls over financial accounting procedures. A copy of the report will be provided to the senior official responsible for management controls at OSIA.

Adequacy of Management's Self-Evaluation. For the OSIA FY 1996 Annual Statement of Assurance, management reported material weaknesses in the areas of plant, property, and equipment and in routine close-out procedures on unliquidated obligations. However, self-evaluations by OSIA finance and accounting personnel did not identify the material management control weakness in procedures to review the validity of account balances in the general ledger. Checklists prepared by the OSIA Internal Review and Quality Assurance Office were not completed correctly, and the checklists did not contain sufficient questions and control objectives to enable OSIA personnel to properly evaluate management controls.

Appendix B. Summary of Prior Audits and Other Reviews

Inspector General, DoD

Inspector General, DoD, Report No. 97-110, "Material Accounting and Management Control Weaknesses in the Defense Agencies' FYs 1995 and 1996 Financial Information," March 17, 1997. The report summarizes accounting system weaknesses identified during audits of Defense agencies' FYs 1995 and 1996 financial data. The report states that Defense agency FYs 1995 and 1996 accounting system weaknesses were primarily related to four key accounting requirements:

- general ledger control and financial reporting;
- property and inventory accounting;
- system controls (fund and internal);
- accrual accounting.

The audits also identified Defense agency accounting system weaknesses in six additional key accounting requirements: accounting for receivables, including advances; audit trails; cash procedures and accounts payable; system documentation; system operations; and user information needs. Consequently, general ledger account data were not reliable and may adversely affect the accuracy and reliability of Defense agency financial statements.

The Defense agencies took aggressive actions to correct certain FY 1994 material accounting system and management control weaknesses. However, actions to correct other weaknesses were in process, not started, or may not be completed until FY 1998 at the earliest. The DoD management improvement initiatives will significantly improve the accuracy and integrity of financial and related information. However, several initiative implementation dates have slipped, and key initiatives need to be tested and implemented to fully measure their success. The report contained no recommendations.

Inspector General, DoD, Report No. 96-039, "Financial Accounting for the Defense Nuclear Agency," December 11, 1995. The report states that the financial accounting system used by the Defense Nuclear Agency (now the Defense Special Weapons Agency) was in substantial compliance with DoD accounting requirements. However, correction of certain deficiencies was essential to produce accurate and auditable financial statements needed to support DoD consolidated statements. The general ledger module contained computer programming errors and omissions, necessary subsidiary records and general ledger accounts were not established, some recorded account balances were incorrect or insupportable, and general ledger transaction histories were erased at the end of each fiscal year. As a result, the general ledger and

supporting information could not be relied on for information necessary to produce auditable and accurate financial statements required by the Chief Financial Officers Act. The report recommends that the Defense Nuclear Agency correct computer logic errors in its financial accounting system, adjust general ledger accounts for incorrect balances, establish necessary subsidiary ledgers, and retain general ledger transaction histories. Management concurred with the recommendations and stated that corrective actions would be completed by December 31, 1996.

Appendix C. 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 (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program and Budget)
Assistant to the Secretary of Defense (Public Affairs)

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

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, Defense Special Weapons Agency
Director, National Security Agency
  Inspector General, National Security Agency
Director, On-Site Inspection Agency
Inspector General, Defense Intelligence Agency
Inspector General, National Imagery and Mapping 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 Government Management, Information, and Technology, 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

On-Site Inspection Agency Comments

ON-SITE INSPECTION AGENCY
PO BOX 17498
WASHINGTON DC 20041-0498

APR 3 1997

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Financial Accounting at the On-Site Inspection Agency (Project No. 7RD-2001)

My staff and I greatly appreciated the assistance provided by your audit project manager and his team in reviewing the capabilities of the On-Site Inspection Agency (OSIA) financial management system to produce audible financial statements as required under the Chief Financial Officer's (CFO) Act.

Your audit disclosed several weaknesses, which are currently receiving our immediate attention. In fact, since your field work was completed, significant progress has been made in several areas. We particularly appreciate the assistance provided by your staff in identifying proper solutions to our unique issues.

Our comments on your specific findings and recommendations are attached. We believe that, upon completion of the actions outlined in your report, the OSIA financial accounting system (the Centralized Accounting and Financial Resources Management System) can provide information necessary to produce financial statements required by the CFO Act.

If we may be of further assistance, my point of contact is Lieutenant Colonel Jake East, (703) 810-4552.

Thomas E. Kuenning, Jr.
Brigadier General, U.S. Air Force
Director

Attachment:
As stated

cc: ATSD(NCB)

Management Comments
to Draft Audit Report
on Financial Accounting
at the On-Site Inspection Agency
(Project No. 7RD-2001)

Recommendation 1

OSIA Comments: Concur with finding and recommendation. The Office of the Comptroller (FM) and Directorate of Resource Management (DR) discovered the problem of accounting for capitalized equipment prior to the beginning of the DoD IG audit. We have implemented corrective action to reconcile financial and property records. A one-time adjustment of $1,070,000 was made to correct accounting records in February 1997.

Estimated Completion Date: 15 April 1997

Recommendation 2

OSIA Comments: Concur with finding and recommendation. Subsidiary ledgers in DR are in the process of being updated to aid in tracing equipment in the accounting records/general ledger.

Estimated Completion Date: 15 April 1997

Recommendation 3

OSIA Comments: Concur with finding and recommendation. Procedure has been implemented for quarterly reconciliation between FM and DR. The DR will provide quarterly reports to update financial records, and FM will reconcile records to reflect changes in capitalized equipment.

The FM will conduct an annual audit of capitalized equipment accounts using random sample method to ensure compliance and accuracy of financial records.

Estimated Completion Date: Completed - Follow up quarterly

Recommendation 4

OSIA Comments: Concur with finding and recommendation. Procedure has been implemented for quarterly reconciliation between FM and DR. The DR will provide quarterly reports to

update financial records, and FM will reconcile records to reflect changes in cost of real property in the custody of contractors.

Estimated Completion Date: 1 August 1997 - Follow up quarterly

Recommendation 5

OSIA Comments: Concur with finding and recommendation. Outstanding travel related liabilities are a result of open unliquidated obligations for prior years and lack of reconciliation between travel and accounting personnel.

The Financial Control Division (FMA) has begun an initial review of outstanding travel obligations for Fiscal Years 1992-1996, and adjustments are being made to the accounting records. Interim progress reports are provided by the Accounting Branch (FMAA) and Finance Branch (FMAF) to FMA weekly. The review will continue through June 1997. In July, the remaining balances will be written off in accordance with current accounting regulations.

We have established and are conducting monthly reviews between FMAF and FMAA to reconcile travel and accounting records.

Estimated Completion Date: 1 August 1997 - Follow up monthly

Recommendation 6

OSIA Comments: Concur with finding and recommendation. Valid procedures for accrual have been published but are not being properly utilized. The FMA will conduct training and publish information in matrix format no later than 1 May 1997. We will conduct an annual review of contracts in August of each year to ensure that the end-of-year statement correctly reflects liabilities for that fiscal year.

Estimated Completion Date: 1 May 1997 - Follow up annually

Recommendation 7

OSIA Comments: Concur with finding and recommendation. The system reflected erroneous accrued payroll liabilities for Fiscal Years 1991-1995. All corrections were made in February 1997.

The system reflected excess accrual for payroll as of 30 September 1996. Incorrect number of days were input for the miscellaneous obligation document (MOD). However, the

Centralized Accounting and Financial Resource Management System (CAFRMS) did not reverse this MOD with the final payroll as it should have. We contacted the Defense Special Weapons Agency for an explanation in September 1996. The MOD was reversed in October 1996.

Estimated Completion Date: Completed

Recommendation 8

OSIA Comments: Concur with finding and recommendation. Procedure has been established for the FMAA team chiefs to review the general ledger monthly.

Estimated Completion Date: Completed - Follow up monthly

Recommendation 9

OSIA Comments: Concur with finding and recommendation. Management control evaluation was adjusted on 1 March 1997 to reflect greater emphasis on the general ledger. Follow-up reviews of the general ledger will be conducted semi-annually (mid and end of fiscal year) to ensure effectiveness.

Estimated Completion Date: Completed - Follow up semi-annually

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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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