Audit Report

PAYROLL EXPENSES REPORTED BY THE
DEFENSE FINANCE AND ACCOUNTING SERVICE
CLEVELAND CENTER

Report Number 98-177 July 9, 1998

Office of the Inspector General
Department of Defense

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Acronyms

BRAC	Base Realignment and Closure
CFO	Chief Financial Officers (Act)
DFAS	Defense Finance and Accounting Service
GLAC	General Ledger Account Code
OMB	Office of Management and Budget
OPLOC	Operating Location
STARS	Standard Accounting and Reporting System

INSPECTOR GENERAL
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July 9, 1998

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE CLEVELAND CENTER

SUBJECT: Audit Report on Payroll Expenses Reported by the Defense Finance and Accounting Service Cleveland Center (Report No. 98-177)

We are providing this report for information and use. This is the fourth and final in a series of reports addressing payroll-related issues. This 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.

Management comments conformed to the requirements of DoD Directive 7650.3, and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson at (703) 604-9582 (DSN 664-9582), e-mail crichardson@DODIG.OSD.MIL, or Mr. Joe E. Richardson at (703) 604-9511 (DSN 664-9511), e-mail jrichardson@DODIG.OSD.MIL. See Appendix E for the report distribution. The audit team members are listed inside the back cover.

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Report No. 98-177
(Project No. 7RF-2010.03)

July 9, 1998

Payroll Expenses Reported by the Defense Finance and Accounting Service Cleveland Center

Executive Summary

Introduction. The audit was performed in compliance with Public Law 101-576, the "Chief Financial Officers Act of 1990," and Public Law 103-356, the "Federal Financial Management Act of 1994." Public Law 103-356 requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and the following years. The Defense Finance and Accounting Service Indianapolis Center is responsible for preparing the financial statement for the Department 97* appropriations, beginning in FY 1996. To meet that requirement, the Deputy Director for Accounting Operations consolidates the financial information received from offices providing accounting support to the Defense organizations and prepares the financial statement for the "Other Defense Organizations," a segment of the DoD consolidated financial statement. During FY 1996, the Defense organizations received $39 billion in appropriations, and their financial statements showed operating expenses of $40.5 billion. Inspector General, DoD, Report No. 98-028, "Personal Services and Benefits Expenses in the FY 1996 Statement of Operations and Changes in Net Position of the Other Defense Organizations," December 2, 1997, reported that payroll constituted $7.1 billion of the operating expenses. For the FY 1996 financial statements, the Defense Finance and Accounting Service Cleveland Center reported operating expenses totaling $5.3 billion for Department of the Navy organizations that received Department 97 appropriated funds. This report is the fourth and final in a series of reports addressing payroll-related issues, including the effect of noncompliant payroll actions on the FYs 1996 and 1997 financial statements.

Audit Objectives. The overall audit objective was to evaluate management controls over the distribution of civilian payroll and related expenses on the FY 1996 financial statements for Other Defense Organizations. We also reviewed the effect of noncompliant payroll actions on the FYs 1996 and 1997 financial statements. Specifically, we reviewed accounting records for payroll and related expenditures to determine the validity of the FY 1996 payroll expenses that the Defense Finance and Accounting Service Cleveland Center submitted to the Defense Finance and Accounting Service Indianapolis Center on the Base Realignment and Closure III and IV appropriations that were allotted to the Department of the Navy. We also assessed the Defense Finance and Accounting Service Cleveland Center's management control program as it relates to the overall audit objective.

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*Department 97 appropriations include general funds, as well as revolving funds, trust funds, and some small special funds, which are specifically allocated through the Office of the Secretary of Defense to Defense organizations and Military Departments.

Audit Results. The FY 1996 Statement of Operations and Changes in Net Position for Other Defense Organizations included $1.3 billion in payroll expenses for Base Realignment and Closure III and IV appropriations allotted to the Department of the Navy in Note 23, that were not traceable to source records. In addition, the Defense Finance and Accounting Service Cleveland Center applied predetermined percentage rates to the total operating expenses for reporting the operating expenses by object class, rather than report the object class actual expenses. As a result, the payroll expenses presented in the FY 1996 financial statements are inaccurate.

The auditability of the FY 1997 and future operating expenses for Department 97 appropriations allotted to the Department of the Navy will be adversely effected until the Defense Finance and Accounting Service Cleveland Center corrects the causes of the incorrect reporting. Although the corrective actions will not change the data provided for FYs 1996 and 1997 financial statements, they could have an affect on FY 1998 financial statements. See Part I for a discussion of the audit results and Appendix A for details of our review of the management control program.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Cleveland Center, modify accounting and reporting systems to allow operating expenses to be reported by Standard General Ledger Account Code on the financial statements, and to establish audit trails to ensure that financial transactions can be traced from initiation to final financial reports.

Management Comments. The Director for Accounting, Defense Finance and Accounting Service concurred with the recommendations and stated that the implementation of the Standard Accounting and Reporting System-Funds Distribution and Reporting in September 1998 would correct the reported problems. See Part I for a discussion of management comments and Part III for the complete text of management comments.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 3
Reported Payroll Expenses 4

Part II - Additional Information

Appendix A. Audit Process
Scope and Methodology 10
Management Control Program Review 12
Appendix B. Summary of Prior Coverage 13
Appendix C. OMB Object Classes and Related DoD Standard General Ledger Accounts 15
Appendix D. Operating Expenses Reported by DFAS Cleveland Center 18
Appendix E. Report Distribution 20

Part III - Management Comments

Defense Finance and Accounting Service Comments 24

Part I - Audit Results

Audit Background

Requirements for Financial Statements. Public Law 101-576, the "Chief Financial Officers (CFO) Act of 1990," November 15, 1990, requires Executive departments and agencies to prepare financial statements for each of their trust funds, revolving funds, and commercial activities. The CFO Act also requires the Inspectors General to audit or arrange for the audit of all financial statements prepared under the CFO Act. The auditors must report on the adequacy of internal controls and compliance with laws and regulations that could have a material effect on the financial statements. The CFO Act, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and the following years.

The DoD Consolidated Financial Statements for FY 1996 include financial information for a reporting entity entitled "Other Defense Organizations." The financial statements for Other Defense Organizations include the financial information for various Defense organizations that received Department 97[1] appropriations. In FY 1996, 35 Defense organizations received $39 billion of Department 97 appropriated funds to perform their missions and functions.

Financial Reports. The Defense Finance and Accounting Service (DFAS) Indianapolis Center is responsible for compiling the financial information submitted on behalf of Other Defense Organizations. Total operating expenses are reported on the Other Defense Organizations Statement of Operations and Changes in Net Position (hereafter referred to as the Statement of Operations) and by object class in Note 23, Program or Operating Expenses. Object classes are defined by the Office of Management and Budget (OMB) and are used to report obligations and expenses for the services or articles procured. Appendix C shows the OMB object classes and the related DoD Standard General Ledger accounts for all operating expenses. The FY 1996 Statement of Operations prepared by the DFAS Indianapolis Center reports that the Other Defense Organizations had operating expenses of $40.5 billion, of which $7.1 billion could be attributed to the object class defined as Personal Services and Benefits.

Accounting Classifications. DFAS Manual 7097.01, "Financial Management Departmental Reporting Manual for Office of the Secretary of Defense (Treasury Index 97) Appropriations," September 1996, identifies limitation codes and titles for DoD Components that are allocated and allotted Defense appropriations and funds. The limitation code is a four-digit suffix to the U.S. Treasury account number. It is used to identify a subdivision of funds restricting the amount or use of funds for a certain purpose or to identify subelements within the account for management purposes. We reviewed U.S.

[1]Department 97 appropriations include general funds, as well as revolving funds, trust funds, and some small special funds, which are specifically allocated through the Office of the Secretary of Defense to Defense organizations and Military Departments.

Treasury account number 97*0510, limitation codes 16B4 and 40B4 that were identified as Department 97 FY 1996 Base Realignment and Closure (BRAC) Part III and IV appropriations allotted to the Department of the Navy.

The DFAS Indianapolis Center included the reported $5.3 billion total operating expenses for all the Department 97 appropriations that were allotted to the Department of the Navy on the FY 1996 Statement of Operations in the object class defined as Personal Services and Benefits.

Accounting Support. The DFAS Cleveland Center provides finance and accounting support for the Department of the Navy at DFAS Cleveland headquarters and operating location (OPLOC) offices. The support includes maintaining general ledger accounting records, preparing the CFO consolidated financial statements for Department 17[2] appropriations, and submitting the adjusted trial balances with footnotes to the DFAS Indianapolis Center on the Department 97 appropriations allotted to the Department of the Navy. For the Department 97 FY 1996 financial statements, DFAS Indianapolis Center records showed that the DFAS Cleveland Center reported operating expenses totaling $1.2 billion in accounting classification number 97*0510.16B4 and $174 million in accounting classification number 97*0510.40B4. The reported operating expenses included an undetermined amount for payroll.

Audit Objectives

The overall audit objective was to evaluate management controls over the distribution of civilian payroll and related expenditures on the FY 1996 Financial Statements for Other Defense Organizations. We also reviewed the effect of noncompliant payroll actions on the FYs 1996 and 1997 financial statements. Specifically, we reviewed accounting records for payroll and related expenditures to determine the accuracy of the FY 1996 payroll expenses that the DFAS Cleveland Center submitted to the DFAS Indianapolis Center on BRAC III and IV appropriations allotted to the Department of the Navy. We also assessed the DFAS Cleveland Center's management control program as it relates to the overall audit objective. This report is the fourth and final in a series of reports addressing payroll-related issues. See Appendix A for a discussion of the audit scope and methodology and for the results of our review of the management control program. See Appendix B for a summary of prior coverage related to the audit objectives.

[2]Department 17 appropriations represent the amounts appropriated by Congress to fund Navy programs and operations.

Reported Payroll Expenses

The FY 1996 Statement of Operations included $1.3 billion in operating expenses for BRAC III and IV appropriations that could not be traced to source records because the financial system used by the DFAS Cleveland Center summarized financial information accumulated from operating locations and, in the process, lost the identity of the source and of the individual general ledger account codes (GLACs). Because the financial system could not retain and produce data by individual GLACs, the DFAS Cleveland Center applied predetermined percentage rates to total operating expenses to estimate operating expenses by object class rather than report actual expenses in Note 23 of the FY 1996 financial statement. As a result, the FY 1996 financial statement could not be relied upon to accurately present payroll expenses. Until the systems are corrected, the financial statements for FY 1997 and beyond will continue to be adversely affected.

Payroll and Related Expenses

The Office of the Deputy Director for Accounting Operations, DFAS Cleveland Center, used reporting procedures that combined all operating expenses, including payroll and related expenses, into one total amount. Consequently, DFAS Cleveland Center reported $5.3 billion of operating expenses in total, rather than by specific GLACs, to the DFAS Indianapolis Center. The operating expenses included $1.3 billion for limitations 16B4 (BRAC III) and 40B4 (BRAC IV); therefore, the payroll and related expenses could not be separately identified for audit verification. Appendix D shows the total operating expenses, by appropriation and limitation, that DFAS Cleveland Center reported to DFAS Indianapolis Center for the Department 97 FY 1996 Statement of Operations.

Requirement for Audit Trails

DoD Financial Management Regulation. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," states that DoD accounting systems must have audit trails; that is, the accounting system must allow a financial transaction to be traced from its source to the accounting records to the financial statements, and from the financial statements back to the accounting records and back to the source records. In Key Accounting Requirement No. 8, "Audit Trails," DoD Regulation 7000.14-R states that all transactions, including those that are computer generated and computer processed, must be traceable to

individual source records. Source records that are necessary for audit trails include transaction type, record or account involved, amount, processing references, and preparer and approver identification.

DFAS Cleveland Center Audit Trail. DFAS Cleveland Center reporting and accounting systems did not have a complete audit trail for FY 1996 payroll expenses. In tracing the $1.3 billion in total operating expenses from the financial statement, the audit trail ended at the DFAS Cleveland Center trial balance. For the two BRAC limitations, the DFAS Cleveland Center could not show the total operating expenses by GLAC, identify individual accounting entries, or identify the OPLOCs that submitted the accounting entries that were reported to DFAS Indianapolis Center. As a result, the payroll expenses were not identifiable or auditable.

Reporting Financial Data

The DFAS Cleveland Center did not follow DFAS Indianapolis Center guidance to report financial data for the FY 1996 Statement of Operations.

Reporting Guidance. On June 25, 1995, DFAS Indianapolis Center issued guidance to the accounting offices, including the DFAS Cleveland Center, for preparing the financial statements for Other Defense Organizations. The guidance directed Defense agencies and other submitters of Department 97 reports to make the transition to full trial balance reporting during FY 1996, using the DoD Standard General Ledger chart of accounts. Full trial balance reporting includes DoD Standard General Ledger summary accounts and supporting accounts for each appropriation. Payroll expenses are accumulated in five GLACs:

- GLAC 6111, Personnel Compensation-Civilian;
- GLAC 6112, Personnel Compensation-Military;
- GLAC 6113, Personnel Benefits-Civilian;
- GLAC 6114, Personnel Benefits-Military; and
- GLAC 6115, Benefits for Former Personnel.

By submitting a full trial balance, the subsidiary accounts for operating expenses, such as payroll expenses, can be easily identified for financial statement reporting.

DFAS Cleveland Center Reporting. The DFAS Cleveland Center reported total operating expenses in GLAC 6100, "Operating/Program Expense," a summary account, rather than by individual GLAC. When asked to provide a breakout of the total operating expenses, DFAS Cleveland Center personnel could not, because the Navy Headquarters Financial System does not retain

detailed expense data after expenses have been summarized. As a result, the payroll expenses were not identifiable for the BRAC limitations that were included in the FY 1996 Statement of Operations.

To provide more detailed information for Note 23 of the financial statement, the DFAS Cleveland Center estimated operating expenses by object class by applying obligation percentage rates obtained from the Navy to total operating expenses. However, because the obligation rates are based on budgetary obligations and not on actual expenditures, the data reported in Note 23 were estimates. Consequently, the FY 1996 financial statement presented payroll expenses that were inaccurate estimates.

Flow of Payroll Data

Reporting by OPLOCs. Six OPLOCs provide financial information to the DFAS Cleveland Center. They are responsible for providing accounting services for the Navy. For example, OPLOC-Pensacola, Florida, provides field level accounting services for the Chief, Naval Education and Training, Pensacola. The Pensacola OPLOC and other OPLOCs use the Standard Accounting and Reporting System (STARS)-Field Level, a system that tracks funds from authorization through the life cycle of the appropriation at the field level. As of FY 1996, STARS-Field Level provided the OPLOCs with the capability to report operating expenses by object class codes and by standard GLACs. Before FY 1996, STARS-Field Level captured operating expenses only by object class code.

Consolidating Payroll into Other Operating Expenses. The Defense Mega Center in Mechanicsburg, Pennsylvania, houses the central processing units for the STARS-Field Level, STARS-Headquarters Claimant Module, and Navy Headquarters Financial System. OPLOCs process payroll expense general ledger accounting data using STARS-Field Level and then transfer data electronically to the STARS-Headquarters Claimant Module. The OPLOC payroll information is consolidated in the STARS-Headquarters Claimant Module database and then is subsequently transferred to the Navy Headquarters Financial System, where the consolidated payroll information merges with other operating expenses and loses its identity.

Preparing Navy Financial Statements

The DFAS Cleveland Center receives trial balances produced by the Navy Headquarters Financial System using the Navy version of the Uniform Chart of Accounts. Therefore, DFAS Cleveland Center must convert the Navy Headquarters Financial System trial balance to an adjusted trial balance that reflects the DoD Standard General Ledger Chart of Accounts. To further

complicate the conversion process, DFAS Cleveland Center receives information at the departmental or appropriation level, not at the subhead or limitation level. Therefore, the adjusted trial balance submitted to the DFAS Indianapolis Center does not tie back to the specific BRAC limitations.

Estimating Operating Expenses. Because the DFAS Cleveland Center did not receive accounting data in detail, by GLAC or by object class, personnel applied predetermined percentage rates to estimate operating expenses by object class. These rates:

- were used for Department 97 (Other Defense) and Department 17 (Navy) appropriations;
- have not been updated to be consistent with the increase or decrease of the claimants' operations in over 7 years;
- vary by appropriation; and
- can be retrieved on-line from the Navy Headquarters Financial System by authorized personnel.

Although the rates are used for Department 17 (Navy) appropriations, DFAS Cleveland Center officials stated that they have no responsibility to maintain or update the percentages.

Unless the DFAS Cleveland Center OPLOCs and other accounting offices participate in the Department 97 reporting process by providing operating expense information by expense element, the Office of the Deputy Director for Accounting Operations, DFAS Cleveland Center, will not have access to detailed, accurate information on operating expenses. As a result, DFAS Cleveland Center will continue to report operating expenses by totals and use faulty data to estimate operating expenses by object class.

System Limitations and Controls

The problems that DFAS Cleveland Center had with accurately reporting expenses were due to limitations of the financial systems and to weaknesses in management controls over financial data reporting. Financial system limitations prevented DFAS Cleveland Center from reporting operating expenses by the individual GLAC. Data corresponding to individual GLACs were unavailable because detailed operating expense data from the accounting offices were collected in the STARS-Headquarters Claimant Module and then transferred to the Navy Headquarters Financial System. Once in the Navy Headquarters Financial System, the payroll information merged with other operating expenses and lost its identity. As a result, the Office of the Deputy Director for Accounting Operations, DFAS Cleveland Center, did not have access to detailed information on actual operating expenses because it used the Navy Headquarters Financial System to prepare Navy trial balances. In addition, the DFAS

Cleveland Center used the Navy obligation rates to calculate operating expenses by object class because the Navy Headquarters Financial System could not provide actual operating expenses by GLAC. According to DFAS Cleveland Center personnel, the center is developing the STARS-Fund Control and Departmental Reporting system. DFAS Cleveland Center personnel stated that existing system limitations will be corrected because STARS-Fund Control and Departmental Reporting will collect accounting and financial data by individual GLACs, thus eliminating the current practice of using obligation rates to estimate operating expenses. DFAS Cleveland Center personnel also stated that the STARS-Fund Control and Departmental Reporting should be operational in FY 1998. Until then, financial statements for FY 1997 and beyond will continue to be adversely affected.

Recommendations and Management Comments

We recommend that the Director, Defense Finance and Accounting Service Cleveland Center:

1. Revise accounting and reporting systems to comply with Defense Finance and Accounting Service Indianapolis Center instructions to report operating expenses by individual general ledger expense account instead of by the summary general ledger expense account (number 6100) for the limitations contained in the FY 1998 financial statements.

Management Comments. The Defense Finance and Accounting Service concurred, stating that the allocation of expenses via percentages should cease with the implementation of the Standard Accounting and Reporting System-Funds Distribution and Reporting module. The estimated completion date is October 31, 1998.

2. Establish audit trails to ensure that financial transactions can be traced from initiation through processing to the issuance of final financial reports by the Defense Finance and Accounting Service Cleveland Center.

Management Comments. The Defense Finance and Accounting Service concurred, stating that the Standard Accounting and Reporting System-Funds Distribution and Reporting module will incorporate the required measures that will ensure the availability of audit trails for transactions. The estimated completion date is October 31, 1998.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed operating expenses of $1.2 billion for limitation 16B4, FY 1996 BRAC III-Navy, and $174 million for limitation 40B4, FY 1996 BRAC IV-Navy, which both were included in the DoD FY 1996 Statement of Operations. We reviewed and analyzed the Department 97 year-end operating expense data that DFAS Indianapolis Center records showed were submitted by DFAS Cleveland Center on behalf of the Navy. We attempted to identify the payroll expenses within the reported operating expenses. The two limitations represented $1.3 billion of the $5.3 billion of Department 97 operating expenses that the DFAS Cleveland Center reported to the DFAS Indianapolis Center.

Use of Computer-Processed Data. We used the FY 1996 computer-processed data with which DFAS Indianapolis Center prepared FY 1996 Other Defense Organizations Statement of Operations. In addition, we used general ledger data and financial reports, processed by computers, that the DFAS Cleveland Center generated for accounting and management purposes. We did not validate the reliability of any accounting and management system because we limited our use of the data to testing management controls, performing analytical reviews, and obtaining an understanding of the procedures that the DFAS Indianapolis and Cleveland Centers used to compile and report operating expenses. Not validating the reliability of data did not affect the results of the audit.

Sampling Method. In FY 1996, 35 Defense organizations spent Department 97 funds for Personal Services and Benefits expenses through 87 limitations.* Using a sampling method known as probability proportional to size methodology, we statistically selected a sample of 15 limitations. Limitations 16B4, FY 1996 BRAC III-Navy, and 40B4, FY 1996 BRAC IV-Navy were the only selected samples that received accounting support from the DFAS Cleveland Center. Because of inadequate audit trails from the financial statements to the accounting and source records at supporting accounting organizations, we curtailed our audit work after five agency limitations. We will not issue an overall audit report addressing FY 1996 payroll expenses for Other Defense Organizations.

The following table shows the extent of the audit trails that existed for payroll expenses of the five selected agency limitations from the financial statements to the accounting records, and from the accounting records back to source records. An "X" in the box indicates supporting accounting records.

*OMB Circular No. A-34, "Instructions on Budget Execution," December 1995, states that an "limitation" is for fund control purposes, and defines the term as "any administrative division or subdivision of funds made by officials that restricts the use of Federal Government funds."

Analyzed by Agency Limitation

Accounting Office	WHS[4]	DFAS Columbus Center		DFAS Cleveland Center	
Limitation	OSD[3] 1120	DCAA[1] 4600	DLA[2] 5100	96 BRAC III Navy 16B4	96 BRAC IV Navy 40B4
Total for payroll	$145.4 million	$315.5 million	$930.1 million	Unknown	Unknown
FY 1996 financial statement	X	X	X	X	X
Submitting office trial balances	X	X	X		
Accounting records	X	X	X		
Subaccounting records	X				
Source documents (payroll summaries)					

[1]DCAA Defense Contract Audit Agency
[2]DLA Defense Logistics Agency
[3]OSD Office of the Secretary of Defense
[4]WHS Washington Headquarters Service

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of Defense has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the objective to fundamentally reengineer the Department and achieve a 21st century infrastructure. The goal is to reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the Financial Management functional area objective to strengthen internal controls. The goal is to improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

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

Technical Assistance. The Technical Director and an Operations Research Analyst of the Quantitative Methods Division, Office of the Inspector General for Auditing, provided technical assistance in selecting an audit sample.

Audit Type, Dates, and Standards. We performed this financial-related audit from April 1997 through February 1998 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control 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 those controls.

Scope of Review of the Management Control Program. We reviewed the management control programs for DFAS Cleveland Center and the DFAS OPLOC-Pensacola to identify the control techniques to ensure that the Department 97 payroll and payroll-related expenses were accurately recorded in the appropriate GLACs and were properly reported to the DFAS Indianapolis Center. Also, we reviewed the DFAS Cleveland Center FY 1996 Annual Statement of Assurance and management's self-evaluation as it applied to controls over expense reporting.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Directive 5010.38. DFAS Cleveland Center management controls for reporting operating expenses were not adequate to ensure that all expenses were properly and accurately classified, reported, and audited. The recommendations in this report, if implemented, will improve the accuracy of operating expenses reported to DFAS Indianapolis Center for future years. A copy of the report will be provided to the senior DFAS official responsible for management controls.

Adequacy of Management's Self-Evaluation. DFAS Cleveland Center officials identified DoD financial-statement reporting as an assessable unit. However, DFAS Cleveland Center officials did not identify the specific material management control weaknesses identified by the audit because the DFAS Cleveland Center evaluation covered a much broader area.

Appendix B. Summary of Prior Coverage

The Office of the Inspector General, DoD, has published several audit reports in response to the requirements of the CFO Act. The following five reports include information specifically related to this audit.

Inspector General, DoD, Report No. 98-134, "Payroll Expenses Reported by the Defense Finance and Accounting Service Columbus Center," May 13, 1998. This is the third in a series of reports addressing payroll-related issues to include the effect of noncompliant payroll actions on FYs 1996 and 1997 financial statements. The report states that the FY 1996 Statement of Operations and Changes in Net Position for Other Defense Organizations included $1.2 billion of the Defense Contract Audit Agency and the Defense Logistics Agency payroll expenses in Note 23 that could not be traced to source records. Also, the DFAS Columbus Center did not follow the DFAS Indianapolis Center guidance for reporting financial data in the FY 1996 Statement of Operations. As a result, the Defense Contract Audit Agency and Defense Logistics Agency payroll expenses for FY 1996 were not identifiable in the reported operating expenses and were not auditable to the source records. Also, in the operating expenses that the DFAS Columbus Center reported to the DFAS Indianapolis Center in GLAC 6100, the Defense Contract Audit Agency payroll expenses were understated by $56.1 million. The report recommends modifying the accounting and reporting systems to allow operating expenses to be reported by standard GLACs on the financial statements, and establishing procedural reviews to ensure that financial information is properly reported and classified. DFAS Columbus Center did not provided comment to the draft of this report. We are working with DFAS to obtain the comments to the final report.

Inspector General, DoD, Report No. 98-058, "Payroll Expenses Reported in FY 1996 for the Office of the Secretary of Defense," February 2, 1998. This is the second in a series of reports addressing payroll-related issues to include the effect of noncompliant payroll actions on FYs 1996 and 1997 financial statements. The report states that the DoD Chief Financial Officer's Other Defense Organizations Statement of Operations and Changes in Net Position for the year ended September 30, 1996, included $145.4 million of payroll expenses for the Office of the Secretary of Defense that could not be traced to source records. As a result, the operating expenses portion of the DoD Chief Financial Officer's Other Defense Organizations Statement of Operations and Changes in Net Position could not be relied upon to accurately present payroll expenses for FY 1996. In FY 1997, the Office of the Secretary of Defense changed to the Defense Civilian Pay System for payroll processing. The new system created a paperless transaction directly from the pay system to the accounting system at the Washington Headquarters Service, and eliminated the need for hard copy source records at the accounting office. Therefore, we made no recommendations.

Inspector General, DoD, Report No. 98-028, "Personal Services and Benefits Expenses in the FY 1996 Statement of Operations and Changes in Net Position of the Other Defense Organizations," December 2, 1997. This is the first in a series of reports addressing payroll-related issues to include the effect of noncompliant payroll actions on FYs 1996 and 1997 financial statements. The report states that the DoD Chief Financial Officer's Other Defense Organizations Statement of Operations and Changes in Net Position for the year ended September 30, 1996, overstated payroll expenses by $8 billion. As a result, the operating expense portion of the DoD Chief Financial Officer's Other Defense Organizations Statement of Operations and Changes in Net Position could not be relied upon to accurately present payroll expenses for FY 1996. We recommended issuing additional instructions requiring individual reporting of operating expenses. Management concurred and issued clarifying instructions in August 1997.

Inspector General, DoD, Report No. 97-201, "Navy and Marine Corps Reserve Financial Reports on the National Guard and Reserve Equipment Appropriation," July 30, 1997. The report states that budget execution for the Navy and Marine Corps Reserve National Guard and Reserve Equipment Appropriation was not fully supported with source documentation. The reports on budget execution were not fully supported because Cleveland Center did not maintain adequate documentation or source records as required by Key Accounting Requirement No. 8, "Audit Trails." As a result, reports on budget execution could not be verified, and the FY 1996 Navy and Marine Corps Reserves ending trial balances may be unreliable. Further, if the DFAS Cleveland Center does not reconcile the FY 1996 financial reports with source documents, the FY 1997 financial statements may also be unreliable. The DFAS Cleveland Center concurred with all recommendations.

Inspector General, DoD, Report No. 97-155, "Internal Controls and Compliance With Laws and Regulations for the FY 1996 Financial Statements of the Other Defense Organizations Receiving Department 97 Appropriations," June 11, 1997. The report states that the consolidated principal statements for Other Defense Organizations did not accurately and reliably represent the financial operations of the Defense organizations and funds that received Department 97 general fund appropriations. Unless improvements in accounting systems and management controls are made, the Other Defense Organizations financial statements for FYs 1997 and 1998 will not be reliable. The report also states that the DFAS Indianapolis Center and the accounting offices supporting the Defense organizations and receiving Department 97 fund appropriations were unable to fully comply with applicable laws and regulations. As a result, the Defense organizations receiving Department 97 general funds did not fully comply with the CFO Act and the Federal Managers' Financial Integrity Act. The report recommends that the Director, DFAS Indianapolis Center, maintain records for audit trails of all adjustment transactions; reconcile the current year Department 97 expenditure data for the Fund Balance With Treasury account to the Department of the Treasury data; and document the review process used and the decision made regarding the auditors' recommended adjustment to the principal statements, including the footnotes. The Director, DFAS Indianapolis Center, concurred with the recommendations.

Appendix C. OMB Object Classes and Related DoD Standard General Ledger Accounts

Object Class	General Ledger Account	Account Definition
Personal Services and Benefits	6111-Personnel Compensation-Civilian	Represents the gross compensation for personal services rendered by Federal civilian employees and non-Federal employees.
	6112-Personnel Compensation-Military	Represents the earned basic, incentive, and special pays for military personnel.
	6113-Personnel Benefits-Civilian	Represents the benefits paid directly to DoD civilian personnel and payments to other funds for the benefit of the employees.
	6114-Personnel Benefits-Military	Represents the benefits paid directly to military personnel or to other funds for military personnel.
	6115-Benefits for Former Personnel	Represents benefits due to former personnel or their survivors.
Travel and Transportation	6116-Travel and Transportation of Persons	Represents the expense of transporting employees and others, including their per diem allowances, while in an authorized travel status.
	6117-Transportation of Things	Represents the expense of transporting things and the care of such things while in the process of being transported.

Object Class	General Ledger Account	Account Definition
Rents, Communications, and Utilities	6118-Rents, Communications, and Utilities	Represents the expense incurred for rents, communications, and utilities purchased from commercial or U.S. Government sources.
Printing and Reproduction	6119-Printing and Reproduction	Represents the expense incurred for printing and reproduction and the related composition and binding operations.
Contractual Services	6120-Other Services	Represents the expense incurred for services not otherwise classified.
Supplies and Material	6121-Supplies and Materials	Represents the expense incurred for supplies and materials, including ammunition. Includes all supplies consumed or utilized that do not meet the capitalization criteria.
Equipment Not Capitalized	6122-Equipment Not Capitalized	Represents the acquisition costs of equipment that do not meet capitalization requirements.
Grants, Subsidies, and Contributions	6123-Grants, Subsidies, and Contributions	Represents the value of grants, subsidies, and contributions made to further or enhance the interest of national defense.
Insurance Claims and Indemnities	6124-Insurance Claims and Indemnities	Represents payments to veterans and their survivors for death or disability, claims and judgments arising from court decisions, contracts, and military operations.

Object Class	General Ledger Account	Account Definition
Other	6130-Annual Leave	Represents the expense for annual leave earned by military personnel and civilian employees during the accounting period.
	6190-Contra Bad Debt Expense-Incurred for Others	Represents bad debt expense.
	6199-Adjustment to Subsidy Expense	Represents the amount of adjustment to subsidy expense in the program fund.
	6400-Benefit Program Expense	Represents amounts paid by the Military Retirement Trust Fund and the DoD Education Benefits Trust Fund.

Appendix D. Operating Expenses Reported by DFAS Cleveland Center

Appropriation and Limitation Symbol	Appropriation Description	Amount Reported in Total (thousands)
0100-1504	Operations and Maintenance	$ 2,996
0100-2004	Operations and Maintenance	13,091
0100-2304	Operations and Maintenance	31,212
0100-5704	Operations and Maintenance	3,211
0100-5804	Operations and Maintenance	1,222
0100-5904	Operations and Maintenance	3,973
0100-6084	Operations and Maintenance	15,036
0103-1104	Base Realignment and Closure	23,418
0130-1882	Defense Health Program	2,541,642
0131-0400	Real Property Maintenance	32,149
0131-5604	Real Property Maintenance	323
0131-6034	Real Property Maintenance	(169)
0132-1104	Disaster Relief	834
0300-1404	Procurement	79
0300-2504	Procurement	9,478
0300-2604	Procurement	770
0300-2904	Procurement	2,952
0300-5304	Procurement	30,076
0300-5604	Procurement	119,379
0300-6034	Procurement	1,170
0350-0400	National Guard and Reserve Equipment	238,777
0400-1204	Research, Development, Test and Evaluation	176
0400-2604	Research, Development, Test and Evaluation	6,172
0400-5604	Research, Development, Test and Evaluation	72,155
0500-0400	Military Construction	16,672
0500-1204	Military Construction	2,234
0500-1404	Military Construction	92,436
0500-5604	Military Construction	11,959
0510-11B4	Base Realignment and Closure	400,921
0510-16B4	Base Realignment and Closure	1,164,874
0510-40B4	Base Realignment and Closure	173,516
0819-2004	Humanitarian Assistance	1,821
0828-1104	Reinvestment for Economic Growth	1,410
1105-0400	State and Private Forestry	40
4965-2004	Emergency Response Fund	97,298
4965-5604	Emergency Response Fund	218
Subtotal		**$ 5,113,521**

Appropriation and Limitation Symbol	Appropriation Description	Amount Reported in Total (thousands)
5188-0400	Disposal of DoD Real Property	$ 5,125
5189-0400	Leased DoD Real Property	4,439
5193-0400	Overseas Military Facilities Investment Recovery	711
8335-0000	Voluntary Separation Incentive Fund	697
8335-0400	Voluntary Separation Incentive Fund	149,557
Subtotal, this page		**$ 160,529**
Subtotal, previous page		**5,113,521**
Total operating expenses*		**$ 5,274,050**

*Includes only operating expense data for Department 97 appropriations submitted to DFAS Indianapolis Center and subsequently reported in the Statement of Operations. The DFAS Cleveland Center reported operating expenses by total appropriations rather than by individual GLACs.

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange
Director, 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
Superintendent, Naval Postgraduate School

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Cleveland Center
  Director, Defense Finance and Accounting Service Columbus Center
  Director, Defense Finance and Accounting Service Denver Center
  Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

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

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

MAY 21 1998

DFAS-HQ/ASRC

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

SUBJECT: Audit Report on Payroll Expenses Reported by the Defense Finance and Accounting Service Cleveland Center (Project No. 7RF-2010.03)

Our comments to the subject draft report are attached.

Please direct any questions concerning this matter to Ms. Hettye Kirkland at (703) 607-5149.

Edward A. Harris
Director for Accounting

Attachment:
As stated

cc:
DFAS-HQ/CEI
DFAS-CL/PI

SUBJECT: Audit Report on Payroll Expenses Reported by the Defense Finance and Accounting Service Cleveland Center (Project No. 7RF-2010.03)

We recommend that the Director, Defense Finance and Accounting Service Cleveland Center:

RECOMMENDATION 1: Revise accounting and reporting systems to comply with Defense Finance and Accounting Service Indianapolis Center instructions to report operating expenses by individual general ledger expense accounts instead of by the summary general ledger expense account (number 6100) for the limitations contained in the FY 1998 financial statements.

DFAS RESPONSE: Concur. Due to present system limitations within the Department reporting system (i.e., Navy Headquarters Financial System (NHFS)) at the DFAS Cleveland Center (DFAS-CL), DFAS-CL has no recourse but to allocate expenses via the application of the percentages in the NHFS Object Class Tables. However, by the estimated September 1998 implementation of the Standard Accounting and Reporting System-Funds Distribution and Reporting (STARS-FDR) module, DFAS-CL should cease using the percentages method of allocating expenses. Estimated Completion Date: October 31, 1998.

RECOMMENDATION 2: Establish audit trails that ensure financial transactions can be traced from initiation through processing to the issuance of final financial reports by the Defense Finance and Accounting Service Cleveland Center.

DFAS RESPONSE: Concur. All measures required to ensure the availability of audit trails for transactions are being incorporated into the DFAS-CL system, STARS-FDR. Estimated Completion Date: October 31, 1998.

Audit Team Members

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

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