Audit Report

COMPILATION OF THE FY 1998 ARMY GENERAL FUND FINANCIAL STATEMENTS AT THE DEFENSE FINANCE AND ACCOUNTING SERVICE INDIANAPOLIS CENTER

Report Number 99-153 May 12, 1999

Office of the Inspector General
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Acronyms

AAA	Army Audit Agency
ASA(FM&C)	Assistant Secretary of the Army (Financial Management and Comptroller)
CFO	Chief Financial Officers
DDB-DR	Departmental Data Base - Direct Reporting
DFAS	Defense Finance and Accounting Service
GL	General Ledger
HQARS	Headquarters Accounting and Reporting System
OMB	Office of Management and Budget

INSPECTOR GENERAL
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May 12, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Compilation of the FY 1998 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center (Report No. 99-153)

We are providing this audit report for review and comments. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Under Secretary of Defense (Comptroller); the Assistant Secretary of the Army (Financial Management and Comptroller); and the Director, Defense Finance and Accounting Service, did not comment on a draft of this report. Therefore, we request that management provide comments on the final report by June 11, 1999.

Management comments should indicate concurrence or nonconcurrence with each applicable finding and recommendation. Comments should describe actions taken or planned in response to agreed-upon recommendations and provide the completion dates of the actions. State specific reasons for any nonconcurrence and propose alternative actions, if appropriate. Management should also comment on the material management control weakness discussed in Appendix A.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird at (703) 604-9175 (DSN 664-9175) (rbird@dodig.osd.mil) or Mr. John J. Vietor at (317) 510-3855 (DSN 699-3855) (jvietor@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

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Office of the Inspector General, DoD

Report No. 99-153 May 12, 1999
(Project No. 8FI-2025.01)

Compilation of the FY 1998 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center

Executive Summary

Introduction. The Defense Finance and Accounting Service (DFAS) Indianapolis Center maintains the Army departmental accounting records and compiles the Army General Fund financial statements. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. We delegated the audit of the FY 1998 Army General Fund financial statements to the Army Audit Agency but assisted them by performing some of the audit work at the DFAS Indianapolis Center. The Army Audit Agency disclaimed an opinion on the FY 1998 Army General Fund financial statements, and we concurred with the disclaimer. The FY 1998 Army Consolidated Balance Sheet reported total assets of $69.6 billion and total liabilities of $33.4 billion as of September 30, 1998. The Consolidated Statement of Net Cost reported net program costs of $63.4 billion for the period ending September 30, 1998.

Objectives. Our objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data from field activities and other sources for the FY 1998 Army General Fund financial statements. We also reviewed management controls and compliance with laws and regulations related to the objective.

Results. The DFAS Indianapolis Center's compilation of financial data from field entities and other sources into the FY 1998 Army General Fund financial statements was not in compliance with applicable laws and regulations. For over 7 years, budgetary status of appropriations data and expenditure data have been used to compile financial data for the Army General Fund financial statements. This interim method is not acceptable. The Army General Fund financial statements may not be auditable until an integrated, transaction-driven accounting system is implemented Army-wide. Improved procedures and internal controls were needed in the following areas.

The DFAS Indianapolis Center made 117 unsupported general ledger adjustments, valued at about $672.9 billion, while compiling the FY 1998 Army General Fund financial statements. The unsupported adjustments increased from $127 billion to $350 billion to $672 billion between FY 1996 and FY 1998. As a result, the FY 1998 Army General Fund financial statements were not auditable. We addressed this condition in our audit report on the compilation of the FY 1997 Army General Fund financial statements; therefore, we make no additional recommendations in this report (Finding A).

The procedures used by the DFAS Indianapolis Center to compile the FY 1998 Army General Fund financial statements were not effective. Planned automated procedures did not work, and alternate procedures were not ready when needed. As a result, the FY 1998 Army General Fund financial statements were late, incomplete, and unauditable. The official revised version of the financial statements was provided on February 16, 1999, allowing insufficient time for the auditors to review the financial statements and meet the March 1, 1999, reporting deadline established by the Office of Management and Budget (Finding B).

See Appendix A for details of the management control program as it relates to controls over the automated processes used to compile the FY 1998 Army General Fund financial statements.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) issue all guidance necessary for compiling the Army General Fund financial statements at least 90 days before the date that the initial version of the Army General Fund financial statements is to be completed. We revised this recommendation in our final report to include all DoD financial statements. We also recommend that the Director, DFAS Indianapolis Center, establish and test the process to be used for compiling the Army General Fund financial statements at least 30 days before the date that the initial version of the Army General Fund financial statements is to be completed, and establish and test backup procedures for compiling the Army General Fund financial statements. We further recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) provide the DFAS Indianapolis Center with all data necessary for compiling the Army General Fund financial statements by the date established by the Office of the Under Secretary of Defense (Comptroller).

Management Comments. The draft audit report was issued on March 17, 1999. Management comments were not received. We request that the Under Secretary of Defense (Comptroller); the Assistant Secretary of the Army (Financial Management and Comptroller); and the Director, DFAS, provide comments on the final report by June 11, 1999.

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Background

Chief Financial Officers Act. This audit was performed in response to the Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994. The CFO Act requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments and agencies, as well as Government corporations. The CFO Act also requires the Inspectors General, or appointed external auditors, to audit financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget (OMB).

Federal Financial Management Improvement Act of 1996. The Federal Financial Management Improvement Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

Role of the DFAS Indianapolis Center. The DFAS Indianapolis Center, Indianapolis, Indiana, provides finance and accounting support to all DoD organizations, and primarily to the Army and the Defense agencies. Support includes maintaining departmental accounting records and preparing financial statements from general ledger trial balances and financial data on the status of appropriations submitted by DoD field accounting entities and other sources. However, the compilation process is complicated because financial data submitted to the DFAS Indianapolis Center are not generated by integrated, transaction-driven, general ledger accounting systems.

Audit of the FY 1998 Army General Fund Financial Statements. We delegated the FY 1998 audit of the Army General Fund financial statements to the Army Audit Agency (AAA). We assisted the AAA by performing some audit work at the DFAS Indianapolis Center, including examining the processes used to prepare the FY 1998 Army General Fund financial statements.

FY 1998 Army General Fund Financial Statements. The FY 1998 Army General Fund financial statements consisted of the Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and Combined Statement of Financing, along with the supporting footnotes, supplementary schedules, and a management overview. The FY 1998 Army Consolidated Balance Sheet reported total assets of $69.6 billion and total liabilities of $33.4 billion as of September 30, 1998. The FY 1998 Army Consolidated Statement of Net Cost reported net program costs of $63.4 billion for the period ending September 30, 1998.

Objectives

The audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data from field activities and other sources for the FY 1998 Army General Fund financial statements. We also reviewed the management control program and compliance with laws and regulations related to the objective.

See Appendix A for a discussion of the audit process, the management control program at the DFAS Indianapolis Center, and the management control weakness found during our audit. See Appendix B for a list of prior audits at the DFAS Indianapolis Center related to the audit objectives.

A. General Ledger Adjustments

The DFAS Indianapolis Center made 117 unsupported general ledger adjustments, valued at about $672.9 billion, while compiling the FY 1998 Army General Fund financial statements. These unsupported adjustments increased from $127 billion to $350 billion to $672 billion between FY 1996 and FY 1998. These adjustments were made because the DFAS Indianapolis Center's Headquarters Accounting and Reporting System and its supporting accounting subsystems did not conform to the general ledger method of accounting. As a result, the FY 1998 Army General Fund financial statements were not auditable.

The Compilation Process

Since FY 1991, The DFAS Indianapolis Center has used a complex interim process to combine financial information from many accounting and budgetary subsystems to compile the Army General Fund financial statements.

Budgetary Data on the Status of Appropriations. Budgetary data on the status of appropriations recorded by the DFAS Indianapolis Center during the fiscal year were adjusted to match year-end reports on the status of appropriations certified by responsible officials. The adjusted status of appropriations data were referred to as certified status of appropriations data. The certified status of appropriations data were then reconciled to the net expenditures recorded by the U.S. Treasury, and departmental adjustments were made. These adjustments allowed for adjusting status of appropriations data to show the effects of:

- in-transit and unmatched transactions on accounts payable and accounts receivable;
- correcting bulk errors caused by deficiencies in accounting systems;
- meeting special reporting requirements; and
- adding department-level information not available to or accounted for by the field accounting systems.

General Ledger Data. Each month, field accounting entities supported by the DFAS Indianapolis Center submitted a general ledger trial balance directly to the departmental general ledger module of the Headquarters Accounting and Reporting System (HQARS). At year-end, the general ledger data were consolidated into a microcomputer database, the Source File, used to prepare the Army General Fund financial statements. General ledger adjustments were then made directly to the Source File. Unsupported adjustments were made for many reasons, including changing general ledger accounts to match certified status of appropriations data and recording other unsupported adjustments. The other unsupported adjustments were made primarily to align the Net Position reported on the Statement of Net Cost with the Net Position reported on the Balance

Sheet. Supported adjustments were made to record data received from nonaccounting sources on selected assets and liabilities and to record auditor-recommended adjustments.

Preparation of the FY 1998 Financial Statements. After the general ledger adjustments were made, the DFAS Indianapolis Center used a variety of microcomputer programs and applications to convert the Source File into the FY 1998 Army General Fund financial statements. The DFAS Indianapolis Center added footnotes and supplementary schedules, and the Assistant Secretary of the Army (Financial Management and Comptroller) (ASA[FM&C]) added an overview section to the financial statements to create the FY 1998 Army CFO annual report.

Responsibilities. The CFO Reporting and Support Team of the DFAS Indianapolis Center Accounting Directorate is responsible for compiling the Army General Fund financial statements.

Adjustments to the General Ledger

The DFAS Indianapolis Center prepared 423 general ledger adjustments, valued at about $993 billion, while compiling the FY 1998 Army General Fund financial statements. This included 117 unsupported adjustments for about $672.9 billion. About $512 billion of the unsupported adjustments were made to force accounting general ledger data to agree with budgetary status of appropriations data. These unsupported adjustments have increased by about 300 percent since 1996. An additional 115 adjustments of about $161.1 billion were made to align the Net Position reported on the Statement of Net Cost with the Net Position reported on the Balance Sheet. Table 1 summarizes the adjustments made by the DFAS Indianapolis Center to the general ledger for FYs 1996 through 1998.

Table 1. FY 1996 Through FY 1998 Departmental General Ledger Adjustments
(billions)

Purpose of Adjustments	FY 1996	FY 1997	FY 1998
Forcing accounting general ledger data to match certified budgetary status of appropriations data	$127.8	$350.0	$511.8
Net position adjustments	—	—	161.1
Subtotal: Unsupported Adjustments	$127.8	$350.0	$672.9
Recording external data	25.0	33.7	190.6
Recording auditor's adjustments	31.2	17.2	44.3
All others	114.9	347.9	85.5
Total	**$298.9**	**$748.8**	**$993.3**

DFAS Indianapolis Center personnel made the adjustments for $511.8 billion to force the accounting general ledger data to agree with budgetary status of appropriations data because the accounting systems used to compile the FY 1998 Army General Fund financial statements did not conform to the general ledger

method of accounting. DFAS Indianapolis Center personnel used status of appropriations data because they believed it to be more accurate. However, the General Accounting Office stated in its report on the Army financial statements for FYs 1992 and 1991, "There can be no assurance that either data source is accurate because discrepancies between them are not investigated." Because DFAS Indianapolis Center personnel made the adjustment to force the accounting general ledger data to agree with budgetary status of appropriations data without attempting to reconcile the differences between the two data sources or determine which was correct, the adjustments for $511.8 billion were unsupported. These unsupported adjustments have increased by about 300 percent since FY 1996.

DFAS Indianapolis Center personnel made the adjustments for $161.1 billion, as shown in Table 1, to force the Net Position reported on the Statement of Net Cost to match the Net Position reported on the Balance Sheet. This type of adjustment was first made in FY 1998 and was necessary because the accounting systems used to compile the Army General Fund financial statements did not support the reporting of equity accounts required for FY 1998.

Accounting Systems

The DFAS Indianapolis Center HQARS and its supporting accounting subsystems did not conform to the general ledger method of accounting required by the Federal Financial Management Improvement Act of 1996; OMB Circular No. A-127, "Financial Management Systems," as revised July 23,1993; or DoD Regulation 7000.14-R, the "DoD Financial Management Regulation."

- The Federal Financial Management Improvement Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

- OMB Circular No. A-127 states, "The design of the financial management systems shall reflect an agency-wide financial information classification structure that is consistent with the U.S. Government Standard General Ledger."

- DoD Regulation 7000.14-R, volume 1, chapter 3, "Accounting Systems Conformance, Evaluation, and Reporting," May 1993, states, "The system must have general ledger control and maintain an appropriate account structure approved by DoD. The general ledger account structure must follow the general ledger accounts for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources."

Headquarters Accounting and Reporting System. The DFAS Indianapolis Center used its HQARS to prepare the FY 1998 Army General Fund financial statements. However, this system did not meet accounting system requirements. The DFAS Indianapolis Center reported the failure of HQARS to meet

accounting system requirements in its September 1997 Chief Financial Officer Financial Management 5-Year Plan (the 5-Year Plan). The 5-Year Plan stated that "departures [from key accounting requirements] in the Headquarters Accounting and Reporting System general ledger control and reporting and system documentation impede progress in achieving auditable CFO Financial Statements." The 5-Year Plan further stated that the departures from key accounting requirements were first identified in FY 1983 and that full elimination of the departures depended on receiving reliable financial information from accounting subsystems. The 5-Year plan did not give a date for fully eliminating departures from key accounting requirements.

The National Defense Authorization Act of 1998 directed DoD to create a Biennial Financial Management Improvement Plan (Biennial Plan) and submit the plan to Congress no later than September 30 of each even-numbered year. The first Biennial Plan was completed in September 1998. Since the Biennial Plan addressed most aspects of DoD financial management operations, it covered many of the financial reporting requirements specified in other legislation, including the reporting requirements for the CFO Financial Management 5-Year Plan. As a result, the 5-Year Plan will no longer be published. The September 1998 Biennial Plan listed HQARS in the inventory of accounting systems. However, the Biennial Plan did not include any details on the failure of HQARS to meet accounting system requirements. Discussions with DFAS personnel confirmed that the problems with HQARS still existed, as reported in the FY 1997 CFO 5-Year Plan. Funding was not available to bring HQARS into compliance with accounting system requirements. As a result, until HQARS is replaced, the previously reported failure to meet accounting system requirements will continue to exist.

Supporting Accounting Subsystems. HQARS receives general fund accounting support from five accounting subsystems, including the Standard Finance System and the Standard Operation and Maintenance Army Research and Development System. In the 5-Year plan, the DFAS Indianapolis Center reported departures from key accounting system requirements for the general fund accounting systems that support HQARS. The 5-Year plan stated that departures from key accounting requirements for general ledger control and reporting impeded the achievement of reliable financial statements. The 5-Year Plan further stated that the departures from key accounting requirements were first identified in FY 1983, but did not give a date for eliminating the departures from key accounting requirements.

The system inventory in the Biennial Plan listed most of the general fund accounting systems that provided support to HQARS. However, the Biennial Plan did not include details on the failure of some of these supporting systems to meet accounting system requirements.

In our audit report on the compilation of the FY 1997 Army General Fund financial statements, we recommended that the DFAS Indianapolis Center establish an action plan with specific target dates for deploying an integrated, transaction-driven accounting system based on general ledger accounting. The DFAS Indianapolis Center concurred and stated that an action plan was issued on July 7, 1998. The action plan called for the complete deployment of the

Defense Joint Accounting System by the end of FY 2003. Although we make no additional recommendations in this report, these types of problems will continue to occur for several years.

Effects of General Ledger Adjustments

Unsupported general ledger adjustments had a material impact on the FY 1998 Army General Fund financial statements.

The Use of Status of Appropriations Data. The DFAS Indianapolis Center believed status of appropriations data to be more accurate than general ledger data because responsible officials certified status of appropriations data as correct. However, significant differences existed between the general ledger and status of appropriations data. While compiling the FY 1998 Army General Fund financial statements, the DFAS Indianapolis Center made adjustments of about $512 billion to force general ledger accounts to match status of appropriations data. These adjustments were the symptom of the underlying material management control weakness: the lack of an integrated, transaction-driven, double-entry general ledger accounting system for preparing the Army General Fund financial statements. Without an integrated accounting system, for over 7 years, DFAS Indianapolis Center personnel have relied on status of appropriation data to prepare a significant portion of the financial statements. Table 2 illustrates the significance of the departmental adjustments made by DFAS Indianapolis Center personnel to force general ledger accounts to match status of appropriations data on the FY 1998 Army General Fund financial statements.

Table 2. Examples of Effects of Departmental General Ledger (GL) Adjustments on the FY 1998 Army General Fund Financial Statements for Selected Financial Statement Lines
(billions)

Financial Statement Line	Unadjusted Balance	Status/GL Adjustments	Other Adjustments	Adjusted Balance
Fund Balance With Treasury	$61.5	$(31.8)	$(0.9)	$29.6
Accounts Payable	$34.2	$(31.0)	$0.1	$3.3
Unexpended Appropriations	$249.3	$(223.7)	$0.0	$25.6

Unsupported adjustments in these amounts called into question the validity of both the general ledger data and the status of appropriations data. As a result, the FY 1998 Army General Fund financial statements were not auditable.

Net Position Adjustments. DFAS Indianapolis Center personnel made the adjustments for $161.1 billion to force the Net Position reported on the Statement of Net Cost to match the Net Position reported on the Balance Sheet. This type of adjustment was first made for FY 1998 and was necessary because the accounting systems used to compile the Army General Fund financial statements did not support the reporting of equity accounts required for FY 1998.

Conclusion

The DFAS Indianapolis Center was not in compliance with requirements to use an integrated standard general ledger accounting system to produce the FY 1998 Army General Fund financial statements. This nonconformance with the general ledger method of accounting has existed for over 7 years. The lack of an integrated, double-entry, transaction-driven general ledger accounting system has been a major reason for disclaimers of opinion since the General Accounting Office first audited the FY 1991 Army financial statements. The General Accounting Office, in Report No. AFMD-92-83 (OSD Case No. 8674), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991," August 7, 1992, concluded that much of the information needed for the financial statements was not produced by a general ledger-controlled accounting system because the DFAS Indianapolis Center determined that the general ledger data were so unreliable that it was necessary to use an alternative source, the status of appropriations data, to prepare the Army financial statements.

In our audit of the FY 1993 Army General Fund financial statements, we stated that the DFAS Indianapolis Center recognized as a problem the fact that the Army General Fund financial statements were compiled from systems that did not conform to the general ledger method of accounting. At that time, the DFAS Indianapolis Center stated that the problem would be corrected by September 1997. In our audit report on the compilation of the FY 1997 Army General Fund financial statements, we recommended that the DFAS Indianapolis Center establish an action plan with target dates for deploying an integrated, transaction-driven, general ledger accounting system to compile the Army General Fund financial statements. The DFAS Indianapolis Center concurred and stated that an action plan to deploy the Defense Joint Accounting System was issued on July 7, 1998. Accordingly, we make no additional recommendations in this report. However, these problems will likely continue to occur until at least FY 2003. The Army General Fund financial statements may not be auditable until an integrated, transaction-driven, general ledger accounting system is implemented Army-wide.

B. Compilation Procedures

The procedures that the DFAS Indianapolis Center used to compile the FY 1998 Army General Fund financial statements were not effective. Planned automated procedures did not work, and alternate procedures were not ready when needed. This occurred because the DFAS Indianapolis Center did not ensure that new automated procedures were completed and tested in time for year-end use, and did not have an alternative method ready when the planned procedures proved unworkable. As a result, the FY 1998 Army General Fund financial statements were late, incomplete, and unauditable. The official revised version of the financial statements was not provided until February 16, 1999, providing insufficient time for the auditors to review the financial statements and meet the March 1, 1999, reporting deadline established by the Office of Management and Budget.

Form and Content of Financial Statements

The form and content of the FY 1998 Army General Fund financial statements are governed by DoD Regulation 7000.14-R, volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," December 1998. Major due dates for the financial statements are specified in chapter 2, "General Instructions for the Financial Statements." Some significant dates for the FY 1998 financial reporting cycle are shown in Table 3.

Table 3. Major Due Dates for FY 1998 Financial Statements

Due Date	Required Action
December 11, 1998	Provide Advance Copy of Unaudited Financial Statements to IG, DoD
December 24, 1998	Provide Unaudited Financial Statements to IG, DoD
February 2, 1999	Provide Final Financial Statements to IG, DoD
March 1, 1999	Provide Audited Statements to OMB

Accounting Data From External Sources

Because the Army did not have an integrated accounting system, the DFAS Indianapolis Center obtained much of the accounting data needed to prepare the FY 1998 Army General Fund financial statements from sources outside the accounting network. The most important external source was the dollar values provided to the DFAS Indianapolis Center by the ASA(FM&C). The dollar values included financial information for environmental cleanup liabilities, depreciation, inventory valuation, and estimates of the value of National Defense Property Plant and Equipment to be removed from the balance sheet. Other external data sources included the Department of Labor and the U.S. Army Materiel Command. DoD Regulation 7000.14-R specified that all

such data should have been provided to the DFAS Indianapolis Center no later than November 16, 1998. However, all ASA(FM&C) data were not received until January 25, 1999.

The Compilation Process

Critical guidance and data that the DFAS Indianapolis Center needed to prepare the financial statements were not available until more than 90 days after the end of FY 1998 because the Office of the Under Secretary of Defense (Comptroller) issued final guidance on the form and content of the FY 1998 financial statements on January 4, 1998, after receiving the final OMB guidance. Also, the ASA(FM&C) did not provide the DFAS Indianapolis Center with all data necessary to produce the financial statements until January 25, 1999.

Compilation Procedures. The procedures that the DFAS Indianapolis Center used to compile the FY 1998 Army General Fund financial statements were not effective. Planned automated procedures did not work, and alternate procedures were not ready when needed.

- **Planned Automated Procedures.** For FY 1998, the DFAS Indianapolis Center had planned to use the Departmental Database - Direct Reporting (DDB-DR) to replace the automated procedures used to generate the Army General Fund financial statements in previous years. The DFAS Indianapolis Center believed that DDB-DR would work properly because an experimental version had been used to prepare budgetary reports during FY 1998. However, in August 1998, changes to computer hardware and software caused technical problems. DDB-DR functioned properly, but processing time increased from approximately 5 minutes to more than 3 hours. Several changes and repairs made some improvements, but processing time remained unacceptable. By the end of September, the DFAS Indianapolis Center concluded that DDB-DR would not work.

- **Interim Procedures.** The DFAS Indianapolis Center did not have alternative procedures or a contingency plan for preparing the financial statements. DFAS Indianapolis Center personnel analyzed several alternatives and began work on an interim solution called the Desktop Application in early November 1998. The Desktop Application also suffered development problems, and on November 23, 1998, the DFAS Indianapolis Center issued a Situation Report stating that financial reporting deadlines would not be met. The DFAS Indianapolis Center eventually used the Desktop Application to prepare the FY 1998 Balance Sheet and the Statements of Changes in Net Position and Net Cost. However, the Statements of Budgetary Resources and Financing had to be prepared manually.

The DFAS Indianapolis Center should have developed its proposed new compilation procedures and tested them before they were needed. The DFAS Indianapolis Center should also have had a reliable and tested backup plan in case primary procedures failed.

Guidance and Data. The FY 1998 statements were further delayed because guidance and data that the DFAS Indianapolis Center needed to prepare the financial statements were not available until more than 90 days after the end of FY 1998.

- **Form and Content Guidance.** The Office of the Under Secretary of Defense (Comptroller) delayed publication of the FY 1998 form and content guidance pending receipt of final OMB guidance, and provided final form and content guidance to the DFAS Indianapolis Center on January 4, 1999, 11 days after the unaudited financial statements were due to the Assistant Inspector General for Auditing, DoD. Changes in form and content guidance often cause changes in the formatting of the financial statements and footnotes, and can result in the recomputation of line item balances. Such changes may also require modifications to the automated systems used to prepare the financial statements. To permit adequate response time, the Office of the Under Secretary of Defense (Comptroller) should provide the necessary guidance to the DFAS Indianapolis Center at least 90 days before the scheduled release of the initial version of the financial statements.

- **Data Calls.** The ASA(FM&C) did not provide the DFAS Indianapolis Center with all the data needed to prepare the FY 1998 Army General Fund financial statements by the established due date. DoD Regulation 7400.14-R required all data to be sent to the DFAS Indianapolis Center by November 16, 1998. However, data on about $500 million in depreciation expense and $4.4 billion in Government-furnished materials were not received until December 1998, and final data on $13.3 billion in war reserves was not provided until January 25, 1999. This further delayed preparation of the financial statements and caused them to be incomplete. Late data calls resulted in 29 additional adjustments, totaling about $57.3 billion, to the revised draft financial reports. The ASA(FM&C) should provide the DFAS Indianapolis Center with all required data by the established due date.

Even if the DFAS Indianapolis Center had used effective compilation procedures, delays in the receipt of guidance and financial data would have made the FY 1998 Army General Fund financial statements late.

The FY 1998 Army General Fund Statements

The FY 1998 Army General Fund financial statements were late and incomplete. The unaudited financial statements were to have been provided to us by December 24, 1998, but were provided on January 8, 1999. However,

the unaudited financial statements were not complete. The DFAS Indianapolis Center made an additional 183 adjustments to the January 8, 1999, statements, of which 14 adjustments for $44 billion were auditor-recommended. Normally, the official revised version of the financial statements should include only auditor-recommended adjustments. As Table 4 shows, these adjustments caused material changes to the financial statements.

Table 4. Changes in Financial Statements Caused by Late Adjustments (billions)

Statement Line	January 8, 1999 Statements	February 16, 1999 Statements	Change	Recommended by Auditors
Inventory and Related Property	$75.8	$21.3	$54.5 decrease	0
Total Program Costs	$67.7	$71.2	$3.6 increase	0
Costs Capitalized on Balance Sheet	$(75.2)	$3.3	$78.4 increase	0

The revised draft version of the financial statements, which included the $225 billion in adjustments, was not provided to the auditors until February 12, 1999. In effect, the auditable financial statements were not received until February 12, 1999.

Recommendations

Revised Recommendation: Because the guidance necessary for the preparation of the Army General Fund financial statements is applicable to all DoD financial statements, we revised recommendation B.1 in the final report to include all DoD financial statements

B.1. We recommend that the Under Secretary of Defense (Comptroller) issue all guidance necessary for the preparation of the DoD financial statements at least 90 days before the date that the initial version of the financial statements is to be completed.

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

a. Establish and test the process to be used for compiling the Army General Fund financial statements at least 30 days before the date that the initial version of the Army General Fund financial statements is to be completed.

b. Establish and test backup procedures for compiling the Army General Fund financial statements.

B.3. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) provide the Defense Finance and Accounting Service Indianapolis Center with all data necessary for compiling the Army General Fund financial statements by the date established by the Office of the Under Secretary of Defense (Comptroller).

Management Comments Required

The Under Secretary of Defense (Comptroller); the Assistant Secretary of the Army (Financial Management and Comptroller); and the Director, DFAS, did not comment on a draft of this report. We request that management provide comments on the final report.

Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. Our review of the compilation of the FY 1998 Army General Fund financial statements covered processes, procedures, and related management controls that the DFAS Indianapolis Center used to consolidate financial data from field activities and other sources. These data were used to prepare the version of the Army General Fund financial statements submitted to the auditors on February 16, 1999. Our examination included a review of the following processes:

- adjustments made to status data,
- adjustments made to general ledger data, and
- transfer of the status-adjusted general ledger data to the printed financial statements, including the overview, footnotes, and supplementary schedules.

Limitations to Audit Scope. We did not examine the accuracy of data submitted by DoD field accounting entities or other sources or attempt to reconcile data with subsidiary records. Examination of this data is the responsibility of the AAA. We compared the Fund Balance With Treasury recorded by the U.S. Treasury for the Army General Fund to the Fund Balance With Treasury reported in the Army General Fund financial statements. We also reviewed the closing positions of Army General Fund appropriations for deficit balances, and general ledger trial balances for reasonableness.

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 following objectives and goals.

> **Objective:** Fundamentally reengineer DoD and achieve a 21st century infrastructure. **Goal:** 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 following functional area objectives and goals.

> **Objective:** Strengthen internal controls. **Goal:** 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 DoD. This report provides coverage of the Defense Financial Management high-risk area.

Use of Computer-Processed Data. To achieve the audit objective, we relied primarily on computer-processed data in the Source21.dbf database. We tested the data and concluded that the computer-processed data were sufficiently reliable to be used in fulfilling the audit objective. However, field-level systems were not included in our review. Therefore, we can comment only on the reliability of data processed after receipt by the DFAS Indianapolis Center.

Audit Period and Standards. We performed this financial-related audit at the DFAS Indianapolis Center from September 1998 through March 1999. The audit was made in compliance with auditing standards established by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and with OMB guidance; however, we limited our scope as noted above. The audit included such tests of management controls and management's compliance with laws and regulations as we considered necessary.

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

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 the Review of the Management Control Program. We evaluated management controls over the DFAS Indianapolis Center's processes and procedures for consolidating financial data from field activities and other sources for preparation of the Army financial statements. We did not assess the adequacy of management's self-evaluation of these controls because the review of the DFAS Indianapolis Center's management control program, as it related to the compilation of all Army financial statements, was covered in AAA Audit Report 99-161, "Army Working Capital Fund Financial Statements; Fiscal Year 1998: Report on Internal Controls and Compliance with Laws and Regulations," February 12, 1999.

Adequacy of Management Controls. A material management control weakness, as defined by DoD Directive 5010.38, existed in the DFAS Indianapolis Center's procedures for compiling the FY 1998 Army General Fund financial statements. Management controls at the DFAS Indianapolis Center were not adequate to ensure that the automated processes used to compile financial statements were ready when necessary, or that backup procedures were available. The control weaknesses identified and our recommendations for improvements are discussed in Finding B.

Recommendations B.1., B.2., and B.3., if implemented, will improve controls over the compilation of the Army General Fund financial statements. A copy of the report will be provided to the senior official responsible for management controls at the DFAS Indianapolis Center.

Appendix B. Summary of Prior Coverage

General Accounting Office

U.S. General Accounting Office Report No. AFMD-92-83 (OSD Case No. 8674), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991," August 7, 1992.

U.S. General Accounting Office Report No. AIMD-93-1 (OSD Case No. 9276-E), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Years 1992 and 1991," June 30, 1993.

Inspector General, DoD

Inspector General, DoD, Report No. 98-212, "Compilation of the FY 1997 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," September 24, 1998.

Inspector General, DoD, Report No. 98-120, "Compilation of the FY 1996 Army Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," April 23, 1998.

Inspector General, DoD, Report No. 96-161, "Compilation of the FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," June 13, 1996.

Inspector General, DoD, Report No. 94-168, "Defense Finance and Accounting Service Work on the Army FY 1993 Financial Statements," July 6, 1994.

Appendix C. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

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

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  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

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

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

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 Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

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