Audit Report

COMPILATION OF THE FY 1998 FINANCIAL STATEMENTS
FOR OTHER DEFENSE ORGANIZATIONS

Report No. 99-191 June 24, 1999

Office of the Inspector General
Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
IG	Inspector General
OMB	Office of Management and Budget
SBR	Statement of Budgetary Resources
SOF	Statement of Financing

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

June 24, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Compilation of the FY 1998 Financial Statements for Other Defense Organizations (Report No. 99-191)

We are providing this report for review and comment. 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. Because the Director, Defense Finance and Accounting Service did not comment on the draft report, we request that the Director provide comments on the final report by July 26, 1999. If we receive comments on the draft report, we will regard them as comments on the final report.

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) (crichardson@dodig.osd.mil) or Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-191 **June 24, 1999**
(Project No. 8FA-2022 01)

Compilation of the FY 1998 Financial Statements for Other Defense Organizations

Executive Summary

Introduction. This report is the second report in a series on the compilation of the FY 1998 financial statements for Other Defense Organizations by the Defense Finance and Accounting Service (DFAS) Indianapolis Center. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare consolidated financial statements. The DoD Agency-Wide financial statements for FY 1998 include financial statements for a reporting entity entitled "Other Defense Organizations." The entity represents a consolidation of financial information from various Defense organizations and funds, including the Military Departments, which use the Treasury Index 97 symbol, also referred to as Department 97. The FY 1998 financial statements for Other Defense Organizations reported $45.2 billion in assets, $227.5 billion in liabilities, and $54.6 billion in budget authority.

Objective. The primary audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data received from field accounting offices for the financial statements for Other Defense Organizations. Because the financial statements were received after the DoD Agency-Wide financial statements were due to the Office and Management and Budget, we limited our focus to reviewing procedures to compile information and the adequacy of disclosure of material discrepancies in the notes to the principal statements. Appendix A discusses the audit scope and methodology. Our review of internal controls was reported in Inspector General, DoD, Report No. 99-139, "Internal Controls and Compliance With Laws and Regulations for the FY 1998 Financial Statements of Other Defense Organizations," April 21, 1999.

Results. The compilation process that DFAS Indianapolis Center used to adjust, compile, and report financial information for Other Defense Organizations needed improvements to ensure that financial statements were complete, consistent, accurate, and fully supported. In compiling the FY 1998 Financial Statements for Other Defense Organizations, the DFAS Indianapolis Center:

- made $22.27 billion of year-end adjustments to the statement of budgetary resources and the statement of financing that were not adequately supported or disclosed,

- did not explain in the notes to the principal statements $1.91 billion of abnormal balances shown in the financial statements and normal balances that included $17.74 billion of abnormal balances in several account balances, and

- identified but did not eliminate $105.2 million of intra-fund transactions from the balance sheet and the statement of net cost.

As a result, the FY 1998 financial statements that DFAS Indianapolis Center compiled for Other Defense Organizations were not reliable and contributed to the problems encountered in the reliability of the DoD Agency-Wide financial statements. See the finding section for additional details.

Summary of Recommendations. We recommend that the Director, DFAS, revise the "Chief Financial Officers Report Quality Review Checklist" to include eliminations. In addition, we recommend that the Director, DFAS Indianapolis Center, disclose and explain discrepancies between financial statements, the impact of forced adjustments of accounting records to match U.S. Treasury records, and abnormal balances and material abnormal balances included in normal balances on the financial statements. Also, we recommend that Director, DFAS Indianapolis Center, ensure that the accounting offices include budgetary accounts in the trial balance submissions, establish procedures to use general ledger trial balances for compiling all financial statements, and develop standard operating procedures that address the compilation process.

Management Comments. The DFAS did not comment on the draft report issued on May 7, 1999. Therefore, we request that the Director provide comments on the final report by July 26, 1999.

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Background

Reporting Requirements. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), to prepare Government-wide financial statements. OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, establishes the minimum requirements for audits of Federal financial statements. The DoD Agency-Wide financial statements for FY 1998 included financial statements for a reporting entity entitled "Other Defense Organizations." The Inspector General (IG), DoD, is not required to render a separate opinion on the financial statements for Other Defense Organizations. However, information from audits of the financial statements of Other Defense Organizations contributed to the disclaimer of opinion on the DoD Agency-Wide financial statements for FY 1998.

Other Defense Organizations. Other Defense Organizations represent a consolidation of financial information from various Defense organizations and funds that use the Treasury Index symbol (Department 97), including the Military Departments. Appendix C lists the organizations and funds included in the Other Defense Organizations. During FY 1998, the Other Defense Organizations reported $45.2 billion in assets, $227.5 billion in liabilities, and $54.6 billion in budget authority.

Accounting Functions and Responsibilities. The Defense Finance and Accounting Service (DFAS) was established in January 1991 to perform accounting functions for DoD. During FY 1998, DFAS accounting offices provided accounting support for Other Defense Organizations, except for the following:

- certain organizations supported by the Washington Headquarters Services Allotment Accounting System,
- the Tricare Management Activity,
- organizations required to perform their own accounting because of security considerations, and
- a few other small organizations.

DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 6B, "Form and Content of the Department of Defense Financial Statements," December 1998, requires DFAS to ensure that the preparation of financial reports is consistent, timely, and auditable, and that controls are in

place to ensure the accuracy of the reports. Beginning in FY 1996, DFAS Indianapolis Center was responsible for preparing the financial statements for Department 97 funds.

In compiling and preparing the financial statements for Other Defense Organizations, DFAS Indianapolis Center did the following:

- obtained fiscal year-end trial balances and other financial information from the supporting accounting offices,
- consolidated the financial information received, and
- made summary adjustments to change general ledger account balances to agree with the applicable balances shown on the year-end certified "Report on Budget Execution for TI [Treasury Index] 97 Appropriations" and other information received from the Other Defense Organizations.

Reporting Policy. Other Defense Organizations use the same DoD form and content guidance as the DoD Components as shown in volume 6B of DoD Regulation 7000.14-R. That guidance implements OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 20, 1998. DFAS prepared the six principal statements discussed in OMB Bulletin No. 97-01: Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, Statement of Financing, and Statement of Custodial Activity.

Objective

The primary audit objective was to determine whether DFAS Indianapolis Center consistently and accurately compiled financial data received from supporting accounting offices for the FY 1998 financial statements for Other Defense Organizations. Because the financial statements were not provided to us until March 8, 1999, 1 week after the DoD Agency-Wide audited financial statements were due to OMB, we were unable to validate the accuracy and rationale for some adjustments and compiled information. As a result, we reviewed procedures to compile information for the statement of budgetary resources and the statement of financing and the adequacy of disclosure of material discrepancies in the notes to the principal statements. Appendix A discusses the audit scope and methodology. Our review of internal controls is reported in IG, DoD, Report No. 99-139, "Internal Controls and Compliance With Laws and Regulations for the FY 1998 Financial Statements of Other Defense Organizations," April 21, 1999.

Compilation Process

The DFAS Indianapolis Center compiled the FY 1998 financial statements for Other Defense Organizations that reflected $54.6 billion in budgetary authority. However, DFAS Indianapolis Center did not adequately support or disclose at least $22.26 billion in year-end adjustments to the statement of budgetary resources and the statement of financing. The financial statements included $19.65 billion of abnormal balances that notes to the principal statements did not explain. In addition, DFAS Indianapolis Center did not eliminate $105.2 million of intra-fund transactions from the balance sheet and the statement of net cost. The compilation process was not effective because DFAS Indianapolis Center did not do the following:

- implement corrective actions fully to correct problems identified by our prior audits,
- have established procedures to ensure that intra-fund transactions were eliminated from the financial statements,
- consistently use general ledger accounts to compile the financial statements as required, and
- have standard operating procedures to provide operational-level instructions for compiling the new financial statements.

As a result, the FY 1998 financial statements that DFAS Indianapolis Center compiled for Other Defense Organizations were not reliable and contributed to the material problems on the Defense Agency-Wide financial statements. Further improvements in the compilation process would increase the value and reliability of the financial statements for Other Defense Organizations.

Compilation Process for Other Defense Organizations

The compilation process for the FY 1998 financial statements was not effective because DFAS Indianapolis Center had not developed and implemented a comprehensive process that would accommodate the unique reporting structure for Other Defense Organizations. IG, DoD, Report No. 99-139, "Internal Controls and Compliance With Laws and Regulations for the FY 1998 Financial Statements of Other Defense Organizations," April 21, 1999, reports that DFAS Indianapolis Center attempted to implement a new compilation system, the Departmental Database-Direct Reporting system, but did not provide the necessary resources to effectively implement the system. As a result, DFAS Indianapolis Center relied on an interim desktop application and manual calculations to compile the financial statements for Other Defense Organizations that were included in the DoD Agency-Wide financial statements. IG, DoD,

Report No. 99-139 discusses problems in internal controls relating to the compilation process. This report expands on coverage shown in IG, DoD, Report No. 99-139 and provides additional details on problems found and improvements needed.

Reporting and Disclosing Unsupported Adjustments

The DFAS Indianapolis Center made $22.27 billion in unsupported adjustments to the statement of budgetary resources (SBR) and the statement of financing (SOF). DFAS made the adjustments without properly researching and reconciling differences between the accounting data and other data sources or providing adequate audit trails. Adjustments to accounting data that are not properly supported by an audit trail indicate potential problems in DoD financial management systems.

Adjustments to Match U.S. Treasury Records. The SBR included at least $15.41 billion of adjustments that were not supported by general ledger transactions. "Obligated Balance, Net - End of Period" and "Total Outlays" included $9.70 billion and $5.71 billion, respectively, of unsupported adjustments, because DFAS Indianapolis Center adjusted the Report on Budget Execution to match the U.S. Treasury records and later used the Report on Budget Execution to compile the SBR. The DFAS Indianapolis Center made the adjustments so that status reporting[1] by accounting offices would match expenditure reporting[2] by disbursing stations and the U.S. Treasury. The adjustments represent the difference between U.S. Treasury records and the records of the accounting offices, and DFAS Indianapolis Center should have disclosed the adjustments on the financial statements. Headquarters DFAS personnel informed us that in future years, the Report on Budget Execution would not be adjusted to match U. S. Treasury records, but will show the amounts recorded in DoD accounting records. However, any differences between U.S. Treasury records and DoD accounting records should be disclosed in the notes to the principal statements. By disclosing the differences, DFAS Indianapolis Center can show the disparity between the records of the accounting offices and the U.S. Treasury and measure the progress achieved in reducing that disparity. Further, because DFAS Indianapolis Center is the focal point at which data from disbursing stations, accounting stations, and the U.S. Treasury converge, it should aggressively work as a facilitator in resolving the discrepancy between the accounting offices' trial balances and the U.S. Treasury records.

Adjustments Between Statements. The DFAS Indianapolis Center made $6.87 billion of unsupported adjustments to force agreement between

[1]Status reporting is the combinations of systems and processes used by accounting offices and consolidated at DFAS centers for reporting the status of budgetary resources to the Under Secretary of Defense (Comptroller) and OMB

[2]Expenditure reporting is the combination of systems and processes used by DoD disbursing stations and consolidated by DFAS Centers for reporting disbursements and collections to the U.S Treasury

corresponding amounts reported on separate financial statements. Further, DFAS Indianapolis Center did not disclose in the notes to the principal statements the amount of the adjustments. Volume 6B of DoD Regulation 7000.14-R requires that deficiencies be explained and the reason for noncompliance annotated in the footnotes.

Adjustment to Force the SBR to Match the Balance Sheet. DFAS Indianapolis Center personnel decreased the "Obligated Balance, Net - End of Period" on the SBR by $475 million to force the SBR to agree with the balance sheet. The combined total of "Unobligated Balances Available," "Unobligated Balances Not Available," and "Obligated Balance, Net - End of Period" on the SBR should match the amount reported for "Fund Balance With Treasury" on the balance sheet. Because the amounts did not match, DFAS Indianapolis Center adjusted the SBR to match the amount reported for Fund Balance With Treasury. DFAS personnel did not know why the discrepancies occurred.

Adjustment to Force the SOF to Match the Statement of Net Cost. DFAS Indianapolis Center personnel adjusted the SOF by $6.38 billion to force line 5, "Net Cost of Operations," reported on the SOF to match the "Net Cost of Operations" reported on the statement of net cost. DoD Regulation 7000.14-R requires that the "Net Cost of Operations" be the same on both statements. The need for large adjustments should alert personnel compiling financial statements that something is wrong. For example, if the other balances on the SOF were correct, the adjustment would have been $16 million rather than a negative $6.38 billion. However, personnel did not consistently add and subtract amounts used to calculate "Total Resources That Do Not Fund Net Cost of Operations," (a line on the SOF) as required in DoD Regulation 7000.14-R.

Impact of Adjustments. By making $6.86 billion of arbitrary adjustments to force agreement between the financial statements without disclosing that the statements were forced to agree, DFAS Indianapolis Center contributed to the unreliability of the DoD Agency-Wide financial statements. Forcing the financial statements to balance created the appearance of agreement between the statements. However, the statements remained inaccurate and unreliable. The DFAS Indianapolis Center should reconcile and resolve discrepancies between statements, and where a complete reconciliation is not achievable, DFAS Indianapolis Center should disclose in the notes to the principal statements the amounts by which financial statements were adjusted to force agreement.

Reporting and Disclosing Abnormal Balances

Information supporting the FY 1998 financial statements for Other Defense Organizations contained at least $19.65 billion in abnormal balances that DFAS Indianapolis Center did not explain or disclose.

Abnormal Balances Shown on the Financial Statements. The FY 1998 financial statements for Other Defense Organizations included $1.91 billion[3] of material abnormal balances that were not explained or adequately disclosed in the notes to the principal statements. DoD Regulation 7000.14-R requires the inclusion of supplementary financial management information that would enhance an understanding of the financial condition of reporting entities. The presence of material, unexplained abnormal balances decreases the reliability of financial statements. DFAS concurred with an audit recommendation in IG, DoD, Report No. 99-014, "Compilation of the FY 1997 Financial Statements for Other Defense Organizations," October 15, 1998, to disclose the reasons or causes for abnormal balances in the financial statements but did not implement the recommendation for the FY 1998 financial statements.

Abnormal Balances Included in Normal Balances. The DFAS Indianapolis Center included $17.74 billion of abnormal balances in line items, which after netting resulted in normal balances on the SBR, as shown in the following table. The balances shown on the statement were normal only because during the compilation process, the abnormal balances were offset by normal balances, which were larger. A normal balance on the face of a financial statement lends credibility that the balance is accurate and reliable.

Abnormal Balances Included in Lines With Normal Balances for the statement of budgetary resources
(in billions)

Line on SBR	Normal Balance	Abnormal Balance Included
Budget Authority	$54.58	$ 5.60
Unobligated Balance Not Available	3.28	0.41
Obligated Balance, Net - End of Period	22.15	7.56
Total Outlays	55.59	4.17
Total		**$17.74**

The DFAS Indianapolis Center should disclose in the notes to the principal statements the material abnormal balances that are included in the normal balances of the financial statements and possible causes for abnormal balances.

[3]We did not include the $6.38 billion unsupported adjustment to the SOF (as discussed in the previous section of this report) as an abnormal balance. DFAS should have disclosed the reasons for that adjustment, which was shown as an abnormal balance.

Eliminations

The DFAS Indianapolis Center identified but did not eliminate $105.2 million of intra-fund transactions from the balance sheet and the statement of net cost, as required by DoD Regulation 7000.14-R. Further, Headquarters, DFAS, year-end guidance requires that eliminating entries for accounts receivable and unearned revenue on the balance sheet and revenue on the statement of net cost be prepared and included in the compilation of the financial statements. DFAS Indianapolis Center personnel identified the intra-fund balances but did not effectively coordinate with the respective CFO [Chief Financial Officers] Team members to ensure that the eliminations were included in the financial statements. To ensure that eliminations are correctly included in the future, Headquarters, DFAS, should revise the "Chief Financial Officers Report Quality Review Checklist" to ensure that personnel preparing the financial statements include required eliminations.

Use of General Ledger Accounts

DoD Regulation 7000.14-R requires DFAS to prepare financial statements from the general ledger. However, DFAS Indianapolis Center used a combination of general ledger data from the trial balance and nongeneral ledger data to prepare portions of the SBR and SOF.

Compilation of the SBR. The DFAS Indianapolis Center did not use general ledger budgetary accounts to prepare the SBR, but instead it used the Report on Budget Execution. DoD Regulation 7000.14-R, volume 6B, indicates that the SBR is a summarization of various lines of data identified on the Report on Budget Execution and is, therefore, similar in content and presentation. However, that similarity did not eliminate the requirement established for the principal statements to be prepared using general ledger account balances.

Some accounting offices supporting the Other Defense Organizations included budgetary account balances in the trial balances submitted to DFAS Indianapolis Center. The Center did not use those account balances because DFAS personnel considered the Report on Budget Execution to be more reliable than the trial balances. However, that report was adjusted by $17.7 billion[4] to match the U.S. Treasury records and to close appropriations canceling on September 30, 1998.

Compilation of the SOF. The SOF is designed to provide a reconciliation between accrual accounting supporting the statement of net cost and budgetary accounting supporting the SBR; however, the compilation process that DFAS Indianapolis Center used did not achieve the required reconciliation. DoD Regulation 7000.14-R, volume 6B, indicates that the reconciliation of

[4] See IG, DoD, Report No. 99-139.

proprietary and budgetary accounts on the SOF ensures a proper relationship between the two accounting functions in the entity's financial management system.

The DFAS Indianapolis Center should coordinate with accounting offices to ensure that the accounting offices include budgetary accounts in the trial balance submissions and follow up with accounting offices that do not provide the required budgetary accounts. Additionally, DFAS Indianapolis Center should implement procedures to use general ledger accounts from trial balances to compile all financial statements. Until DFAS Indianapolis Center prepares the financial statements of Other Defense Organizations from the same source of data, those financial statements will be difficult to reconcile, and differences will continue to exist between the financial statements.

Procedures and Documentation

Standard Operating Procedures. The CFO Team at DFAS Indianapolis Center did not have standard operating procedures to establish operational-level instructions and controls for compiling financial statements for Other Defense Organizations. In view of the new financial statements required by OMB, it was especially important that DFAS Indianapolis Center develop and implement standard operating procedures to guide accountants in preparing the financial statements.

Documentation of Methodology. The DFAS Indianapolis Center did not adequately document the procedures and methodologies used to prepare the FY 1998 financial statements for Other Defense Organizations. Key Accounting Requirement[5] No. 8, "Audit Trails," requires that audit trails including documentation be maintained so that auditors can ensure that transactions are properly accumulated, classified, coded, and recorded in all affected accounts and later reported in the proper financial statement. Because DFAS Indianapolis Center did not adequately document procedures to prepare the FY 1998 financial statements, accounting personnel provided verbal explanations based on their best recollections on how reported balances were computed. In some cases, supporting documentation did not match the reported balances in the SOF. Consequently, during our verification testing, we could not fully verify the accuracy or validity of the financial statements.

[5]DoD Regulation 7000.14-R, volume 1, identifies 13 key accounting requirements. Key accounting requirements are a composite of General Accounting Office, OMB, Department of Treasury, and DoD regulations All DoD accounting systems must comply with key accounting requirements.

Materiality to DoD Agency-Wide Statements

The FY 1998 financial statements for Other Defense Organizations could not be relied on and contributed to the material misstatement of the DoD Agency-Wide financial statements. For FY 1998, reported balances on the financial statements of Other Defense Organizations were material to 47 lines on the DoD Agency-Wide financial statements. For DoD to achieve a favorable audit opinion on the DoD Agency-Wide financial statements, the material line items for Other Defense Organizations supporting financial statements must comply with required accounting standards.

Other Matters of Interest

Imputed Financing. The DFAS Indianapolis Center did not include imputed financing for cost subsidies to Other Defense Organizations. Entities are required to recognize as an expense the full cost of goods or services received.[6] To the extent that an entity pays less than full cost for the goods or services, the entity should recognize the difference in its accounting records as an imputed cost and simultaneously as an imputed financing source.[7]

Based on information that DFAS Headquarters provided, DFAS Indianapolis Center included $122.8 million in imputed costs for the civilian employees retirement system and for health and life insurance benefits. However, DFAS Indianapolis Center did not include other material costs such as the costs associated with personnel pay and benefits paid by the Military Departments for military personnel assigned to specific Other Defense Organizations. Therefore, the imputed costs for Other Defense Organizations were understated by an undetermined material amount. However, we are not making recommendations regarding recognition of imputed costs because OMB directed that Federal agencies report only employee pensions, related post-employment benefits, and losses in litigation proceedings as imputed costs. To ensure consistency, agencies should not recognize any other costs until OMB provides further guidance.[8]

[6]Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards," July 31, 1995.

[7]Statement of Federal Financial Accounting Standards No 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," May 10, 1996, requires subsidized goods and services to be recognized by the receiving entity.

[8]OMB Memorandum for Chief Financial Officers and IGs, "Technical Guidance for the Implementation of Managerial Cost Accounting Standards for the Federal Government," April 6, 1998.

Recommendations

Deleted Recommendations. As a result of additional audit work, we deleted draft Recommendations 1. and 3.d. We renumbered the remaining recommendations.

1. We recommend that the Director, Defense Finance Accounting Service, revise the "Chief Financial Officers Report Quality Review Checklist" to require that personnel preparing the financial statements include eliminations.

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

a. Reconcile and resolve discrepancies between financial statements and where reconciliation is not achievable disclose in the notes to the principal statements the amount by which the financial statements were adjusted to force agreement in the financial statements.

b. Disclose in the notes to the principal statements the impact on the financial statements of any adjustments made to force accounting office records to match the U.S. Treasury records. If adjustments are not made, disclose any differences between U.S. Treasury records and accounting office records.

c. Explain material abnormal balances reported on the financial statements and disclose and explain in the notes to the principal statements material abnormal balances included in the normal balances reported on the financial statements.

d. Coordinate with supporting accounting offices to ensure that the offices include budgetary accounts in trial balance submissions and follow up with accounting offices that do not provide required budgetary accounts.

e. Develop and implement procedures to use general ledger accounts from trial balances for compiling all financial statements.

f. Develop standard operating procedures for the "Chief Financial Officers Team" that address the compilation of the financial statements for Other Defense Organizations.

Management Comments Required

DFAS did not comment on a draft of this report. We request that DFAS provide comments on the final report.

Appendix A. Audit Process

Scope

Financial Statements Reviewed. We reviewed the process used to compile and prepare the FY 1998 financial statements for Other Defense Organizations. We did not perform audit work to determine the reliability of the values shown in trial balances that accounting offices sent to DFAS Indianapolis Center. We focused on the SBR and the SOF because FY 1998 was the first year that OMB required those statements. We reviewed procedures used to compile the statements, and we interviewed personnel responsible for compiling the statements to determine their methodology in the absence of written procedures. Our review included $22.26 billion in unsupported adjustments to the SBR and the SOF. DFAS Indianapolis Center did not provide the FY 1998 financial statements for Other Defense Organizations to us in December 1998, as required by DoD Regulation 7000.14-R, volume 6B. Because DFAS Indianapolis Center did not provide the statements until March 8, 1999, 1 week after the DoD Agency-Wide audited financial statements were due at OMB, we were unable to review adjustments made to other financial statements and verify that reported balances were supported based on trial balances received. Our review of internal controls is reported in IG, DoD, Report No. 99-139.

Amounts Reported in the FY 1998 Financial Statements and Materiality Thresholds. The FY 1998 financial statements for Other Defense Organizations showed total assets of $45.2 billion, total liabilities of $227.5 billion, total budgetary authority of $54.6 billion, net cost of operations of $54.9 billion, and obligations incurred of $61.1 billion. The FY 1998 materiality threshold* for the DoD Agency-Wide financial statements is $3.75 billion, and the materiality threshold for the FY 1998 financial statements for Other Defense Organizations is $97.1 million.

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 the following objective and goal:

> **Objective:** Fundamentally reengineer the Department and achieve a 21st Century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

*The IG, DoD, uses a design materiality threshold of 1 percent of reported assets, less intragovernmental assets. That criterion is based on guidance on materiality as defined in the Financial Accounting Standard Board Statement of Financial Concepts No 2 and the Federal Audit Manual, published by the General Accounting Office.

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 objective and goal:

> **Financial Management 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 Department of Defense. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

Auditing Standards. This audit was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, based on the objectives of the audit and the limitation in scope

Computer-Processed Data. We used computer-processed data in this audit; however, we did not confirm the reliability of the data because the accounting systems used to prepare the financial statements for Other Defense Organizations had serious limitations. The lack of reliable financial information was described as a material management control deficiency in the DoD Annual Statement of Assurance for FYs 1997 and 1998. The lack of reliable information did not adversely affect our analysis.

Audit Period and Locations. We performed this financial-related audit from February through April 1999 at the DFAS Indianapolis Center.

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

Appendix B. Summary of Prior Coverage

The Inspector General, DoD, has issued numerous reports in support of our audit responsibilities dictated by the Chief Financial Officers Act. The Inspector General, DoD, reports listed below include audit reports issued during FYs 1998 and 1999 specifically related to internal controls and compilation of information supporting the financial statements for Other Defense Organizations.

Inspector General, DoD, Report No. 99-139, "Internal Controls and Compliance With Laws and Regulations for the FY 1998 Financial Statements of Other Defense Organizations," April 21, 1999.

Inspector General, DoD, Report No. 99-062, "Major Deficiencies in the Compilation and Consolidation of the Financial Statements for Other Defense Organizations," December 29, 1998.

Inspector General, DoD, Report No. 99-014, "Compilation of the FY 1997 Financial Statements for Other Defense Organizations," October 15, 1998.

Inspector General, DoD, Report No. 99-006, "Consolidation Process for FY 1997 Financial Statements for Other Defense Organizations," October 6, 1998.

Inspector General, DoD, Report No. 98-208, "Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements," September 23, 1998.

Inspector General, DoD, Report No. 98-178, "Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of Other Defense Organizations," July 13, 1998.

Inspector General, DoD, Report No. 98-062, "Compilation of the FY 1996 Financial Statements for Other Defense Organizations," February 4, 1998.

Inspector General, DoD, Report No. 98-029, "Revenues and Expenses From Reimbursable Activity for Other Defense Organizations," December 5, 1997.

Inspector General, DoD, Report No. 98-027, "Comprehensiveness of the FY 1996 Other Defense Organizations Financial Statements," November 28, 1997.

Appendix C. Defense Organizations and Funds Included in "Other Defense Organizations"

American Forces Information Services
Ballistic Missile Defense Organization
Defense Acquisition University
Defense Advanced Research Projects Agency
Defense Building Maintenance Fund
Defense Commissary Agency
Defense Contract Audit Agency
Defense Emergency Response Fund
Defense Finance and Accounting Service
Defense Health Program
Defense Homeowners Assistance Fund
Defense Information Systems Agency
Defense Intelligence Agency
Defense Legal Services Agency
Defense Logistics Agency
Defense Manpower Data Center Facility
Defense Medical Program Activity
Defense Prisoner of War/Missing Persons Office
Defense Reserve Mobilization Income Insurance Fund
Defense Security Assistance Agency
Defense Security Service
Defense Special Weapons Agency
Defense Support Projects Office
Defense Technology Security Administration
DoD Education Activity
DoD Education Benefits Fund
Federal Energy Management Program
Joint Chiefs of Staff
National Defense Stockpile Transaction Fund
National Imagery and Mapping Agency
National Security Agency
National Security Education Trust Fund
Office of Economic Adjustment
Office of the Inspector General
Office of the Secretary of Defense*
On-Site Inspection Agency
Pentagon Reservation Maintenance Revolving Fund
Tricare Support Office
U S Court of Appeals for the Armed Forces
U.S Special Operations Command
Voluntary Separation Incentive Trust Fund
Washington Headquarters Services
William Langer Jewel Bearing Plant Revolving Fund

*Includes other "Department 97" funds provided to Military Departments and Defense agencies

Appendix D. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

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

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
Salvatore D. Guli
Charles J. Richardson
Marvin L. Peek
Cole M. Cox
Jonathan R. Witter