May 31, 2002

Financial Statement

Major Deficiencies in Financial Reporting for Other Defense Organizations-General Funds
(D-2002-096)

Office of the Inspector General of the Department of Defense

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No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

Article I, Section 9

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Acronyms

DFAS	Defense Finance and Accounting Service
FFMIA	Federal Financial Management Improvement Act
IG	Inspector General
OMB	Office of Management and Budget
TI	Treasury Index
USD(C)	Under Secretary of Defense (Comptroller)
USGSGL	United States Government Standard General Ledger

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202–4704

May 31, 2002

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

SUBJECT: Report on Major Deficiencies in Financial Reporting for Other Defense Organizations-General Funds (Report No. D-2002-096)

We are providing this audit report for information and use. We conducted this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. No written response was required, and none was received.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Jonathan R. Witter at (703) 604-9487 (DSN 664-9487) (jwitter@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Thomas F. Gimble
Acting
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for Auditing

Office of the Inspector General of the Department of Defense

Report No. D-2002-096 **May 31, 2002**
(Project No. D2002FI-0002)

Major Deficiencies in Financial Reporting for Other Defense Organizations-General Funds

Executive Summary

Who Should Read This Report and Why? This report should be read by officials who are responsible for accounting and reporting on the financial activities of the Other Defense Organizations-General Funds, and by officials who use the financial reports of the Other Defense Organizations-General Funds to make management decisions. It explains major financial reporting deficiencies that diminish the quality and utility of the Other Defense Organizations-General Funds financial reports.

Background. This financial related audit was performed in response to the Chief Financial Officers Act of 1990, as amended, which requires DoD and other Government agencies to produce complete, reliable, timely, and consistent financial information. The "Other Defense Organizations-General Funds" is one reporting entity included in the Department of Defense agency-wide financial statements. The entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol, also referred to as Department 97. (See Appendix B for a list of Other Defense Organizations-General Funds.) During FY 2001, the Other Defense Organizations received $64.3 billion of budget authority. This report addresses, in summary form, the major deficiencies that continue to undermine the reliability of the reporting process.

Results. Although DoD and Defense Finance and Accounting Service have taken steps to improve the financial reporting process of the Other Defense Organizations, deficiencies related to financial systems, management controls, budgetary reporting, and trial balance reporting continue to exist. These deficiencies continue to exist because DoD and Defense Finance and Accounting Service have not fully implemented corrective actions recommended in prior reports issued by the Inspector General of the Department of Defense. Many of the deficiencies are recognized by DoD and will not be fully corrected until DoD implements new systems that are compliant with the Federal Financial Management Improvement Act of 1996. Therefore we are not making any new recommendations. Until these deficiencies are corrected, financial reports such as financial statements and reports on budget execution will not be reliable. For details of the audit results, see the Finding section of the report

Management Comments. We provided this draft report on April 4, 2002. No written response was required, and none was received.

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Background

Other Defense Organizations. The reporting entity, "Other Defense Organizations," represents a consolidation of financial information from 48 Defense organizations and funds that use the Treasury Index (TI) 97 symbol. The DoD agency-wide consolidating financial statements include two columns for Other Defense Organizations: Other Defense Organizations-Working Capital Funds, which includes the financial activity of working capital funds not connected with the Military Departments, and Other Defense Organizations-General Funds, which includes the financial activity of all remaining organizations and funds using the TI 97 symbol. This audit focused on Other Defense Organizations-General Funds, which received $64.3 billion in budget authority in FY 2001. (Later references to Other Defense Organizations in this report will refer to the Other Defense Organizations-General Funds unless otherwise noted.)

Accounting Support. During FY 2001, Defense Finance and Accounting Service (DFAS) provided accounting support for the Other Defense Organizations that use TI 97 funds. Accounting offices supporting the Other Defense Organizations submit financial information to DFAS Indianapolis (Sustaining Forces) for inclusion in the reports on budget execution and the annual financial statements.

Audit Coverage. Since 1996 the Inspector General of the Department of Defense (IG DoD) has conducted a series of audits addressing the financial reporting process supporting the Other Defense Organizations-General Funds. The ensuing audit reports identified major deficiencies that, until corrected, seriously impair the usefulness of financial reports.

Objectives

The announced audit objective of this financial-related audit was to determine whether DFAS Indianapolis (Sustaining Forces) consistently and accurately compiled financial data from supporting accounting offices and other sources for the FY 2001 financial statements for Other Defense Organizations-General Funds. After announcing our audit, we narrowed our scope. Specifically, our audit determined the status of previously reported major deficiencies in the financial reporting process supporting the Other Defense Organizations. We performed follow-up work on previously identified deficiencies. We did not perform a financial statement audit and our conclusions are not limited to one particular fiscal year. See Appendix A for a discussion of the audit scope and methodology, review of management control program, and prior coverage related to the audit objectives.

Major Deficiencies in Financial Reporting

Major deficiencies in the Other Defense Organizations-General Funds financial reporting process continue to exist. The reporting process includes deficiencies related to four areas:

- financial systems,
- management controls,
- budgetary reporting, and
- trial balance reporting.

DoD and DFAS initiated improvements to the financial reporting process supporting the Other Defense Organizations. However, the deficiencies persist because DoD has not implemented Department-wide systems that comply with the Federal Financial Management Improvement Act of 1996 and because DFAS has not fully implemented prior IG DoD recommendations. As a result, DoD and DFAS cannot provide fully reliable and accurate budgetary reports, trial balances, and annual financial statements.

Role of Financial Reporting

The Federal Accounting Standards Advisory Board establishes concepts and standards for financial reporting. *Statement of Federal Financial Accounting Concepts*, "Objectives of Federal Financial Reporting," September 2, 1993, states that the financial reporting process for an entity "provides information for formulating policy, planning actions, evaluating performance, and other purposes" to the end-users of financial information. End-users include citizens, Congress, Government executives, and program managers. For financial information to benefit the end-user, "Objectives of Federal Financial Reporting," states that financial information should be understandable, reliable, relevant, timely, consistent, and comparable. Since 1997, the IG DoD, has reported that the financial reporting processes for the Other Defense Organizations have major deficiencies that undermine the reliability and consistency of the financial products provided to end-users.

Financial Systems

The Federal Financial Management Improvement Act (FFMIA) of 1996 and Office of Management and Budget (OMB) Circular A-127, "Financial Management Systems," July 23, 1993, require each Federal agency to establish and maintain a single, integrated financial management system. The financial management system is further required to comply with generally accepted

accounting principles; use the United States Government Standard General Ledger (USGSGL); and comply with all applicable OMB and U.S. Treasury requirements. However, the network of systems supporting the Other Defense Organizations is not integrated and does not use the USGSGL at the transaction level.

Integrated Financial Management Systems. The financial reporting process for the Other Defense Organizations does not consist of integrated financial management systems as required by FFMIA and OMB Circular A-127. The following examples illustrate this deficiency.

DFAS Indianapolis (Sustaining Forces). DFAS Indianapolis (Sustaining Forces) did not employ an integrated financial management system for departmental financial reporting. DFAS Indianapolis (Sustaining Forces) used the Program Budget Accounting system to account for funding, the "TI 97 Application"[1] to prepare reports on budget execution; miscellaneous systems to report on expenditures; and an entirely separate set of systems to compile financial statements.

DFAS Columbus. DFAS Columbus accounting personnel use the Defense Business Management System to perform transaction level accounting for their Other Defense Organizations clients. However, to prepare proprietary trial balances, DFAS Columbus accounting personnel developed elaborate spreadsheets, imported budgetary account balances from the Defense Business Management System into the spreadsheets, and subsequently used the budgetary balances to calculate balances for proprietary accounts.

Use of the USGSGL. IG DoD audit reports have shown that the systems used to collect and report financial data for the Other Defense Organizations do not use the USGSGL at the transaction level. Also, DFAS acknowledged in its FY 2001 Statement of Assurance,

> . . . each of the existing DoD accounting systems has its own general ledger and . . . until a single, standard general ledger is developed and implemented in the DoD systems, control over accounting and reporting will be impossible.

Significant amounts of Other Defense Organization funds (also referred to as Department 97 funds) are allocated to Military Departments and accounted for by the accounting systems used to support the Military Departments. Therefore, those funds are subject to the diversity of the different general ledgers the Military accounting systems use. As a result, during the year-end reporting cycle, accounting offices reporting on Department 97 funds submit year-end trial balances to DFAS Indianapolis (Sustaining Forces) in multiple non-standard

[1]The "TI 97 Application" is a database accounting personnel at DFAS Indianapolis (Sustaining Forces) developed and maintain.

general ledger formats. The Under Secretary of Defense, Comptroller, (USD[C]) acknowledged the limitation by stating,

> . . . many of the Department's financial management systems do not substantially comply with federal financial management systems requirements, applicable GAAP [Generally Accepted Accounting Principles], and the U.S. Government Standard General Ledger at the transaction level. . . .[2]

Impact on Reporting Process. General Accounting Office Report No. 02-29, "Financial Management, FFMIA Implementation Critical for Federal Accountability," October 1, 2001, states that without integrated financial systems, Federal entities are generally unable to routinely produce timely, reliable, and useful financial information. The report further states that by not implementing the USGSGL, "agencies are challenged to provide consistent financial information across their component entities and functions." In concert with the General Accounting Office, we believe that the limitations of the systems used by DoD directly contribute to the deficiencies in management controls, budgetary reporting, and trial balance reporting. Additionally, until DoD implements integrated systems that collect and report data consistently, we believe that the benefits of auditing the financial information are minimal.

Management Controls

The Federal Managers' Financial Integrity Act and OMB Circular No. A-123, "Management Accountability and Control," June 21, 1995, require Federal agencies to integrate appropriate management controls[3] into the systems that the agency uses. OMB Circular A-123 further requires Federal entities to document their management controls and ensure the documentation is readily available for review. IG DoD audit reports have identified management control weaknesses throughout the financial reporting community. The following examples illustrate the lack of adequate controls identified at multiple locations.

Controls Over Reviewing Financial Information. IG DoD audit reports published in 2001 and 2002 reported that the Defense Agency Financial Services Accounting Office, DFAS Columbus, DFAS San Antonio, and Washington Headquarters Services each did not have adequate controls in place to review, identify, and correct anomalies in trial balances prepared for the Other Defense Organizations they serve. As a result, those accounting offices prepared trial

[2]USD(C), Memorandum, "Management Representation Letter Relative to the Department's Fiscal Year (FY) 2001 Department of Defense Agency-wide Financial Statements," February 26, 2002.

[3]OMB Circular A-123, Management, Accountability, and Control," June 21, 1995, defines management controls as "the organization, policies, and procedures used by agencies to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported, and used for decision making."

balances that contained abnormal balances. Implementing and enforcing policies to review financial information can overcome this management control weakness.

Controls Over Year-End Accounting Entries. IG 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, and IG DoD, Report No. 99-014, "Compilation of the FY 1997 Financial Statements for Other Defense Organizations," October 15, 1998, recommended that DFAS document audit trails supporting year-end accounting entries. However, DFAS continues to make accounting entries that are not adequately supported with full reconciliations and adequate audit trails. For example, when preparing the year-end financial statements for FY 2001, DFAS prepared two accounting entries totaling $771 million to force Net Cost reported on the Statement of Financing to match Net Cost reported on the Statement of Net Cost. In another example, accounting personnel at DFAS Indianapolis (Sustaining Forces) prepared 10 accounting entries totaling $4.6 billion as part of the FY 2001 year-end reporting cycle. Accounting personnel prepared the entries to force buyers' and sellers' records to match so that the effects of intragovernmental transactions could be eliminated.[4] However, DoD has not demonstrated that seller information is sufficiently reliable to warrant sweeping adjustments to force buyers' records to match sellers' records. Additionally, accounting personnel did not perform a detailed reconciliation between the two sets of records to affirm the credibility of one set over the other. Therefore, the entries prepared to unilaterally force one set of records to match another are deemed unreliable.

The inability to prepare financial reports that report all transactions consistently, vividly demonstrates the inability of DoD to produce financial reports that meet the essential characteristic of consistency as identified in "Objectives of Federal Financial Reporting." DFAS Indianapolis (Sustaining Forces) will not be able to overcome the control weakness of unsupported year-end accounting entries until DoD implements an integrated financial management system to capture and report data accurately and consistently.

Control Weaknesses Acknowledged by DFAS. The DFAS FY 2001 Annual Statement of Assurance, acknowledged 42 material management control weaknesses. Of the 42, at least 11 affected the financial reporting process for the Other Defense Organizations and could be generally grouped into the following two categories:

- General ledger controls, reconciliations, reliability of financial reporting; and
- Fund Balance With Treasury.

[4]DoD Regulation 7000.14, volume 6B, chapter 13, "Adjustments, Eliminations, and Other Special Intragovernmental Reconciliation Procedures," directs DFAS to force the buyers' accounting records to match the sellers' records prior to eliminating transactions between the two parties because it is believed that the amounts reported by the seller are more accurate. Therefore the corresponding amounts reported by the buyer must be adjusted to match the seller records.

Because DoD accounting, finance, and feeder systems do not fully comply with Federal financial management systems requirements, the management control weaknesses identified by our audit and DFAS will continue. Additionally, the quality of the financial reporting process and financial products—such as reports and financial statements—will continue to be at risk.

Budgetary Reporting

OMB Circular A-34, "Instructions on Budget Execution," November 3, 2000, requires Federal entities to prepare monthly reports on budget execution that show the source of budgetary resources, the status of budgetary resources, and the relation of obligations to net outlays. OMB, DoD, and Federal entities use the reports on budget execution for planning and managing Federal funds. As a financial service provider, DFAS uses the budget data, including the reports on budget execution, to prepare the annual financial statements. Therefore, the reports on budget execution must be accurate and reliable. However, since 1997, the IG DoD has reported major deficiencies related to reports on budget execution, including abnormal balances and unsupported accounting entries to force internal accounting records to match U.S. Treasury records. Those deficiencies continue to exist as the following examples illustrate.

Abnormal Balances[5] for Open Appropriation Accounts. For the Other Defense Organizations open appropriation accounts, DFAS Indianapolis (Sustaining Forces) prepared reports on budget execution at the end of FY 2001 that contained material abnormal balances that were not adequately explained in required footnotes. For example, the September 30, 2001, reports on budget execution reported $1 billion of abnormal balances for "Obligated Balances, Net as of October 1."

Abnormal Balances for Appropriation Accounts Scheduled to Close. For fixed appropriation accounts[6], section 1552, title 31, United States Code, requires that the appropriation account be closed on September 30 of the 5th fiscal year after the period of availability for obligation. The reports on budget execution prepared for appropriation accounts scheduled to close on September 30, 2001, reported material abnormal balances. For example, one appropriation, "Research Development Test and Evaluation," (Basic Symbol 0400) reported a total of $487 million of abnormal balances. The existence of abnormal balances at the time an appropriation account is scheduled to close is most likely indicative of control deficiencies in the procedures for managing and reporting on funds.

Differences Between Reports on Budget Execution and U. S. Treasury Records. IG DoD Report No. 97-155 recommended that DFAS develop and

[5]The normal balance for an account is always positive. However, if an account goes below $0 it becomes a negative balance and therefore is abnormal. An abnormal balance represents more decreases to an account than increases and is generally indicative of a reporting anomaly that requires explanation.

[6]DoD Financial Management Regulation, volume 3, chapter 10, Appendix C, defines fixed accounts as appropriations or fund accounts with balances available for a definite amount of time.

implement management controls to monthly reconcile current year expenditure data to budget data and to Department of the Treasury data for Fund Balance With Treasury, and determine the causes for undistributed disbursements. However, the FY 2001 year-end reports on budget execution contained material unreconciled differences with U. S. Treasury records for disbursements and collections. DFAS Indianapolis (Sustaining Forces) continues to adjust the reports on budget execution to match Treasury records. For example, during FY 2001 DFAS Indianapolis (Sustaining Forces) prepared accounting entries for appropriation-level reports on budget execution that adjusted disbursements by $3.9 billion in order to force those reports to match U.S. Treasury records. Accounting personnel did not perform a reconciliation to determine to which Other Defense Organization the differences should be attributed.

Impact on Users. Those who read and use the reports on budget execution are relying on reports that may not accurately reflect the true status of fiscal operations. For example, DFAS Indianapolis (Sustaining Forces) continues to prepare material adjustments to force internal records to match the U.S. Treasury records which were prepared at the appropriation level rather than the entity and sub-entity level for funds appropriated prior to FY 2000. Therefore, readers of entity or sub-entity level reports on budget execution would not see the portion of the adjustment that applies to their entity.

Trial Balance Reporting

Financial events are recorded as transactions and those transactions are recorded in accounts. A list of accounts with their balances constitutes a trial balance. Accounting personnel use trial balances to prepare financial statements. Therefore, trial balances must be complete and accurate in order to produce complete and accurate financial statements. Major deficiencies in the quality of trial balances prepared for the Other Defense Organizations continue to exist. The following examples illustrate some of those deficiencies.

Completeness of Trial Balances. To be useful, trial balances should be complete. However, the trial balances used to prepare financial reports for the Other Defense Organizations were not always complete. DFAS Indianapolis (Sustaining Forces) requires general ledger trial balances to be submitted quarterly and at the end of the fiscal year for Defense agencies and other TI-97 reporting entities and sub-entities. Accounting offices supporting the Other Defense Organizations did not submit trial balances for all of the Other Defense Organizations entities and sub-entities. Therefore, DFAS Indianapolis (Sustaining Forces) manually prepares partial, year-end trial balances from reports on budget execution. For example, during FY 2001, as part of the year-end reporting process, accounting personnel prepared trial balances with an absolute value of $5.6 billion for 18 sub-entities. The manually created trial balances were not complete because reports on budget execution do not contain financial data for the entire scope of an entity's operations, such as accrued annual leave expenses; property, plant, and equipment; and related depreciation. Additionally, amounts reported for accounts payable and accounts receivable are not reported in separate intragovernmental and public categories in the reports on budget execution.

Abnormal Balances in the Trial Balances. IG DoD Report No. D-2000-153, "Compilation of the FY 1999 Financial Statements For Other Defense Organizations-General Funds," June 23, 2000, recommended that accounting offices supporting the Other Defense Organizations correct abnormal balances on quarterly and annual trial balances submitted to DFAS Indianapolis (Sustaining Forces). The accounting offices supporting the Other Defense Organizations continued to submit trial balances to DFAS Indianapolis (Sustaining Forces) that contained material abnormal balances during FY 2001. For example:

- General ledger account 1013, Funds with Treasury, has a normal debit balance; however, accounting offices submitted trial balances that contained negative, and therefore abnormal, balances of $75 million for that account.

- General ledger account 2113, Accounts Payable, has a normal credit balance. However, accounting offices submitted trial balances that contained abnormal balances of $122 million for that account.

Differences Between Trial Balances and Reports on Budget Execution. As in past years, the FY 2001 year-end Reports on Budget Execution and trial balances prepared for the Other Defense Organizations reported material differences for similar categories of financial data reported. For example, the trial balance for Department 97 appropriations for the North Atlantic Treaty Organizations Security Investment Program (appropriation 0804.0100), reported $691 million for Fund Balance with Treasury, but the corresponding information on the Reports on Budget Execution reported $367 million, a difference of $324 million. Accounting personnel at DFAS Indianapolis adjusted the trial balances to match the Reports on Budget Execution.[7] DFAS-Indianapolis (Sustaining Forces) adjusted the general ledger amounts reported in the trial balances to match related amounts reported in the reports on budget execution because DFAS Indianapolis (Sustaining Forces) believes that the budgetary data is generally more accurate than the proprietary data. This accounting entry was unsupported because the differences between reports on budget execution and trial balances are not investigated and mathematically reconciled.

Impact on Users. Trial balances are the primary source of data for preparing the financial statements for the Other Defense Organizations; therefore, the quality of the trial balances affects the quality of the financial statements for any given year. Because the process to manually prepare trial balances produces incomplete trial balances, the resulting financial products are at risk of being incomplete. Furthermore, until these deficiencies are corrected, the quality of the financial statements for any given year is at risk because of abnormal balances in trial balances and unsupported ending balance adjustments.

[7]DoD Financial Management Regulation (FMR), volume 6A, chapter 2, specifically requires DFAS to reconcile differences between general ledger amounts and all other related financial balances. All un-reconciled differences are to be investigated and any appropriate adjustments are to be documented and processed to balance the agencies' and entities' general ledger accounts.

Improvement Initiatives

DoD Initiatives. Although major deficiencies continue to exist, the DoD has taken action to correct them. The following examples are provided.

Financial Management Modernization Program. Secretary of Defense, Memorandum, "Financial Management Information Within the Department of Defense," July 19, 2001, established a Department-wide Financial Management Modernization Program. The goal of this program is to transform financial and non-financial systems and processes so that they effectively work together to provide reliable, accurate, and timely financial management information. To implement the program, the Secretary of Defense established a Program Management Office to develop a DoD-wide enterprise architecture. The enterprise architecture will prescribe how the Department's financial and non-financial feeder systems and business processes will interact.

Independent Audits. USD(C) requires that nine of the Other Defense Organizations prepare annual stand-alone financial statements and obtain audits from independent certified public accountant firms.[8] The results of these audits can collectively assist USD(C) in identifying and correcting pervasive deficiencies at the individual agency level.

Joint Review Process. As part of the annual financial statement compilation process, the USD(C) established a joint review process through which USD(C), DFAS, and IG DoD, meet to review a draft version of the financial statements. Participants in the joint review identify areas of concern and DFAS, as the financial statement preparer, provides explanations and, as necessary, planned corrective action. The joint reviews provide a useful opportunity to identify obvious errors and omissions early in the financial statement compilation process.

DFAS. During FY 2001, DFAS reorganized under the Defense Business Evolution plan to, among other purposes, allow greater concentration on management controls and better focus on resolving weaknesses. Also, DFAS is taking steps towards general ledger compliance with its initiative to integrate four General Ledger Fund accounting systems. Further, DFAS Indianapolis (Sustaining Forces) has implemented multiple corrective actions addressing the unique needs associated with the financial reporting processes for Other Defense Organizations. Following is a list of some of those initiatives.

Audited Financial Statements Team. DFAS Indianapolis (Sustaining Forces) established a team of accounting personnel dedicated to the Other Defense Organizations departmental financial reporting.

[8]DoD Financial Management Regulation 7000.14-R, volume 6B, chapter 1, "Introduction and Summary," November 2001, requires annual stand-alone statements and audits at Defense Logistics Agency, Defense Finance and Accounting Service, Defense Information Systems Agency, Defense Contract Audit Agency, Missile Defense Agency, Defense Advanced Research Projects Agency, Defense Commissary Agency, Defense Security Service, and Defense Threat Reduction Agency.

General Ledger Reconciliation Report. Accounting personnel designed and implemented the General Ledger Reconciliation Report that accounting offices now use to identify and correct trial balance anomalies such as abnormal balances.

Cash Management Report. Accounting personnel also implemented the Cash Management Report for FY 2000 funds (and forward) to identify the difference between U. S. Treasury records and internal DoD records at the entity and sub-entity level.

Written Procedures. Accounting personnel took action to document the Other Defense Organizations consolidation and compilation process and developed standard operating procedures for report preparation.

Conclusion

DoD and DFAS have taken action to improve the financial reporting process supporting the Other Defense Organizations; yet, major deficiencies continue to exist related to financial systems, management controls, budgetary reporting, and trial balance reporting. The existing deficiencies directly impair the quality and reliability of the financial reports that are generated by the financial reporting process. Until these major deficiencies are remedied, we do not believe further intensive audits of those processes will yield significant benefit. Therefore, we do not anticipate conducting additional detailed audits of those processes until management can assert that the processes—including systems, controls, and data—are compliant with generally accepted accounting principles and can generate reports that are accurate and reliable. We make no audit recommendations because recommendations have been made in previous reports that address most of the deficiencies. Furthermore, the deficiencies are not likely to be effectively remedied until a comprehensive set of integrated finance and accounting systems and management control initiatives are implemented. For those deficiencies for which no previous recommendations were made, DoD has already acknowledged the deficiencies and has initiated corrective action.

Appendix A. Scope and Methodology

Scope

Financial Information, Procedures, and Control Reviewed. The audit was designed to assess the status of major deficiencies identified in previous IG DoD reports. In addition, we assessed the current status of material control deficiencies and instances of material noncompliance with laws and regulations that have been identified in previous audit reports. We reviewed the reports on budget execution, and assessed the status on abnormal balances, differences between reports on budget execution and U.S. Treasury records, and the differences between the reports on budget execution and trial balances. We also reviewed trial balances, and assessed the status of:

- manually created trial balances,
- abnormal balances on the trial balance,
- inconsistencies between trial balances and reports on budget execution,
- status of inadequate audit trails, and
- use of the USGSGL.

We reviewed the procedures and controls to accumulate financial data; produce appropriation-level reports submitted to the OMB, the USD(C), and DFAS; and to prepare the annual financial statements. We also reviewed the FY 2000 DoD Financial Management Improvement Plan, the DFAS Arlington and DFAS Indianapolis (Sustaining Forces) FY 2001 Annual Statements of Assurance, and prior audit reports. We did not review supporting financial data and financial reports related to the Other Defense Organizations-Working Capital Funds.

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 DoD Financial Management high-risk area.

Methodology

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 had serious limitations. The lack of reliable financial information was described as a material management control deficiency in the DFAS Annual Statement of Assurance for FY 2001. The lack of reliable information did not adversely affect our conclusions because our audit objective was to assess the status of prior deficiencies in the reporting process for Other Defense Organizations.

Audit Dates and Standards. We performed this audit from October 2001 through April 2002 at DFAS Indianapolis (Sustaining Forces) in accordance with generally accepted government auditing standards.

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

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require 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. Many different Defense organizations comprise the Other Defense Organizations reporting entity, and collectively, an Other Defense Organizations Management Control Program does not exist. Therefore, we reviewed the 2000 DoD Financial Management Improvement Plan and the DFAS FY 2001 Annual Statement of Assurance. These documents provided the aggregate visibility needed to identify pervasive management control weaknesses affecting the group of Other Defense Organizations listed in Appendix B.

Adequacy of Management Controls. Our review of management controls was limited to following up on the current status of major deficiencies reported in prior IG DoD reports. We determined that management control weaknesses persist related to financial systems, budgetary reporting, and trial balance reporting. The 2000 DoD Financial Management Improvement Plan acknowledged that the current DoD financial systems are not compliant with FFMIA. The DFAS FY 2001 Annual Statement of Assurance acknowledged that management weaknesses exist related to general ledger controls, reconciliations, reliability of financial reporting, and Fund Balance With Treasury. We are not making recommendations because recommendations addressing many of these deficiencies have already been made and DoD has recognized the deficiencies as material weakness.

Prior Coverage

The General Accounting Office and the IG DoD have multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at http://www.gao.gov. IG DoD reports can be accessed on the Internet at http://www.dodig.osd.mil.

Appendix B. Other Defense Organizations-General Funds

American Forces Information Service
Defense Acquisition University
Defense Advanced Research Projects Agency
Defense Building Maintenance Fund

Defense Commissary Agency
Defense Contract Audit Agency
Defense Contract Management 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 Logistics Agency
Defense Medical Program Activity
Defense Prisoner of War/Missing Persons Office

Defense Security Cooperation Agency
Defense Security Service
Defense Threat Reduction Agency
DoD Component Level Accounts

DoD Education Activity
DoD Education Benefits Fund
DoD Human Resources Activity
Federal Energy Management Program

Joint Chiefs of Staff
Joint Logistics Systems Command
Missile Defense Agency
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, DoD
Office of the Secretary of Defense (OSD)
Other Prior Year Residual "97" Funds
Other "97" Funds Provided to the Air Force by OSD

Other "97" Funds Provided to the Army by OSD
Other "97" Funds Provided to the Navy by OSD
Other "97" Funds Provided to Washington Headquarters Services by OSD
Pentagon Reservation Maintenance Revolving Fund

Ready Reserve Mobilization Income Insurance Fund
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* not listed in the DoD Regulation 7000.14-R

Appendix C. Report Distribution

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Defense Acquisition University
Defense Advanced Research Projects Agency
Defense Commissary Agency
Defense Contract Audit Agency
Defense Contract Management Agency
Defense Finance and Accounting Service
Defense Information Systems Agency
Defense Intelligence Agency
Defense Logistics Agency
Defense Prisoner of War/Missing Persons Office
Defense Security Cooperation Agency
Defense Security Service
Defense Threat Reduction Agency
DoD Education Activity
DoD Human Resources Activity
Joint Chief of Staffs
Joint Logistics Systems Command
Missile Defense Agency
National Imagery and Mapping Agency
Office of Economic Adjustment
Technical Research Institute

Other Defense Organizations (Cont'd)

TRICARE Management Activity
U.S. Court of Appeals of the Armed Forces
U.S. Special Operations Command
Uniformed Services University of the Health Sciences
Washington Headquarters Services

Non-Defense Federal Organization

Office of Management and Budget

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 Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

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