Audit Report

OFFICE OF THE INSPECTOR GENERAL

FUND BALANCES WITH THE TREASURY ACCOUNTS ON THE FY 1993 FINANCIAL STATEMENTS OF THE DEFENSE LOGISTICS AGENCY BUSINESS AREAS OF THE DEFENSE BUSINESS OPERATIONS FUND

Report No. 94-159 June 30, 1994

Department of Defense

Additional Copies

To obtain additional copies of this report, contact the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch, Audit Planning and Technical Support Directorate, at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

Inspector General, Department of Defense
OAIG-AUD (ATTN: APTS Audit Suggestions)
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

DoD Hotline

To report fraud, waste, or abuse, call the DoD Hotline at (800) 424-9098 or write to the DoD Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of writers and callers is fully protected.

Acronyms

ACRS	Appropriation Control and Reporting System
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
GAAP	Generally Accepted Accounting Principles
OMB	Office of Management and Budget

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

June 30, 1994

MEMORANDUM FOR THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Fund Balances with the Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund (Report No. 94-159)

We are providing this report for your review and comments. It discusses the reasonableness of the cumulative $1.04 billion reported as fund balances with the Treasury for the Defense Logistics Agency business areas. Defense Logistics Agency comments on a draft of this report were considered in preparing this final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, we request the Defense Logistics Agency and Defense Finance and Accounting Service provide comments on unresolved recommendations by August 29, 1994. Comments that were received too late from the Comptroller of the Department of Defense will be considered as a reply to the final report.

The courtesies extended to the staff are appreciated. If you have any questions about this audit, please contact Mr. Stuart Dunnett, Audit Project Manager, at (614) 337-8009. Copies of the final report will be distributed to the organizations listed in Appendix D. The audit team members are listed on the inside back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-159 **June 30, 1994**
(Project No. 4LE-2001)

FUND BALANCES WITH THE TREASURY ACCOUNTS ON THE FY 1993 FINANCIAL STATEMENTS OF THE DEFENSE LOGISTICS AGENCY BUSINESS AREAS OF THE DEFENSE BUSINESS OPERATIONS FUND

EXECUTIVE SUMMARY

Introduction. The Defense Logistics Agency business areas are part of the Defense Business Operations Fund. As part of a multi-year audit approach to the financial statements of the Defense Business Operations Fund, we examined the cumulative $1.04 billion fund balances with the Treasury reported for the DLA business areas on financial statements for FY 1993.

Objectives. The overall objective of this audit was to determine whether the fund balances with the Treasury accounts on the FY 1993 financial statements for the DLA business areas are presented fairly, in accordance with generally accepted accounting principles. The audit also evaluated applicable internal controls related to fund balances with the Treasury accounts.

Audit Results. The DLA's business area's fund balances with the Treasury accounts were not prepared in accordance with generally accepted accounting principles for Federal agencies. As a result, presentation related to DLA's cumulative $1.04 billion for fund balances with the Treasury accounts in its FY 1993 statements of financial position, cash flow, and related footnotes are misleading and cannot be relied upon by users of the financial statements.

Internal Controls. The audit identified material internal control weaknesses, in that controls were not in place to ensure that the amounts recorded as fund balances with the Treasury were reported in accordance with generally accepted accounting principles. Specifically, audit trails were not adequate, reconciliations were not performed to support reported amounts, and transactions were not matched to the proper accounting period. See Part I for details of the internal controls reviewed and Part II for a discussion of the weaknesses identified.

Potential Benefits of Audit. The audit identified no quantifiable monetary benefits. However, improved financial reporting in DLA business areas through enhanced accounting and internal control systems should result in improved cash management.

Summary of Recommendations. We recommended that guidance be rescinded related to fund balances with the Treasury because it was not in accordance with generally accepted accounting principles; that procedures and controls be issued to establish adequate audit trails, reconciliations, and controls over appropriation limits; that sublimits be established for business areas; and that discrepancies be disclosed in the FY 1993 statements of cash flow and accompanying footnotes.

Management Comments. The Comptroller of the DoD comments were received too late to be included in this report, and will be considered as a response to the final report. The Defense Finance and Accounting Service did not comment on the draft of

this report. DLA concurred with the recommendation to establish appropriate sublimits for business areas, and partially concurred with the recommendation to disclose discrepancies in the FY 1993 statements of cash flow and accompanying footnotes. DLA stated that footnote disclosures in the FY 1993 financial statements were adequate. See Part II for a full discussion of DLA's comments and Part IV for the complete text of the comments.

Audit Response. We request that DLA provide additional comments on the unresolved issues related to proper disclosure in its FY 1993 financial statements of cash flow and accompanying footnotes, including the apparent anti-deficiency act violations indicated in those footnotes, and that the Defense Finance and Accounting Service provide comments to the final report by August 29, 1994.

Table of Contents

Executive Summary i

Part I - Introduction 1

Background 2
Objectives 3
Scope and Methodology 4
Internal Controls 4
Prior Audits and Other Reviews 5

Part II - Finding and Recommendations 7

Fund Balances with the Treasury 8

Part III - Additional Information 17

Appendix A. Comparison of Trial Balances to the Statements of Financial Position 18
Appendix B. Summary of Prior Audits and Other Reviews 19
Appendix C. Summary of Potential Benefits Resulting from Audit 21
Appendix D. Organizations Visited or Contacted 22
Appendix E. Report Distribution 23

Part IV - Management Comments 25

Defense Logistics Agency Comments 26

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

This report is part of a series of audits performed to fulfill the requirements of the Chief Financial Officers Act of 1990 that we perform a financial statement audit of the Defense Logistics Agency (DLA) business areas of the Defense Business Operations Fund (DBOF). Rather than performing separate financial audits of each business area, we elected to audit selected accounts of the FY 1993 consolidated statement of financial position for the DLA DBOF business areas. This audit was completed in conjunction with similar audits performed by the Military Departments' audit agencies. Information from this report will be used as part of a consolidated report on the principal and combining financial statements of the DBOF for FY 1993, althought we do not plan to opine formally on those statements until additional progress has been made in improving internal controls and developing auditable systems of records.

Generally accepted accounting principles (GAAP) for Federal agencies are promulgated by the Federal Accounting Standards Advisory Board, the Comptroller General of the United States, and the Director, Office of Management and Budget (OMB). The applicable GAAP defines fund balances with the Treasury as the aggregate amount of funds in an entity's accounts with the Treasury for which the entity is authorized to make expenditures and pay liabilities. Fund balances are increased by:

o appropriations, reappropriations, continuing resolutions, appropriation restorations, and allocations;

o transfers and reimbursements from other agencies; and

o collections credited to appropriation or fund accounts that the entity is authorized to spend or use to offset its expenditures.

Fund balances are decreased by:

o disbursements made to pay liabilities or to purchase assets, goods, and services;

o investments in U.S. securities;

o cancellation of expired appropriations;

o transfers and reimbursements to other entities or to the Treasury; and

o sequestration or rescission of appropriation.

The accuracy of the amounts reported in the account balances are the joint responsibility of the Defense Finance and Accounting Service (DFAS) and DLA. Fund balances with the Treasury are reported as assets on the statements of financial position for each of DLA's five business areas as listed in the table.

Reported Fund Balance with Treasury

Business Area	Reported FY 1993 Fund Balances (millions)
Supply Management	$ 695.8
Distribution Depots	346.9
Industrial Plant Equipment	11.0
Reutilization and Marketing	(8.6)
Clothing Factory	(1.3)
Total	$1,043.8

The balances must be supported by DFAS and DLA accounting records per GAAP and reconciled to the corresponding accounts reported on the Treasury records. Explanations must be provided for any discrepancies between the general ledger accounts and the fund balances with the Treasury. Information on fund balances is also presented on the statements of cash flow and in the footnotes to the financial statements.

Objectives

The overall objective of the audit was to determine whether the fund balances with the Treasury accounts on DLA's business areas' FY 1993 financial statements were presented fairly, in accordance with generally accepted accounting principles. The audit also evaluated the internal control structure for the fund balances with the Treasury.

Scope and Methodology

We evaluated selected fund balances accounts from the DLA DBOF business areas of Supply Management and the Defense Reutilization and Marketing Service. Those two business areas represented 88 percent of DLA's total FY 1993 collections ($12.1 billion) and 90 percent of disbursements ($11.4 billion) reported through the Appropriation Control and Reporting System (ACRS), which was used as a basis for summary collection and disbursement reports. The results of our review are discussed in Part II. We also tested the reliability of computer-processed data used to report fund balances with the Treasury. We did not review general and application controls of the computer-processed system.

We tested the audit trails and matching procedures of the systems and the processes used by DLA and DFAS to report fund balances with the Treasury to determine whether we could trace the fund balances reported on the financial statements down through each summary level of data and back to the source transactions. We evaluated the presentation of fund balances with the Treasury in DLA's FY 1993 financial statements for adherence with the GAAP and compliance with OMB Bulletin 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, and DoD policies.

Our audit was conducted from November 1993 through February 1994, in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. The audit included such tests of the internal controls as were considered necessary. The organizations visited or contacted are in Appendix D.

Internal Controls

The audit identified material internal control weaknesses as identified by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Internal controls were not in place to ensure that fund balances with the Treasury were reported in accordance with GAAP. Internal controls were not implemented to ensure that audit trails were adequate and reconciliations were performed to support amounts reported to the Department of Treasury. Additionally, controls did not ensure that transactions were posted to the proper accounting period. Those problems were not reported as material weaknesses by DFAS in accordance with OMB Circular A-123, because the system controlling fund balances with the Treasury accounts was not included as an

assessable unit in their annual review. Recommendations 2. and 3., if implemented, will assist in correcting the weaknesses. No quantifiable monetary benefits are associated with correcting the internal control weaknesses. A copy of this report will be provided to the senior officials responsible for internal controls in the Office of the Secretary of Defense and DLA.

Prior Audits and Other Reviews

Since the inception of the DBOF, the Inspector General, DoD, and the General Accounting Office have completed three audits on the preparation of financial statements related to fund balances with the Treasury. The audits reported on the inability of DoD Components and DFAS to produce accurate, reliable, and auditable financial statements. See Appendix B for details on the prior audit coverage.

Part II - Finding and Recommendations

Fund Balances with the Treasury

The FY 1993 fund balances with the Treasury accounts for the Defense Logistics Agency business areas of the Defense Business Operations Fund were not prepared in accordance with generally accepted accounting principals for Federal agencies. The condition occurred because DoD's definition of fund balances did not meet the Office of Management and Budget guidelines, collection and disbursement data compiled by the Defense Finance and Accounting Service through the Appropriation Control and Reporting System lacked audit trails and proper period matching procedures, data collected by the Defense Finance and Accounting Service were not reconciled to the Defense Logistics Agency's accounting records even though significant variances existed between the two sets of records, and disclosures of statements of cash flow and footnotes were inadequate. As a result, presentation related to the Defense Logistics Agency's cumulative $1.04 billion for fund balances with the Treasury accounts in its FY 1993 statements of financial position, cash flow, and related footnotes are misleading and cannot be relied upon by users of the financial statements.

Background

DFAS uses the ACRS as a basis for the fund balances with the Treasury accounts on the DLA business areas' financial statements. The ACRS was originally developed by DoD's Washington Headquarters Service to assist DoD activities with funds control, Treasury reporting functions, and controls over cash outlays.

The ACRS accumulates collection and disbursement information from several sources. Collection and disbursement information is submitted for the Army, the Navy, and the Air Force by the DFAS Centers in Indianapolis, Indiana; Cleveland, Ohio; and Denver, Colorado, respectively. The DLA data are submitted to the DFAS, Defense Accounting Office in Arlington, Virginia, through DFAS-Indianapolis. Additionally, the State Department submits collection and disbursement data for the DLA's overseas transactions.

The Cash Outlay Subsystem of the ACRS is used to process, report, and reconcile data on receipts, reimbursements, and disbursements. It monitors cash payments (net of refunds received and reimbursements collected) and completes the following functions, as described in the ACRS "Users Guide."

o It produces reports indicating for each appropriation/period of availability the net disbursements or collections for each appropriation and the limit authorized to expend funds.

o It produces a "cash book" of collection and disbursement information by appropriation/period of availability, type of fund, and component.

o It reconciles collection and disbursement data in the "cash book" with records provided by the Department of the Treasury to ensure that no information has been deleted or added.

o It represents amounts reported on lines 14A (Disbursements [net of refunds]) and 14B (Reimbursements Collected) of DD Form 1176, "Report on Budget Execution."

Applications of the ACRS are processed on a stand-alone personal computer at the DFAS Defense Accounting Office, with summary data sent to DFAS-Columbus, in Columbus, Ohio. DFAS-Columbus personnel used the ACRS reports as the source for manual entries used to report fund balances with the Treasury for DLA business areas for FY 1993.

Validity of Reported Fund Balances

The $1.04 billion shown for the FY 1993 fund balances with the Treasury accounts for DLA business areas of the DBOF was not supportable. The amount was computed on a basis of accounting that was not in accordance with the GAAP. This occurred primarily because:

o DoD policy prescribed an inadequate definition of fund balances with the Treasury accounts.

o DFAS procedures did not maintain adequate audit trails and did not match adjustments to their proper periods.

o Reconciliations were not completed for FY 1993 between two sets of financial records.

o Disclosures on the statement of cash flow and footnotes to the financial statements were inadequate.

Adequacy of Definition. The assertion on the FY 1993 statement of financial position that DLA business areas had a cumulative $1.04 billion in fund balances with the Treasury on September 30, 1993, is misleading. The $1.04 billion is misleading because it was computed using the DoD definition of fund balances with the Treasury instead of the applicable GAAP. It does not represent an asset to DLA because the $1.04 billion does not include key components of the DLA fund balances and does not represent a future benefit to the DLA business areas. The existing GAAP definition of fund balances should have been used to compile and report DLA's fund balances.

The Comptroller of the DoD elected not to use the existing GAAP definition of fund balances with the Treasury in reporting below the DoD level. In a letter dated November 3, 1993, the Deputy Comptroller of Management Systems stated that there are no fund balances with the Treasury account at the DLA level. However, the Comptroller of the DoD issued guidance, "FY 1993/1994

DoD Form and Content for Financial Statements," January 12, 1994, directing DFAS to report as fund balances with the Treasury the net differences between DLA collections and disbursements.

Completeness. The DoD definition is incomplete. It excludes key components such as appropriations, suspense accounts, and fund transfers. The essential components are included in the GAAP definition of fund balances with the Treasury, but not the DoD definition. Without all applicable components, the net of collections and disbursements is a meaningless figure on the statement of financial position.

Future Benefit. The net of collections and disbursements does not represent future benefits to the DLA components. In accordance with GAAP, an asset is a probable future economic benefit controlled by the reporting entity that resulted from past transactions or events. The purpose of reporting fund balances with the Treasury as assets on the statements of financial position is that the balances represent the DLA business areas' claims to Treasury funds that can be used to pay expenditures and liabilities. The net of collections and disbursements cannot be used to pay expenditures and liabilities because the balance is transferred to a central DoD account at the beginning of the next fiscal year. Expenditures and liabilities are paid from appropriations that are allocated to each business area at the beginning of the fiscal year through unit cost authority and obligated during the year.

DFAS Controls and Procedures over the ACRS Data. The DFAS is responsible for managing the various collection and disbursement systems that provide data to the ACRS. However, DFAS controls and procedures lacked adequate audit trails and proper period matching procedures.

DFAS-Indianapolis Headquarters Accounting and Reporting System provides data to the ACRS. In its FY 1993 annual assurance report, DFAS-Indianapolis stated that the accounting and reporting system documentation was not complete enough to allow an accountant who is unfamiliar with the accounting system to determine internal processing flows and controls and the systems compliance with prescribed accounting requirements. As part of our review we verified that the system documentation was not in condition for audit.

Audit Trails. Relevant transactions (source documents) need to be identified, recorded in financial records, and summarized into financial statements. Such action requires an accounting system that tracks transactions from source documents through journals, ledgers, trial balances, and the financial statements and back. The ACRS and its supporting automated systems do not maintain adequate audit trails to source documentation.

For example, we performed tests to determine whether we could trace the summary collection and disbursement amounts in the ACRS back to the source transactions through the use of automated records maintained by DFAS-Indianapolis. Each month DFAS-Indianapolis sends collections and disbursements summary data for processing by the ACRS and subsequent forwarding to DFAS-Columbus. DFAS-Indianapolis maintains a history file of financial transactions. We requested data from that history file, which

summarized collections and disbursements processed by DFAS-Indianapolis for each month during FY 1993 by individual disbursing stations. The summarized data did not support the amounts reported by the ACRS. Moreover, $87.4 million of adjustments made by DFAS-Indianapolis to the FY 1993 data were not traceable to the relevant source documents. As a result, adjustments were posted to the current period rather than the period when the transactions occurred. Specific examples are discussed under matching procedures in this report.

Discussions with DFAS-Indianapolis personnel indicated that microfiche records were available that provided a trail to the ACRS data by disbursing station by month. About 130 disbursing stations report both Army and DLA transactions to DFAS-Indianapolis on a monthly basis. We concluded, however, that performing a manual reconstruction of data was not practical and would be prohibitively expensive. DFAS-Indianapolis is responsible for maintaining the integrity of the data available on the automated history file. Accordingly, we concluded that the automated data provided to us by DFAS-Indianapolis was not supportable.

Matching Procedures. Headquarters, DFAS did not implement procedures to ensure that posting dates in DLA's accounting records matched posting dates reported by DFAS-Indianapolis. Under the matching principle of accounting, transactions should be reported in the same period as they occur. According to GAAP guidance, discrepancies resulting from time lags are to be reconciled and errors corrected when financial reports are prepared. However, Headquarters DFAS procedures did not require DFAS-Indianapolis to make adjustments to the proper accounting period.

For example, DFAS-Indianapolis adjusted appropriation accounts to correct errors resulting from the use of erroneous appropriation numbers on interfund transactions (noncash transfers of funds between appropriations within the DoD). Adjustments totaling $17.6 million were reported by the ACRS for the DLA business areas from October through December 1993 to correct current and prior period errors. All the adjustments, however, were made to the current period because the DFAS-Indianapolis personnel did not complete research to determine the period that should have been corrected. Additionally, other interfund transactions that failed edit procedures at DFAS-Indianapolis were placed in a suspense account and not researched for proper accounting. As of September 30, 1993, $10.9 million had not been distributed from the suspense account.

Other collections and disbursements were missing from the ACRS. For example, $151.2 million in FY 1993 collections ($86.5 million) and disbursements ($64.7 million) related to sales of excess material by the Defense Reutilization and Marketing Service were processed through its Deposit Fund Sales Account (Suspense) in DFAS-Columbus that were not monitored by the ACRS. The Defense Reutilization and Marketing Service is a DLA business area and data from the ACRS were used in its FY 1993 financial statements.

As of September 30, 1993, the suspense account showed a residual credit balance of $21.8 million that had not been reconciled to either the ACRS or the Defense Reutilization and Marketing Service accounting records, and was not reported in DLA's financial statement.

Recording, summarizing, and properly reporting errors and adjustments would produce more meaningful financial statements and reduce the risk of large reporting errors. DFAS has not established the necessary controls to accurately report prior period adjustments to the yearend closing balances in the financial statements. Because of those misstatements, the financial statements do not reflect current operations; and comparability between accounting periods is hindered.

Reconciliation Procedures. The ACRS and the DLA accounting records were not reconciled in FY 1993. Both sets of financial records provide data related to collection and disbursement transactions. However, as stated in Appendix A, an approximate $2.5 billion discrepancy existed between DFAS and DLA records. DFAS personnel said that the differences were due to timing. To ensure that the same transactions are accounted for in both sets of records, OMB requires that differences resulting from time lags be reconciled and discrepancies resulting from errors be corrected when financial reports are prepared. However, reconciliations were not completed during FY 1993 primarily because DFAS had not maintained adequate controls over appropriation limits. Appropriation limits are codes used to trace funds to organizations.

In April 1992, the Washington Headquarters Service published the "Budget and Fiscal Coding Manual," which prescribes guidance related to appropriations and funds controlled by DoD agencies. DFAS is responsible for maintaining oversight over the procedures prescribed in the manual to provide consistent and accurate financial operations throughout DoD agencies. DFAS did not adequately control appropriation limits used by the Defense agencies to report collections and disbursements through the ACRS.

For example, collections and disbursements related to the DLA supply management business area could not be reconciled. Transactions from the business area were processed on two different accounting systems. Operations transactions were processed on the DFAS Defense Business Management System, while materiel management transactions (formerly stock fund) were processed on the DLA Standard Automated Supply Management System. As a result, DFAS-Columbus personnel could not reconcile more than $1.9 billion in FY 1993 operations transactions.

DFAS-Columbus identified the lack of appropriation sublimits for both accounting systems as being a principle cause for irreconcilable data. DFAS-Columbus wrote a memorandum to DFAS Headquarters on January 8, 1992, requesting additional sublimits for the supply management business area. The sublimit changes were not approved until December 9, 1993. However, the changes have not been implemented for interfund transactions, because DFAS

has not communicated the urgency of the change to the Military Standard Billing System Committee, which needs to take action. DFAS and DLA are both members of the committee.

We identified other transactions that were not reconcilable because of the lack of controls over appropriation limits. For example, during FY 1993 only about $3.1 million of the $2.7 billion in overseas transactions from two of the five DLA business areas were reported in the ACRS. The $2.7 billion was not reconciled by DFAS-Columbus, and we were not able to determine how much of the $2.7 billion should be allocated to each individual DLA business area. We also identified an additional $24.7 million in collections and disbursements reported from the ACRS for supply management that were not identifiable to authorized limits.

Disclosure. The lack of reconciliations and corresponding discrepancies between the ACRS and DLA accounting records were not adequately disclosed in the statements of cash flow and the footnotes to the financial statements. DLA is responsible for the footnotes to the financial statements.

Statements of Cash Flow. The statements of cash flow were misleading. The primary purpose of a statement of cash flow is to provide information about cash collections and disbursements made during FY 1993 and to show how the changes that occurred in other financial statement accounts affected cash. However, two sets of records were used for this information and the records differed significantly (see Appendix A). According to DFAS personnel, DoD Manual 7220.9, "DoD Accounting Manual," October 1983, allows them to post unreconciled differences between the two sets of records to either the accounts receivable or accounts payable accounts of the respective business areas. The adjustment would be valid only if differences were attributed to timing differences and those timing differences were validated through reconciliations between two sets of records. However, DFAS did not perform reconciliations or disclose the material differences between the two sets of records on the statements of cash flow.

Footnote Disclosures. Footnotes to the financial statements should provide information that enhances understandability. However, footnote disclosures often conflicted with the information presented in the principle statements. For example, footnotes related to supply operations and the Defense Reutilization and Marketing Service showed negative unobligated balances available and significantly overstated invested capital. Negative unobligated balances imply that funds were overobligated and resulted in an antideficiency act violation.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Comptroller of the Department of Defense:

a. Rescind guidance in the FY 1993/1994 DoD Form and Content for Financial Statements that allows the Defense Finance and Accounting Service and the Defense Logistics Agency to report fund balances with the Treasury as the net difference between collections and disbursements.

b. Direct Defense Finance and Accounting Service to implement the generally accepted accounting principles prescribed by the Office of Management and Budget for fund balances with the Treasury.

Management Comments. The Comptroller of the DoD comments were received too late to be included in this report, and will be considered as a response to the final report. We request any additional comments comments to the final report be provided by August 29, 1994.

2. We recommend that the Director, Defense Finance and Accounting Service, issue procedures and controls that require personnel to:

a. Establish adequate audit trails to the amounts reported by the Appropriation Control and Reporting System and validate that collections and disbursements are matched to the appropriate periods.

b. Establish controls over appropriation limits.

c. Reconcile data reported by the Appropriation Center and Reporting System to the accounting records of the Defense Logistics Agency business areas.

Management Comments. The Director, DFAS, did not respond to the draft of this report. We request comments to the final report by August 29, 1994.

3. We recommend that the Director, Defense Logistics Agency, in coordination with the Director, Defense Finance and Accounting Service:

a. Establish appropriation sublimits for Defense Logistics Agency business areas.

Management Comments. DLA concurred with the recommendation and stated that DLA approved the use of appropriation sublimits on December 9, 1993. DLA further stated that DFAS is responsible for establishing and controlling sublimits and DFAS is expected to coordinate with DLA when the sublimits are established.

b. Disclose discrepancies in the FY 1993 statements of cash flow and accompanying footnotes for the Defense Logistics Agency business areas.

Management Comments. DLA partially concurred with the recommendation and stated that footnote disclosures were adequate to influence the judgment of an informed reader because the footnotes disclose the dollar differences between DLA general ledger accounts and the DFAS ACRS cashbook. Additionally, footnotes identified the undistributed balances that had not been reconciled.

Audit Response. DLA's comments were not responsive to our recommendation. The financial statements did not adequately disclose that the statements of cash flow forced an agreement between two unrelated and unreconciled sets of accounting data (DLA general ledger accounts and the DFAS fund balances accounts). Without adequate disclosures, a reader of the financial statements could mistakenly believe that the statements of cash flow, originated from the general ledger, showed how changes that occurred in other financial statement accounts affected cash, and that general ledger accounts could be reconciled to fund balances with Treasury accounts. We also believe that the FY 1993 financial statement footnotes were inadequate because they did not:

o explain how an activity could have a negative unobligated balance available at yearend, without an anti-deficiency act violation having occurred;

o disclose the magnitude of the discrepancy (about $2.5 billion) between the DLA general ledger accounts and the cash book; and

o disclose that DLA used the DoD definition of fund balances with Treasury, which did not comply with generally accepted accounting principles.

We request that DLA reconsider its position and provide additional comments to the final report by August 29, 1994. Those comments should include a summary of actions taken regarding the apparent anti-deficiency act violations disclosed in the footnotes.

Part III - Additional Information

Appendix A. Comparison of Trial Balances to the Statements of Financial Position

A $2.5 billion discrepancy was shown between the fund balance obtained from the trial balances and the fund balances with Treasury accounts on the statements of financial position. The trial balance was obtained from DLA systems, while the fund balances on the statements of financial position was obtained from the DFAS ACRS.

Table A.1. shows the difference between the collections and the disbursements (including undistributed) contained on the trial balance generated for the five DLA business areas by DLA systems. Table A.2. shows the difference between the collections and disbursements as reported on the ACRS.

Table A.1. Trial Balance Data for FY 1993

Activity	Collections (millions)	Disbursements (millions)	Net (millions)
Supply Management	$12,003.5	$12,709.7	($ 706.2)
Distribution Depots	1,471.2	2,148.1	(676.9)
Industrial Plant Equipment	57.7	54.6	3.1
DRMS*	471.0	511.9	(40.9)
Clothing Factory	35.8	37.3	(1.5)
Total	$14,039.2	$15,461.6	($1,422.4)

Table A.2. ACRS Cashbook Data for FY 1993

Activity	Collections (millions)	Disbursements (millions)	Net (millions)
Supply Management	$11,761.8	$11,066.0	$ 695.8
Distribution Depots	1,495.2	1,148.3	346.9
Industrial Plant Equipment	41.2	30.2	11.0
DRMS*	327.7	336.3	(8.6)
Clothing Factory	35.8	37.1	(1.3)
Total	$13,661.7	$12,617.9	$1,043.8

*Defense Reutilization and Marketing Service

The data provided from the trial balances by the DLA business areas accounting system are not reconcilable to the amounts computed by the ACRS.

Appendix B. Summary of Prior Audits and Other Reviews

The following three reports and two reviews included reportable conditions similar to those identified during our audit. Prior audit coverage indicated major discrepancies between cash balances reported by DoD and balances maintained by the Treasury.

The General Accounting Office (GAO) Report No. GAO/AFMD-92-79 (OSD Case No. 9057-B), "Financial Management: Status of the Defense Business Operations Fund," June 15, 1992, stated that key policies are still being developed related to cash management and intrafund transactions within the DBOF. GAO also reported that the DoD has made limited progress in developing accurate and reliable cost accounting systems. GAO reported that the DoD needed to implement a cash management policy to ensure efficient operations and improve policies and procedures to report and account for intrafund transactions. The report made no recommendations.

GAO Report No. GAO/AFMD-93-52R (OSD Case No. 9339), "Defense Business Fund," March 1, 1993, stated that financial data cannot be relied upon. Specifically, significant differences existed between the DBOF disbursements reported by the DoD and those reported by the Treasury. As of September 30, 1992, the difference between the two sets of records was approximately $558 million. Additionally, significantly different amounts were reported for the DBOF fiscal year net operating results in its financial and budget reports. For example, GAO noted that if the individual business areas' gains and losses were not netted against each other, the gross difference was more than $14 billion.

GAO concluded that successful implementation of the DBOF will require substantial commitment to place a high priority on financial management, including developing performance indicators; enhance existing financial systems in the short term to improve the accuracy of financial data and develop and implement new systems that are capable of meeting the DBOF needs; and make a realistic evaluation of management and personnel resources required to accomplish the DBOF objectives. The report made no recommendations.

Inspector General, DoD, Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operation Fund-FY 1992," June 30, 1993, concluded that the reliability and usefulness of the principal and combining DBOF statements are questionable. The auditors could not ascertain the overall accuracy of the financial statements, but did note material weaknesses in the internal control structure and major discrepancies in cash balances reported. The Inspector General, DoD, reported footnote disclosure weaknesses and discrepancies between the financial statements and balances maintained by the Treasury. Specifically, cash transactions could not be verified and transactions made for or by others were not recorded in a timely manner. The report also stated that financial data were not reconciled to

ensure consistent reporting of the same information. Further, the report stated that information in the DBOF cash status reports was inaccurate and that audit trails were inadequate.

The DoD concurred with the finding that there were inadequate controls over cash and that reconciliations should be performed. The DoD partially concurred that the cash status reports were inaccurate. The Comptroller asserted that when reconciliations are performed and data are not arbitrarily changed, the report is useful to managers. The Comptroller nonconcurred with the finding that audit trails were inadequate within the DBOF, stating that "within current accounting systems, individual transactions retain an audit trail through the first level of summarization." The report made no recommendations.

Federal Manager's Financial Integrity Act Reviews. The Department of Defense FY 1993 Federal Managers' Financial Integrity Act Annual Assurance Report, reported 12 material nonconformances to the GAO accounting principles, standards, and related requirements for the DBOF. The nonconformances were the areas of general ledger control and financial reporting, accrual accounting, audit trails, cash procedures and accounts payable, and user information needs. The targeted correction date for those deficiencies is FY 1996 whereby the DBOF Improvement Plan will be implemented. DoD reported that full achievement of the DBOF objectives hinges on standardized and modernized finance and accounting systems.

The DFAS-Columbus Center Federal Managers' Financial Integrity Act Annual Assurance Report for FY 1993 reported 17 new material weaknesses and 5 prior material weaknesses still uncorrected. The system of internal accounting and administrative control at DFAS-Columbus was evaluated in accordance with guidelines issued by OMB, in consultation with the Comptroller General. New material weaknesses identified during the period included a 3 month backlog of disbursements within the Accounting and Support Division, Operations and Maintenance, a backlog of interfund bills, and the lack of a review of the unliquidated obligation general ledger account for accuracy and completeness. The expected correction date for those deficiencies is FY 1994. Uncorrected material weaknesses include a lack of reconciliation between general and subsidiary ledger accounts within the stock fund area, lack of controls to process transactions for others/transactions by others and standard form vouchers, a lack of reconciliation between general and subsidiary ledger unliquidated obligations accounts, and a lack of research to clear large undistributed collection and disbursement balances.

Appendix C. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Type of Benefit
1.	Compliance. Improved financial reporting.	Nonmonetary
2. and 3.	Internal Control. Ensure proper controls over the recording of collection and disbursement transactions.	Nonmonetary

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Comptroller of the Department of Defense, Arlington, VA

Other Defense Agencies

Headquarters, Defense Finance and Accounting Service, Arlington, VA
- Defense Finance and Accounting Service, Defense Accounting Office, Arlington, VA
- Defense Finance and Accounting Service, Columbus, OH
- Defense Finance and Accounting Service, Indianapolis, IN

Headquarters, Defense Logistics Agency, Alexandria, VA
- Defense Construction Supply Center, Columbus, OH
- Defense Reutilization and Marketing Service, Battle Creek, MI

Other Federal Agencies

Department of State, Washington, DC
Department of the Treasury, Washington, DC

Appendix E. Report Distribution

Office of the Secretary of Defense

Comptroller of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Naval Audit Service

Department of the Air Force

Auditor General, Air Force Audit Agency

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service, Columbus Center
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
  National Security and International Affairs Division, Technical Information Center
  National Security and International Affairs Division, Defense and National Aeronautics and Space Administration Management Issues
  National Security and International Affairs Division, Military Operations and Capabilities Issues

Non-Defense Federal Organizations (cont'd)

Chairman and Ranking Minority Member of each of the following Congressional Committees and Subcommittees:
- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on Defense, Committee on Appropriations
- House Committee on Armed Services
- House Committee on Government Operations
- House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY REFER TO DDAI

19 MAY 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Fund Balances with the Treasury Accounts on the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 93

This is in response to your 23 March 1994 request.

1 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Office

cc:
FO

TYPE OF REPORT: AUDIT DATE OF POSITION:

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Fund Balances with the Treasury Accounts on the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 93

RECOMMENDATION 3: We recommend that the Director, Defense Logistics Agency, in coordination with the Director, Defense Finance and Accounting Service:

a. Establish appropriation sublimits for the Defense Logistics Agency business areas.

b. Disclose discrepancies in the FY 93 statements of cash flow and accompanying footnotes for the Defense Logistics Agency business areas.

DLA COMMENTS:

a. Concur. We approved the appropriation sublimits on 9 December 1993. DFAS is responsible for establishing and controlling appropriation sublimits. We expect to coordinate with DFAS when they establish the sublimits.

b. Partially concur. The finding states that the lack of reconciliations and corresponding discrepancies between the ACRS and DLA accounting records were not adequately disclosed.

We believe the footnotes disclosing the lack of reconciliations and discrepancies were sufficient to adequately influence the judgement of an informed reader. In summary, we disclosed:

- the dollar differences between the ACRS and the general ledgers (Note No. 2) and

- the lack of reconciliations (Note No. 26).

We will continue to disclose financial facts that we believe are significant, Adequacy of footnote disclosure is a matter of opinion. For practical, cost/benefit, and administrative reasons, we will not revise the FY 93 footnotes to further disclose information that we believe are adequately addressed.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(x) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, X46481
REVIEW/APPROVAL: J.S. ROUNDTREE, CAPT, SC, USN, Acting Chief Financial Officer, FO, x46201, 5/5/94

COORDINATION: Jim O'Laughlin, FOX, X46100
A. Broadnax, DDAI, x49607, 5/16/94
[signature], DDAI, 17 May 94

DLA APPROVAL: [signature]

18 MAY 1994

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

Audit Team Members

Shelton R. Young
Gordon P. Nielsen
Stuart D. Dunnett
Curt W. Malthouse
Timothy F. Soltis
Ronald L. Meade
Brian L. Henry
Melissa A. Sikora
Mark Starinsky