Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE ARMY FY 1993 FINANCIAL STATEMENTS

Report No. 94-168 July 6, 1994

Department of Defense

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CFO	Chief Financial Officers
DBARS	Departmental Budgetary Accounting and Reporting System
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
FSDB	Financial Statement Data Base
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget
USAAA	U.S. Army Audit Agency

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

July 6, 1994

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE, INDIANAPOLIS CENTER
AUDITOR GENERAL, ARMY AUDIT AGENCY

SUBJECT: Audit Report on Defense Finance and Accounting Service Work on the Army FY 1993 Financial Statements (Report No. 94-168)

We are providing this final report for your review and comments. It discusses the Defense Finance and Accounting Service's work on the Army's FY 1993 financial statements. Comments on a draft of this report were considered in preparing the report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, we request that the Director, Defense Finance and Accounting Service, provide final comments on the unsolved recommendations by September 6, 1994. See the "Response Requirements for Each Recommendation" section at the end of each finding for the recommendations you must comment on and the specific requirements for your comments.

The courtesies extended to the audit staff are appreciated. If you have any questions regarding this audit, please contact Mr. Richard B. Bird, Program Director, at (317) 542-3859 (DSN 699-3859), or Mr. John J. Vietor, Project Manager, at (317) 542-3855 (DSN 699-3855). The planned distribution of this report is listed in Appendix E. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 94-168 **July 6, 1994**
(Project No. 3FI-2007)

DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE ARMY FY 1993 FINANCIAL STATEMENTS

EXECUTIVE SUMMARY

Introduction. The Defense Finance and Accounting Service, Indianapolis Center (the DFAS Indianapolis Center), maintains the Army's departmental accounting records and prepares both the Army's General Fund and Defense Business Operations Fund (DBOF) financial statements. For FY 1993, assets of $303.5 billion were reported on the Army's General Fund financial statements, and assets of $23.6 billion were reported on the Army's DBOF financial statements. The Chief Financial Officers Act of 1990 requires the Inspector General, DoD, to audit financial statements of DoD activities in accordance with applicable generally accepted Government auditing standards, but allows delegation of the audit work. The Inspector General, DoD, delegated the audits of the Army's FY 1993 financial statements to the U.S. Army Audit Agency. The Inspector General, DoD, assisted the U.S. Army Audit Agency by performing the required audit work at the DFAS Indianapolis Center.

Objective. The objective of the audit was to determine whether the DFAS Indianapolis Center correctly presented, in the Army's FY 1993 General Fund and DBOF financial statements, the financial data submitted by field accounting activities and other sources. To accomplish the objective, we evaluated the processes, including internal controls and methods, that the DFAS Indianapolis Center used to prepare the Army's FY 1993 financial statements submitted on December 31, 1993. We did not express an opinion on the financial statements. This was done by the U.S. Army Audit Agency.

Audit Results. The DFAS Indianapolis Center needed to improve the processes used to prepare the FY 1993 financial statements. Weak internal controls over these processes did not ensure that the DFAS Indianapolis Center correctly presented the Army financial data in the FY 1993 financial statements. However, during the past year, the DFAS Indianapolis Center made substantial improvements in its processes for consolidating status and general ledger data and preparing the financial statements. Particularly noteworthy were improved controls over the yearend reporting and certification process. Our findings were as follows.

o The DFAS Indianapolis Center did not always detect or correct errors in the financial data submitted to the Army's departmental general ledger. This occurred because reasonableness tests were not applied to general ledger accounts and line items in the financial statements; interfaces were not adequate to pass data; and automated edits were not in place. As a result, the Army's DBOF financial statements for FY 1993 were materially misstated by $2.2 billion. Also, the Army's General Fund financial statements for FY 1993 were misstated by $2.7 billion (Finding A).

o Adjustments made by the DFAS Indianapolis Center to the status and general ledger data were not adequately documented and were sometimes incorrect. For about 39 percent, or $9.8 billion, of the status adjustments we reviewed, and about 18 percent, or $48.3 billion, of the general ledger adjustments we reviewed, adequate supporting documentation was not attached to the adjustment vouchers. DBOF

inventory accounting was not performed correctly. Also, inputs and adjustments to the departmental general ledger were not properly organized and controlled. As a result, the DBOF financial statements were materially misstated by $2.7 billion (Finding B).

Internal Controls. We evaluated internal controls and the implementation of the DoD Internal Management Control Program, and we identified material internal control weaknesses. The weaknesses are similar to those identified by the DFAS Indianapolis Center in its FY 1993 Annual Statement of Assurance for the Internal Management Control Program. If they are not corrected, a significant risk exists that the Army's General Fund and DBOF financial statements for FY 1994 will be misstated. Part I of this audit report describes the internal controls assessed. Details of the internal control weaknesses are discussed in Part II.

Potential Benefits of Audit. Implementation of the recommendations in this audit report will result in more accurate and reliable financial statements. We identified no potential monetary benefits associated with the audit. For other benefits, see Appendix C, "Summary of Potential Benefits Resulting from Audit."

Summary of Recommendations. We recommended that the Director, DFAS Indianapolis Center, improve internal controls over the processes used to prepare the financial statements. Recommended actions included:

o implementing both edit and reasonableness checks for abnormal general ledger and line-item balances;

o implementing automated interfaces between departmental source systems and the departmental general ledger;

o establishing specific criteria for adequately supporting adjustment vouchers;

o strengthening separation of duties by establishing an independent review and input of all status and general ledger adjustments; and

o developing step-by-step procedures for making adjustments to the departmental general ledger, particularly the DBOF inventory.

Management Comments and Audit Response. The Director, DFAS Indianapolis Center, concurred with most of our recommendations to improve internal controls over the processes used to prepare the financial statements. However, he did not fully concur with our recommendations to improve procedures for DBOF inventory accounting. We request that the Director, DFAS Indianapolis Center, reconsider his position on these recommendations when responding to the final report. A discussion of management's comments and our responses is in Part II of this report, and the complete text of management's comments is in Part IV. We request that the Director, DFAS Indianapolis Center, respond to the final report by September 6, 1994.

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

Part I - Introduction

Background

Public Law 101-576, the Chief Financial Officers (CFO) Act of 1990, requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of 23 executive departments and agencies, as well as Government corporations. The CFO Act requires preparation of organization-wide financial statements for FY 1993, including financial statements for the Army. The CFO Act also requires the Inspectors General (IGs), or appointed external auditors, to audit the financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget (OMB). The IG, DoD, delegated the audits of the Army's General Fund and Defense Business Operations Fund (DBOF) financial statements for FY 1993, including expressing the opinions, to the U. S. Army Audit Agency (USAAA). The IG, DoD, assisted the USAAA by performing the required audit work at the Defense Finance and Accounting Service, Indianapolis Center (the DFAS Indianapolis Center). The audit work included examining the departmental processes used to prepare the Army's financial statements.

The DFAS Indianapolis Center provides finance and accounting support to the Army. The DFAS Indianapolis Center maintains departmental records and prepares financial statements, both General Fund and DBOF, from financial data submitted by field accounting activities and other sources. See Appendix A, "Process Used to Prepare the Financial Statements," for details. The DFAS Indianapolis Center employed 2,829 people during FY 1993 and spent $86.4 million on operations.

The Army's FY 1993 General Fund financial statements reported assets of $303.5 billion and expenses of $71.9 billion, including $65.3 billion in program or operating expenses. The Army's FY 1993 DBOF financial statements reported assets of $23.6 billion and expenses of $13.2 billion.

Objective

The objective of the audit was to determine whether the DFAS Indianapolis Center correctly presented, in the Army's FY 1993 General Fund and DBOF financial statements, the financial data submitted by field accounting activities and other sources. To accomplish this objective, we evaluated the processes, including internal controls and methods, that the DFAS Indianapolis Center used to prepare the Army's FY 1993 financial statements submitted on December 31, 1993. The audit was performed to assist USAAA in formulating its opinions on the Army's FY 1993 General Fund and DBOF financial statements.

Scope and Methodology

Our audit work was limited to an examination of the DFAS Indianapolis Center's departmental processes for consolidating the status and general ledger data. These data were used to prepare the version of the Army's General Fund and DBOF financial statements that was submitted to us on December 31, 1993. Our examination included reviewing the following processes:

- o yearend reporting and certification, including the controls over yearend status data, the Treasury trial balance, unsupported undistributed disbursement balances, and general ledger reconciliations;
- o adjustments to status data;
- o adjustments to general ledger data;
- o comparison of general ledger data to status data; and
- o transfer of the status-adjusted general ledger data to the financial statement data base and the printed financial statements.

Generally, we used judgmental sampling to review the adjustments to status and general ledger data. See Appendix B for details of our sampling plans. We established the materiality threshold at 1 percent of the total assets reported on the Statement of Financial Position, or $3.0 billion for the Army's General Fund financial statements and $0.2 billion for the Army's DBOF financial statements.

We did not examine the accuracy of data submitted by field accounting activities or other sources. Additionally, our audit work on the Army's DBOF financial statements was limited to examining four line items on the Statement of Financial Position:

- o Fund Balance With Treasury,
- o Inventories Held For Sale,
- o Inventories Not Held For Sale, and
- o Property, Plant and Equipment.

The four line items represented 91 percent of the $23.6 billion of assets on the Statement of Financial Position.

To fulfill the audit objective, we relied primarily on computer-processed data. We performed a limited review of the automatic data processing controls over the accounting systems used by the DFAS Indianapolis Center to prepare the financial statements. Based on this limited review, except where noted in the report, we concluded that the computer-processed data were sufficiently reliable to be used in fulfilling the audit objective.

Audit Period, Locations, and Standards. We performed this financial statement audit at the DFAS Indianapolis Center during the period April 1993 through April 1994. The audit was made in accordance with auditing standards established by the Comptroller General, as implemented by the IG, DoD, and with OMB guidance; however, we limited our scope as noted above. The audit included such tests of internal controls and management's compliance with laws and regulations as we considered necessary. Appendix D lists the organizations we visited or contacted.

Internal Controls

We evaluated internal controls over the DFAS Indianapolis Center's departmental processes that consolidated the status and general ledger data for preparation of the financial statements. The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Internal controls were effective for the yearend reporting and certification process. The DFAS Indianapolis Center had:

o established specific controls, such as coding adjustments, using a separate input group, controlling voucher and coding sheets, requiring specific documentation for adjustments, and reviewing system output after adjustments were made;

o held training classes to explain the controls to employees; and

o enforced the controls during the yearend reporting and certification process.

Controls over the movement of status-adjusted general ledger data to the printed financial statements were also effective. We manually verified that in the automated process for moving the status-adjusted general ledger data through the financial statement data base, controls were in place to produce the basic financial statements. The DFAS Indianapolis Center had made significant control improvements over the status and general ledger process used previously. The DFAS Indianapolis Center had:

o established an audit trail so that external auditors could identify the number and dollar value of adjustments made,

o classified the adjustments by type,

o provided a written description of the purpose of each adjustment, and

o attached support documentation to most adjustment vouchers.

However, controls were either not in place or were ineffective for portions of the process used to make adjustments and prepare the financial statements. The DFAS Indianapolis Center did not:

o detect or correct errors in the financial data used to prepare the financial statements, or

o adequately document all adjustments made to the financial data.

Reported Control Weaknesses. We evaluated the DFAS Indianapolis Center's process for implementing the Internal Management Control Program and concluded that implementation was adequate. Although the DFAS Indianapolis Center had not reported the specific material internal control weaknesses we identified, it reported generic material weaknesses in the preparation of the Army's financial statements. The DFAS Indianapolis Center reported that the reliability of the financial statements was questionable because of inadequacies in the accounting system, the lack of an integrated general ledger system, failure to adhere to prescribed policies, and weak internal controls. The DFAS Indianapolis Center also reported that these weaknesses will not be fully corrected until September 1997. At that time, the inadequate departmental and field accounting systems are scheduled to be replaced with DoD-wide migratory accounting systems identified by DFAS Headquarters through its strategic plan and corporate information management initiatives. In the interim, the DFAS Indianapolis Center plans to work with the Army to improve the reliability of the financial data used to prepare the financial statements. In this report, we have recommended some additional interim improvements over adjustments and the preparation of financial statements. These improvements address internal control weaknesses.

The internal control weaknesses that we identified, and our recommendations for improvement, are discussed in Findings A and B, Part II. All recommendations in this report, if fully implemented, will assist in correcting the internal control weaknesses or minimize their impact until the new accounting system is implemented in FY 1997. No quantifiable monetary benefits will result from correcting the identified weaknesses. Other benefits of implementing our recommendations are detailed in Appendix C, "Summary of Potential Benefits Resulting from Audit." A copy of the final report will be provided to the senior official responsible for internal controls at DFAS Headquarters.

Prior Audit Coverage

The Army's General Fund financial statements were audited by the General Accounting Office (GAO) in FYs 1991 and 1992. The GAO issued a disclaimer of opinion and reported significant problems with the DFAS Indianapolis Center's departmental processes for consolidating financial data. The Army's DBOF financial statements were audited by USAAA in FY 1992. USAAA issued a disclaimer of opinion, and reported that the DFAS

Indianapolis Center's use of status data in place of general ledger data for producing the financial statements was not in compliance with the DoD Accounting Manual.

Army's General Fund Financial Statements. The GAO issued the FY 1991 audit opinion on August 7, 1992, in Report No. AFMD-92-83 (OSD Case No. 8674), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991." The GAO also reported on an operational audit on August 7, 1992, in Report No. AFMD-92-82 (OSD Case No. 8674), "Financial Management: Immediate Actions Needed to Improve Army Financial Operations and Controls." The GAO reports said that the DFAS Indianapolis Center could not rely on data from the accounting system and processed about $250.0 billion in adjustments. The adjustments were made without adequate supporting documentation or supervisory review. Much of the information needed for the financial statements was not produced by a general ledger-controlled accounting system. The DFAS Indianapolis Center determined that the general ledger data were so unreliable that it was necessary to use an alternative source, the status data, for preparing the Army's financial statements.

The GAO issued the FY 1992 audit opinion on June 30, 1993, in Report No. 93-1 (OSD Case No. 9276-E), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Years 1992 and 1991." The FY 1992 audit opinion stated that the DFAS Indianapolis Center made unsupported adjustments to the financial statements. For example, the DFAS Indianapolis Center made $7.0 billion of adjustments, for which no supporting documentation was available, so that general ledger balances would agree with the status data. The DFAS Indianapolis Center used the status data because they considered the status data more accurate than the general ledger data. Although the DFAS Indianapolis Center used the status data to produce the Statement of Cash Flows (Direct Method), control weaknesses over adjustments to the status data prevented the GAO from expressing an opinion. In addition, the DFAS Indianapolis Center made $5.7 billion of adjustments and corrections to the status data, but could not provide adequate documentation to support some of the adjustments.

Army's DBOF Financial Statements. Although the Army DBOF consolidated financial statements for FY 1992 were not audited, the USAAA performed a financial statement audit of two of the three existing DBOF business areas. The two Depot Maintenance business areas, Ordnance and Other, were audited, but the larger and more significant Supply Management business area was not audited. The audit opinion, "Defense Business Operations Fund, Depot Maintenance, Army Report of Financial Audit," Report No. NR 93-463, was issued on June 30, 1993. USAAA disclaimed an opinion on the two Depot Maintenance business areas. The manner in which the DFAS Indianapolis Center consolidated the financial data from the field accounting activities was not a reason for the disclaimer of opinion. However, the DFAS Indianapolis Center had used status data instead of general ledger data as the source for the financial resource line items on the financial statements. This was not in compliance with the DoD Accounting Manual's requirement to use an integrated standard general ledger to produce the financial statements.

Other Matters of Interest

The DFAS Indianapolis Center was not in compliance with the DoD requirement to use an integrated standard general ledger to produce the Army's financial statements. We believe the cause of the internal control weaknesses we identified was the inadequate accounting system used to produce the Army's General Fund and DBOF financial statements. Both the DFAS Indianapolis Center and external audits have recognized and reported this problem. The DFAS Indianapolis Center has stated that the problem will be corrected by September 1997, when the present accounting system will be replaced with a standard DoD-wide migratory accounting and reporting system. Therefore, we are not recommending that an integrated, double-entry, transaction-based general ledger system be developed and implemented for preparation of the Army's financial statements. However, we believe that strict compensating controls need to be established at the DFAS Indianapolis Center, to reduce risks in the inadequate accounting system now used and to increase the accuracy and reliability of the financial statements. We have identified some interim compensating controls. See the recommendations in Part II of this report.

Part II - Findings and Recommendations

Finding A. Sources of Departmental General Ledger Data

The DFAS Indianapolis Center did not detect or correct errors in the financial data in the departmental general ledger. This occurred because:

o reasonableness tests were not applied to general ledger accounts and line items on the financial statements to ensure that balances did not vary by excessive and unjustifiable amounts between fiscal years;

o interfaces between systems and the departmental general ledger were not adequate to pass data properly; and

o the general ledger system had no automated edits in place to identify and reject abnormal transactions or balances.

As a result, assets and liabilities on the Army's FY 1993 financial statements contained $4.9 billion in errors. If these internal control weaknesses are not corrected, there is a significant risk that the Army's FY 1994 General Fund and DBOF financial statements will also be misstated.

Background

For financial and some nonfinancial data, the departmental general ledger system receives its trial balances directly from the field accounting systems. Most nonfinancial data are submitted as hard copy from nonaccounting systems. Information not available at the field accounting activities, such as funding data, undistributed disbursements, and other expenditure data, must be entered into the general ledger at the DFAS Indianapolis Center. Computer programs extract the selected data from the Departmental Budgetary Accounting and Reporting System (DBARS), the Funds Distribution Subsystem, and the Expenditure System; create either a hard copy report or data files; and translate the data into general ledger account format. The data are then entered into the general ledger system. Any errors resulting from the extract programs, translations, or hard copy reports must be corrected by manually inputting adjusting vouchers.

Reasonableness Tests

Automated and manual tests were not being used to ascertain the reasonableness of line items on the financial statements or to detect erroneous general ledger balances reported by the field accounting activities. The DFAS Indianapolis Center failed to identify and correct at least $4.8 billion in errors that caused misstatements of assets and liabilities on the financial statements.

o Accrued leave: the DFAS Indianapolis Center did not identify a $2.0 billion error in accrued leave. Accrued leave, line 5a on the FY 1992 Army General Fund Statement of Financial Position, was reported as $2.5 billion. Since the Army had downsized during FY 1993, the accrued leave for FY 1993 should have decreased. Instead, it had increased to over $3.7 billion. Our research of the data transferred to the departmental general ledger showed that data on accrued military leave from the DBARS were reported incorrectly, resulting in a $2.0 billion overstatement. This error could have been detected with a manual or automated reasonableness check of line-item balances on the financial statements when these balances varied excessively and unjustifiably between fiscal years.

o Inventories not held for sale: the DFAS Indianapolis Center did not identify a $2.2 billion error in this line item. Inventories not held for sale, line 2c on the FY 1992 DBOF Statement of Financial Position, was stated as $1.8 billion. However, the FY 1993 amount had increased to $4.6 billion. This was an excessive and unjustifiable increase that should have been researched. During our review of adjustment documents that affected this line item, we found that the DFAS Indianapolis Center had made the $2.2 billion error by overstating work-in-process inventories reflected in the inventories not held for sale for FY 1993. If the DFAS Indianapolis Center had made an adequate reasonableness check of line items on the financial statements, had identified excessive and unjustifiable variances, and had conducted research, the $2.2 billion error could have been detected and corrected, and the resulting overstatement would not have occurred.

o Property, plant and equipment: the DFAS Indianapolis Center did not identify a $0.6 billion error in this line item. The Fort Riley, Kansas, field accounting activity reported $0.6 billion of property, plant and equipment to the DFAS Indianapolis Center in FY 1992. However, Fort Riley reported only $23.5 million in FY 1993. After research, we found that the Fort Riley field accounting activity reported only the net change instead of the yearend balance for FY 1993. The DFAS Indianapolis Center did not question this excessive and unjustifiable variance. If the DFAS Indianapolis Center had performed reasonableness checks of general ledger account balances reported by field accounting activities, this understatement could have been identified and corrected.

Interfaces

Manual and automated interfaces between the departmental general ledger and other source systems were not adequate to pass the required information correctly. Information not available at the field accounting activities, such as funding data, undistributed disbursements, and other expenditure data, must be entered into the general ledger at the DFAS Indianapolis Center. These interfaces extract the desired data from their original systems and convert the data to general ledger format. The data are then entered into the general ledger system. We found an uncorrected $2.0 billion error that resulted from inadequacies in the interface between the military pay system and the departmental general ledger. We also identified adjustments that the DFAS Indianapolis Center had made to correct errors caused by inadequacies in the passing of data from departmental source systems through the DBARS instead of directly into the departmental general ledger. The adjustments totaled $95.3 billion.

o Accrued leave: financial data on accrued leave were incorrectly extracted from hard copy reports. This resulted in an uncorrected $2.0 billion error that would have been avoided if the data had been reported directly from the Standard Finance System to the departmental general ledger. The Standard Finance System is used to perform financial accounting for the military pay system.

o Funding data: Funding data were reported twice, first through the funds distribution interface and then by extracting data from the DBARS. Vouchers totaling at least $88.1 billion were prepared to correct this duplication and avoid a misstatement on the financial statements. This error could have been avoided if the interface had been automated.

o Advances: outstanding prior year advances, valued at about $1.0 billion, were passed twice from the DBARS into the departmental general ledger. This amount was identified when the departmental general ledger accounts were compared to the DBARS amounts. Correcting vouchers were prepared, and no misstatement occurred. These correcting vouchers could have been avoided if the interface with the DBARS had been automated.

o Accrual data: accrual data, when extracted from the DBARS, were generally shown with the debit and credit signs reversed. Although the DFAS Indianapolis Center had been aware of interface problems for several years, the interface had not been corrected. Correcting vouchers for $6.2 billion were prepared, and no misstatement occurred. These correcting vouchers could have been avoided if the interface with the DBARS had been automated.

The DFAS Indianapolis Center was able to detect most of the errors caused by inadequate interfaces because the departmental general ledger data were adjusted to match status data. As stated previously, departmental general ledger data, not status data, should be the basis for the financial statements. However, if the departmental general ledger data had been used to prepare the Army's FY 1993 financial statements, the inadequate interfaces would have resulted in material

misstatements. The DFAS Indianapolis Center should develop and implement accurate automated interfaces between all departmental source systems and the departmental general ledger.

Abnormal Balances

The departmental general ledger system did not contain automated edits to reject incorrect submissions or adjustments of data that created abnormal account balances. Although the DFAS Indianapolis Center identified some abnormal balances, adequate research was not done to resolve them. As a result, the assets reported on the financial statements were understated by $0.1 billion. Abnormal balances are amounts in general ledger accounts that are the opposite of the normal balance for that type of account. The abnormal account balances arrived at the DFAS Indianapolis Center as trial balances submitted by field accounting activities. Abnormal balances are also the result of incorrect adjustments to the departmental general ledger.

o Property, plant and equipment balances: because of the lack of automated edits, the DFAS Indianapolis Center failed to identify a $0.1 billion error in property, plant and equipment accounts, causing assets on the financial statements to be understated by that amount. The DFAS Indianapolis Center accepted 21 abnormal balances ($0.4 billion of negative property, plant, and equipment balances) submitted by field accounting activities at the end of FY 1993. The DFAS Indianapolis Center had located these abnormal account balances, but did not perform research to determine why the abnormal balances existed. Instead, the balances were adjusted to zero. Our research showed that of the negative $0.4 billion of property, plant and equipment submitted by field accounting activities, $0.1 billion should have been submitted as a positive balance. Adequate research of the negative account balances would have identified the $0.1 billion error.

o Financial resource balances: the DFAS Indianapolis Center did not identify and correct two abnormal general ledger balances, a positive balance of $2.2 billion in the undistributed collections account and a negative balance of $0.3 billion in accounts receivable. The abnormal balances were the result of incorrect adjustments to the departmental general ledger. The general ledger system did not have automated edits to reject adjustments that resulted in abnormal account balances. These abnormal account balances had no adverse effect on the FY 1993 financial statements because the financial resource general ledger accounts were compared and adjusted to status data. For FY 1993, the general ledger data submitted from the field were not reliable enough to be used to prepare the financial statements. However, in the future, when the actual general ledger data will be used to compile the financial resource line items, these abnormal account balances will need to be identified, researched, and corrected.

Conclusion

Additional controls and changes in procedures are needed to identify and correct errors in data input into the departmental general ledger. The DFAS-Indianapolis Center failed to detect over $4.9 billion of errors that caused the following misstatements of assets and liabilities on the FY 1993 financial statements:

- o $2.2 billion overstated in inventory;
- o $2.0 billion overstated in accrued leave;
- o $0.6 billion understated in property, plant and equipment; and
- o $0.1 billion understated in property, plant and equipment.

The $2.2 billion error caused a material misstatement of the assets on the DBOF FY 1993 financial statements. The other three errors misstated the General Fund FY 1993 financial statements by $2.7 billion. When the auditors brought these errors to the attention of the DFAS Indianapolis Center, they made adjustments to correct the final FY 1993 financial statements. Reasonableness checks of line item balances in the financial statements and account balances in the departmental general ledger would identify excessive variances that should be researched for possible identification and correction of erroneous data. Replacing extractions and manual entry of data from the DBARS with direct, accurate, automated interfaces with the source systems would eliminate many manual adjustments and increase the accuracy of the data in the departmental general ledger system. Identifying abnormal general ledger account balances and requiring them to be researched and corrected would eliminate errors in the financial statements. Achieving the long-term goal of a fully integrated, double-entry, transaction-driven general ledger system will eliminate much of the risk in the labor-intensive accounting system used at present. However, interim measures should be taken to address the existing system's defects.

Recommendations, Management Comments, and Audit Responses

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

1. Design and implement procedures for reasonableness checks of general ledger account balances and line items on the financial statements, to ensure that excessive and unjustifiable variances between fiscal years are not caused by errors in the financial data. At a minimum, the procedures should address:

o the dollar and percentage levels of variances between fiscal years in balances and line items that require research;

o how the variances will be identified;

o who will identify the variances; and

o who will perform the research and correct any errors.

2. Implement direct, automated interfaces between all departmental source systems and the departmental general ledger.

3. Establish edits within the general ledger system to detect and reject the input of trial balances or adjustments that result in abnormal general ledger account balances (balances that are the opposite of the normal balance for that type of account).

4. Establish and implement policies and procedures to require abnormal general ledger account balances to be adequately researched and resolved.

Management Comments. The Director, DFAS Indianapolis Center, concurred with our finding and recommendations except for Recommendation A.3. See Part IV for the full text of management's comments.

The Director, DFAS Indianapolis Center, did not concur with Recommendation A.3., stating that in some cases, abnormal balances may be proper. He stated that rejecting all abnormal balances would be inappropriate and impractical, and would cause unacceptable delays in preparing the financial statements. As an alternative, he stated that he would use exception reports to monitor improperly abnormal balances more closely. Exception reports exclude account balances that are properly abnormal.

Audit Response. We recognize that rejecting all abnormal balances may be inappropriate and could cause unacceptable delays in preparing the financial statements. Also, the volume of improperly abnormal balances should be low because the Director, DFAS, concurred with USAAA's recommendations to require subordinate DFAS accounting offices to review their general ledger balances monthly, and to research and correct abnormal balances. We believe that using exception reports to monitor improperly abnormal balances meets the intent of the recommendation, provided that the DFAS Indianapolis Center identifies, researches, and resolves these balances before the final financial statements are issued.

Finding B. The Adjustment Process

Adjustments made by the DFAS Indianapolis Center to departmental general ledger and status data were not adequately documented and were sometimes incorrect. Also, the process of adjusting departmental general ledger data was not always efficient or well-controlled. These inadequacies existed because the DFAS Indianapolis Center had not:

o established clear criteria for what constituted adequate supporting documentation for adjustments;

o implemented procedures for independent review and input by allowing separate groups of employees to prepare, review, and input adjustments;

o developed and implemented detailed procedures to correctly perform DBOF inventory accounting; or

o developed and implemented a formal control plan for adjusting the departmental general ledger;

As a result, the Army's DBOF FY 1993 financial statements were materially overstated by about $2.7 billion. If the internal control weaknesses we identified are not corrected, a significant risk exists that the Army's FY 1994 General Fund and the DBOF financial statements will be misstated.

Background

The DFAS Indianapolis Center makes numerous departmental adjustments to both general ledger and status data. Data submitted by field accounting activities pass basic data edits and balancing routines. Departmental status data are adjusted to agree with data certified by the field accounting activities. The DFAS Indianapolis Center then makes adjustments to general ledger and status data so that data submitted by field accounting activities remain unadjusted. See Appendix B, "Sampling Plan," for a summary of the general ledger and status adjustments we reviewed.

General Ledger Data. The DFAS Indianapolis Center makes many departmental adjustments to general ledger data, such as:

o adjusting general ledger accounts to match certified status data,

o reclassifying or revaluing assets in accordance with DoD guidance, and

o adding asset information from nonaccounting sources.

Status Data. The DFAS Indianapolis Center makes two types of departmental adjustments to status data. The first type is bulk adjustments, which are applied mechanically to data extracts and reloaded into the main file. Bulk adjustments generally address deficiencies in the accounting system and in reporting. The second type is individual adjustments, which are manually prepared to correct errors and meet accounting or reporting requirements.

DBOF Inventory Accounting. The DBOF financial statements for FY 1993 included inventories valued at $18.1 billion: inventories held for sale of $13.5 billion, and inventories not held for sale of $4.6 billion. These inventories represented 77 percent of the $23.6 billion of assets on the DBOF Statement of Financial Position. Field accounting activities report inventories to the DFAS Indianapolis Center from two sources: general ledger trial balances and non-general ledger inventory reports. The field accounting activities use data from their general ledgers to compile the inventory reports. Therefore, inventory balances in the departmental general ledger at the DFAS Indianapolis Center should equal the inventory balances on the inventory reports. Inventories held for sale are carried at the standard price for day-to-day operations. However, for the yearend financial statements, the DFAS Indianapolis Center revalues the inventory to its net realizable value, removing the DBOF surcharge and adjusting the value to properly reflect excess and obsolete inventory.

Supporting Documentation for Adjustments

Adjustments to departmental general ledger and status data were inadequately documented and sometimes incorrect. Of the adjustments we reviewed, the DFAS Indianapolis Center was eventually able to support 95 percent of the adjustment vouchers for general ledger data and 98 percent of the adjustments for status data. However, internal controls over documentation requirements were not always effective and needed improvement. About 18 percent of the general ledger adjustment vouchers and 39 percent of the status adjustments we reviewed did not have adequate supporting documentation attached to the vouchers.

General Ledger Adjustments. We evaluated 137 adjustment vouchers (89 for the General Fund and 48 for DBOF) that were prepared in order to adjust the departmental general ledger. Ninety-five percent of the adjustments we reviewed were adequately supported. To be adequately supported, an adjustment needed to be backed by objective, contemporary, and complete documentation that the adjustment was necessary and correct. Table 1. below shows the results of our review of adjustments to the general ledger data.

Table 1. Adjustments to General Ledger Data
(Debits Only, Dollars in Billions)

Category	Number of Adjustments	Dollar Value	Percentage
Supported	131	$393.5	95
Not Supported	6	2.7	5
Total Sample	137	$396.2	100

Although 95 percent of the adjustments we reviewed were supported, 25 (18 percent) of the 131 supported adjustments required considerable research to locate the documentation. The vouchers for these 25 adjustments, valued at $48.3 billion, did not have the supporting documentation initially attached or did not have specific references to the documentation. A more serious problem was that a few unsupported vouchers caused material misstatements in the financial statements. For example, the six unsupported adjustment vouchers we identified had documentation attached, but the documentation did not support the dollar amounts of the adjustments. This resulted in a $2.7 billion material misstatement in a DBOF inventory account.

This documentation and review problem existed because the DFAS Indianapolis Center had not established specific criteria for what constituted adequate supporting documentation for general ledger adjustments. Duties also were not clearly separated among the preparers and reviewers of adjustments and employees who entered the adjustments into the departmental general ledger. If documentation requirements and separation of duties had been properly established and enforced, adjustments would have been independently examined to ensure that necessary documentation was attached to the adjustment vouchers, and that adjustment amounts were reviewed for technical correctness. Unless adjustments are adequately supported and reviewed, unnecessary or incorrect adjustments will cause material misstatements of the financial statements.

Status Data Adjustments. We evaluated all bulk adjustments, as well as a sample of 310 individual adjustments (167 for the General Fund and 143 for DBOF) to the status data. All of the bulk adjustments and 98 percent of the individual adjustments we reviewed were supported. To be adequately supported, an adjustment needed to be backed by objective, contemporary, and complete documentation that it was necessary and correct. Table 2. below shows the results of our review of adjustments to status data.

Table 2. Adjustments to Status Data
(Debits Only, Dollars in Billions)

	Bulk			Individual		
Category	Number	Percentage	Value	Number	Percentage	Value
Supported	15,493	100	$10.0	304	98	$21.9
Not Supported	0	0	0	6	2	0.3
Total	15,493	100	$10.0	310	100	$22.2

All of the bulk adjustments and 98 percent of the individual adjustments we reviewed were supported. However, for 121 (39 percent) of the 304 individual adjustments that were supported, we had to perform considerable research to locate the supporting documentation. The vouchers for 121 adjustments, valued at $9.8 billion, did not have the documentation initially attached or did not have specific references to the documentation. An adequate review of the adjustment voucher cannot be performed before input if no documentation is attached. Unless adjustments are adequately supported and reviewed, there is considerable risk that unnecessary or incorrect adjustments will occur, causing material misstatements of the financial statements. This problem existed because the DFAS Indianapolis Center had not established specific criteria for what constituted adequate supporting documentation for adjustments to status data. The DFAS Indianapolis Center also had not clearly separated duties between the preparers of adjustments and employees who entered the adjustments into the status system. The same group of employees that prepared the adjustment vouchers also input the adjustments into the status system. If documentation requirements and separation of duties had been properly established and enforced, adjustments would have been independently examined to ensure that documentation was attached to the adjustment vouchers.

DBOF Inventory Accounting

The DFAS Indianapolis Center did not correctly perform DBOF inventory accounting. This occurred because the DFAS Indianapolis Center:

o had not properly recorded the adjustment to revalue inventory for the Supply Management business area;

o had inappropriately adjusted the general ledger inventory balances to match balances on the wrong inventory reports; and

o had not verified with field accounting activities whether uncleared transactions were already included in general ledger inventory balances before recording those transactions as inventory in transit.

As a result, on the Statement of Financial Position for the Army's DBOF financial statements, assets were overstated by $2.7 billion, or 11 percent. When the auditors informed the DFAS Indianapolis Center of these accounting errors, the DFAS Indianapolis Center made adjustments to correct the overstatements in the final FY 1993 financial statements. However, the weak internal controls that allowed these accounting errors need to be strengthened.

Revaluation of Inventory. When recording the adjustment to revalue the DBOF inventory, the DFAS Indianapolis Center overstated inventory on the financial statements by $2.2 billion. The DFAS Indianapolis Center revalued the $23.1 billion Supply Management inventory reported by field accounting activities to $14.9 billion in order to present the inventory at net realizable value, as required by DoD. However, $2.2 billion remained in a work-in-process general ledger account. The DFAS Indianapolis Center lacked adequate guidance on how to make the adjustment to revalue inventory. This overstatement could have been avoided if the DFAS Indianapolis Center had developed detailed procedures for making the adjustment to revalue inventory. Detailed procedures are needed, especially since the inventory revaluation adjustment was used to record over 70 percent of the $23.6 billion in DBOF assets on the Statement of Financial Position.

Adjusting Inventory Balances. We also noted that the DFAS Indianapolis Center inappropriately adjusted the departmental general ledger inventory account balances to make them match balances on non-general ledger inventory reports. In doing so, the DFAS Indianapolis Center used the wrong inventory reports. A more serious problem was that the DFAS Indianapolis Center did not perform any research to reconcile the variances between the general ledger inventory account balances and the inventory report balances. This resulted in three unneeded general ledger adjustments for $232.8 million, which caused the DBOF inventory on the financial statements to be overstated by $145.8 million.

The DFAS Indianapolis Center should not adjust inventory balances reported by field accounting activities unless it makes comparisons to the correct inventory reports, identifies a valid variance, and performs the necessary research to determine whether the departmental general ledger is actually incorrect and needs to be adjusted. This action must be coordinated with field accounting activities to ensure that the proposed adjustment is correct and needed.

Inventory in Transit. The DFAS Indianapolis Center made an inappropriate adjustment to record $353.0 million of inventory in transit. The adjustment lacked adequate support and caused inventory balances on the financial statements to be overstated by $353.0 million. The DFAS Indianapolis Center, without coordinating with field accounting activities, recorded uncleared expenditures (transactions for others and interfund amounts, both identified in the departmental expenditure system) as inventory in transit. The DFAS Indianapolis Center concluded that because the expenditures had been made but had not cleared the accounting system, the adjustment to the inventory account

was needed. However, since the DFAS Indianapolis Center did not verify with field accounting activities that the inventory associated with the uncleared expenditures was not recorded in the field general ledgers, the adjustment should not have been made. Also, the $353.0 million consisted of uncleared expenditures that were up to 60 days old. Because of inventory procedures used in the field, inventory would not be in transit for uncleared expenditures over 10 days old. The DFAS Indianapolis Center needs to coordinate with field accounting activities to determine the amount of uncleared expenditures to be recorded in the departmental general ledger as inventory in transit.

Controls Over the Departmental General Ledger

The process that the DFAS Indianapolis Center used to adjust departmental general ledger accounts was not efficient or well-controlled. In order to present the Army's financial data on the FY 1993 financial statements, the DFAS Indianapolis Center had to prepare and process 650 manual adjustment vouchers (602 for the General Fund and 48 for DBOF). This included processing numerous adjustments to reverse prior incorrect adjustments. It also included several attempts to make the general ledger data associated with the financial resource line items match the certified status data. Problems included the following.

o The DFAS Indianapolis Center prepared numerous vouchers to adjust the DBOF inventories. One of the vouchers was carelessly prepared and caused a DBOF inventory account to be overstated by $2.2 billion. This amount should have been removed from the inventory general ledger account when the DFAS Indianapolis Center recorded the adjustment to revalue the inventory. This error could have been detected and corrected if the process for adjusting the departmental general ledger had been better organized and controlled.

o The DFAS Indianapolis Center had offset an incorrect general ledger account when recording an adjustment, causing accounts receivable to be overstated by about $8.7 million. If the DFAS Indianapolis Center had verified the ending balance for the total accounts receivable, the resulting increase could have been noted and corrected.

o On two occasions, the DFAS Indianapolis Center passed $968.0 million of prior-year advances from the DBARS into the general ledger. An additional voucher had to be prepared to reverse the error.

The DFAS Indianapolis Center needs to develop and implement step-by-step procedures for the adjustment process, which includes checking the results of adjustments on general ledger account balances.

Conclusion

The DFAS Indianapolis Center's adjustment process needs improvement. The DFAS Indianapolis Center made adjustments to departmental general ledger and status data that were not adequately documented and controlled. This increased the risk that unnecessary or incorrect adjustments could cause a material misstatement of the financial statements.

To reduce this risk, clear, enforceable criteria are needed for documentation to support adjustments. The DFAS Indianapolis Center needs to develop and issue policies that address the need for evidence to be contemporary, objective, and complete, as well as the nature and extent of documentation needed to support the dollar amounts on the adjustment vouchers. By allowing all status and general ledger adjustments to be independently reviewed and input, documentation requirements could be enforced.

The comparisons between general ledger accounts and certified status data were done in an environment that lacked organization and control. By inputting other data, balancing accounts, and making departmental adjustments during the comparison process, the DFAS Indianapolis Center obscured the actual adjustments that were needed. More important, differences between the departmental general ledger and status data were obscured. The DFAS Indianapolis Center could not determine the reasons for inaccuracies in the general ledger data, which created a high risk that the financial statements would be inaccurate. A detailed control plan should be developed and implemented. Also, unless adjustments are adequately documented and the adjustment process is better organized, the DFAS Indianapolis Center's adjustments cannot be efficiently and effectively audited within the time frame required by OMB for auditing financial statements.

Recommendations, Management Comments, and Audit Response

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

1. Develop and implement policy and procedures establishing specific criteria for what constitutes adequate supporting documentation for various types of status and general ledger adjustments. At a minimum, address:

o the need for the evidence to be contemporary, objective, and complete; and

o the types of documentation, such as lists, spreadsheets, system queries, and adding machine tapes, that are needed to support the amounts on adjustment vouchers.

2. Strengthen separation of duties by establishing procedures for independent review and input of all status and general ledger adjustments. At a minimum, address the need to:

o enforce documentation requirements for providing evidence for adjustment vouchers, and

o ensure that adjustment vouchers receive detailed technical review.

3. Develop and implement detailed procedures for making adjustments to revalue inventories of the Defense Business Operations Fund Supply Management business area. At a minimum, the procedures should address:

o general ledger accounts that are affected, and

o specific general ledger debits and credits to be made.

4. Issue detailed guidance for adjusting Defense Business Operations Fund inventory general ledger balances based on inventory reports. At a minimum, the guidance should address:

o comparison of inventory account balances in the departmental general ledger to inventory account balances on the appropriate inventory reports;

o identification of variances;

o required research; and

o coordination with field accounting activities.

5. Coordinate with field accounting activities to determine the amount of uncleared expenditures that should be recorded in the Defense Business Operations Fund general ledger accounts as inventory in transit.

6. Develop and implement a sequential process for organization and control of all inputs and adjustments to the departmental general ledger.

Management Comments. The Director, DFAS Indianapolis Center, concurred with Recommendations B.1., B.2., and B.6.

Recommendation B.3. The Director, DFAS Indianapolis Center, agreed to develop and implement procedures for making adjustments to revalue DBOF inventories. DFAS will coordinate with supply management officials to perform this action. It is the responsibility of the supply management officials, not DFAS, to develop these procedures.

Recommendation B.4. The Director, DFAS Indianapolis Center, agreed to issue detailed guidance for adjusting DBOF inventory general ledger balances. This will be a joint effort with logistics managers. The Director also

stated that the systems now in use in the Supply Management business area automatically adjust the general ledger balances to agree with the inventory balances in the logistics systems. However, this automated capability is unavailable in the Depot Maintenance business area. Therefore, DFAS will issue guidance for adjusting Depot Maintenance inventory balances until an automated adjustment system is available.

Recommendation B.5. The Director, DFAS Indianapolis Center, nonconcurred with our recommendation to coordinate with field accounting activities to determine the amounts of uncleared expenditures that should be recorded in the departmental general ledger as inventory in transit. He stated that the uncleared expenditures should be recorded as accounts payable, not as inventory in transit, until the uncleared expenditures can be properly identified.

Audit Response. Comments from the Director, DFAS Indianapolis Center, were responsive, except for Recommendations B.3. and B.4.

Recommendation B.3. Although the Director, DFAS Indianapolis Center, concurred with the recommendation, his proposed actions were not fully responsive. We agree that supply management officials are responsible for revaluing the inventories. However, the DFAS Indianapolis Center is responsible for making the revaluation adjustment to the departmental general ledger, based on data from supply management offices. As stated in the finding, the DFAS Indianapolis Center made a $2.2 billion error when making the revaluation adjustment because its employees lacked adequate accounting guidance. DFAS, not supply management officials, is responsible for making the accounting adjustment. Therefore, DFAS Indianapolis Center should implement the required accounting procedures for making the revaluation adjustment.

Recommendation B.4. Although the Director, DFAS Indianapolis Center, agreed with the recommendation, his proposed actions were not fully responsive. Ensuring accurate inventory general ledger balances at field accounting activities is a joint effort with logistics managers. However, issuing the required guidance for making adjustments to the departmental general ledger is the responsibility of the DFAS Indianapolis Center. As stated in the finding, the DFAS Indianapolis Center made $232.8 million of unneeded adjustments that overstated the DBOF inventory on the financial statements by $145.8 million because its employees lacked adequate guidance. Therefore, the DFAS Indianapolis Center should issue detailed accounting guidance for making these adjustments.

Recommendation B.5. The Director, DFAS Indianapolis Center, nonconcurred with our recommendation. However, his proposed corrective action met its intent, which was to ensure that procedures were in place to prevent accountants at the DFAS Indianapolis Center from making unsupported adjustments to the departmental general ledger. We wanted the DFAS Indianapolis Center to avoid making another $353.0 million unsupported adjustment in FY 1994. Since the Director stated that he will not use uncleared expenditures to record inventory in transit unless they can be properly identified, unsupported adjustments of this type should not occur in the future.

Response Requirements for Each Recommendation

Responses to the final report are required from the Director, DFAS Indianapolis Center, for the items indicated with an "X" in the chart below.

	Response Should Cover:			
Recommendation Number	Concur/ Nonconcur	Proposed Actions	Completion Date	Related Issues
3.	X	X	X	IC*
4.	X	X	X	IC

* IC = material internal control weakness.

Part III - Additional Information

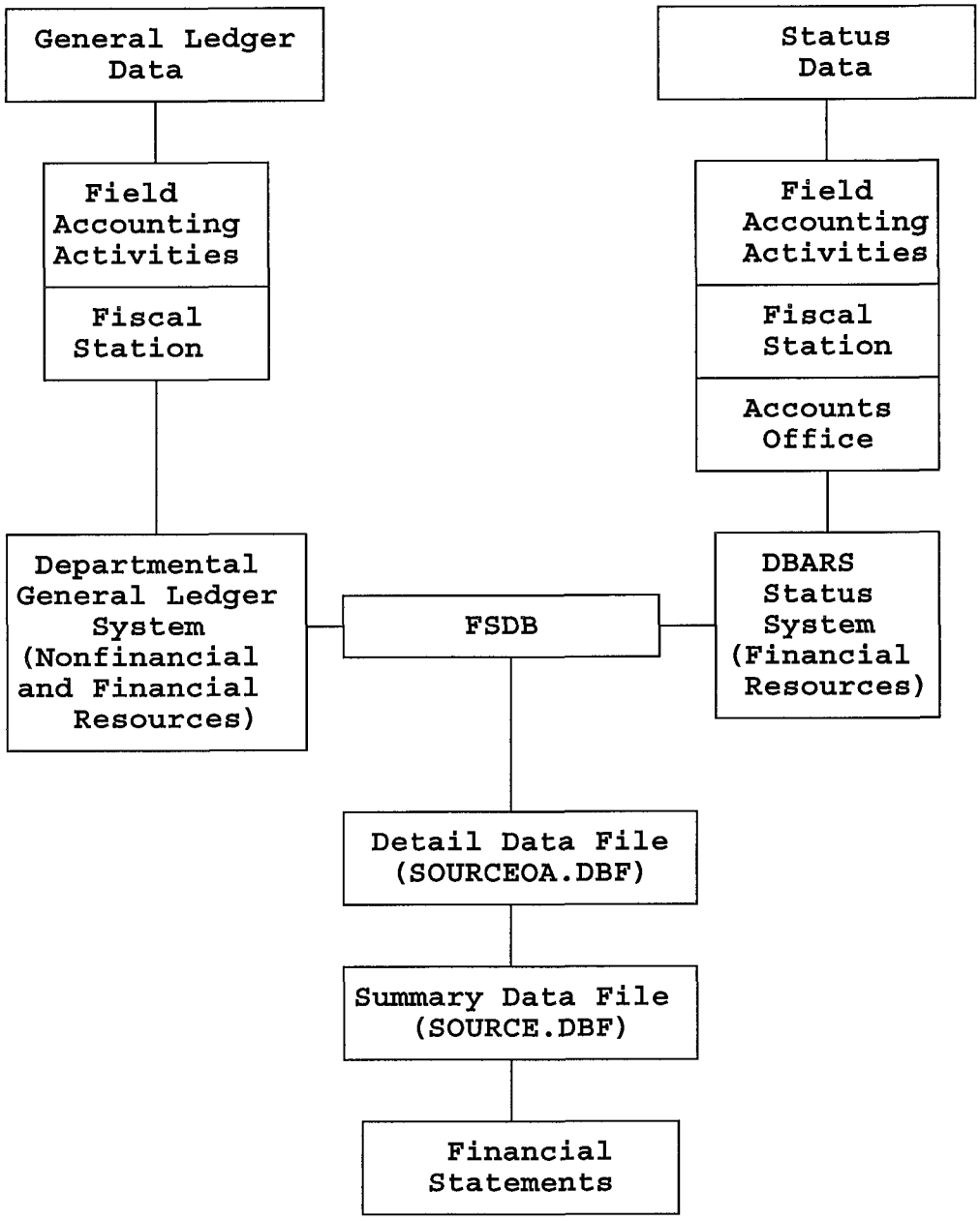
Appendix A. Process Used to Prepare the Financial Statements

Because the accounting systems used to prepare the financial statements are not based on the general ledger method of accounting, the DFAS Indianapolis Center must use a complex manual process to prepare the statements. First, the information on financial resources (status data) that is accumulated during the fiscal year in the Departmental Budgetary Accounting and Reporting System (DBARS) is updated to match yearend certified status reports. Status data are financial information on the status of appropriations, and include obligation data, disbursements, and collections. Field accounting activities report status data to the DBARS during the fiscal year. Departmental information not available or accounted for in the field accounting systems is added. The status data are then adjusted at the departmental level to align the data correctly for reporting purposes, to correct bulk errors caused by system deficiencies, or to meet special requirements. Few of the many adjustments made to status or departmental general ledger data at the DFAS Indianapolis Center are caused by actual accounting errors. Most adjustments are made to compensate for deficiencies in accounting systems and interfaces, or to correct errors made while attempting to compensate for accounting system deficiencies. In this audit report, we refer to all types of changes to status or departmental general ledger data as adjustments.

Financial data are also reported directly into the departmental general ledger from the field accounting activities as trial balances. The DFAS Indianapolis Center receives information on nonfinancial resources as electronic reports or hard copies from activities such as the Army Materiel Command. The nonfinancial resource data are entered directly into the departmental general ledger, where they are accumulated for use in preparing future financial statements. The same type of departmental information (discussed in the preceding paragraph) that is added to the status data is also added to the departmental general ledger, and the same types of departmental adjustments are made. The status data are then compared to financial information in the general ledger. The financial resource accounts in the general ledger are adjusted to match the status data and budgetary reports. The DFAS Indianapolis Center then consolidates the information in the departmental general ledger into a microcomputer data base called the Financial Statement Data Base (FSDB). The FSDB contains two files; one, named SOURCE.DBF, is summary level, and the other, named SOURCEOA.DBF, contains details. The FSDB is used to produce the Army's financial statements.

The following diagram shows how financial data flow from the field through the processes at the DFAS Indianapolis Center to the financial statements.

Flow of Financial Data



Data for financial resource line items are compiled from status data received from field accounting activities and stored in the DBARS; expenditure data are received from the expenditure system and stored in the DBARS. Status data are then input to the FSDB to produce financial statements.

Data for nonfinancial resource line items are compiled from trial balances or hard copy documents received from the field accounting activities and reported directly into the departmental general ledger. Departmental general ledger data are then input to the FSDB to produce the financial statements.

Status data and general ledger data are compared for financial resource line items only. The departmental general ledger data are adjusted to match the status data.

Appendix B. Sampling Plan

We used four sampling plans to review the adjustments made to the status and departmental general ledger data. The sampling plans were for:

- Army General Fund status data,
- Army General Fund general ledger data,
- DBOF status data, and
- DBOF general ledger data.

A discussion of each sample follows.

Sample of Army General Fund Status Data

The audit universe of status data consisted of DBARS adjustments made at the departmental level. The universe was divided into two populations: bulk adjustments, which are mechanically generated to address deficiencies in the accounting system, and individual adjustments, which are manually generated to address identified account variances. A census sample was performed on 15,437 bulk adjustments with an absolute value of $8.7 billion. A judgmental sample was performed on the individual adjustments. The sample of individual adjustments was drawn from a universe of 3,245, with an absolute value of about $20.3 billion. The individual adjustment population was divided into four strata. The first stratum consisted of $0 adjustments. A census sample was performed on the seven adjustments in this stratum. The second stratum consisted of adjustments between $0 and $100,000, which were excluded because they constituted about 50 percent of the universe size but less than 1 percent of the universe value. The third stratum consisted of adjustments between $100,000 and $250.0 million. We randomly selected 81 items. The fourth stratum consisted of all adjustments equal to or greater than $250.0 million. A census sample was performed on the 79 adjustments in this stratum. The overall sample for the individual adjustments consisted of:

- 7 items in stratum 1,
- 0 items in stratum 2,
- 81 items in stratum 3, and
- 79 items in stratum 4.

The total sample consisted of 15,437 bulk and 167 individual adjustments.

Adjustments to Status Data
($ in Billions)

	Bulk		Individual	
	Number	Dollar Value	Number	Dollar Value
Universe	15,437	$8.7	3,245	$20.3
Sample	15,437	8.7	167	14.2

Sample of Army General Fund General Ledger Data

The universe of general ledger adjustments consisted of manual journal vouchers used by the DFAS Indianapolis Center to adjust individual account balances in the departmental general ledger. As of January 3, 1994, there were 602 such vouchers in the universe. We randomly selected 89 vouchers for review. To identify the actual vouchers to be reviewed, we assigned randomly generated numbers to a numerical roster of the manual vouchers that existed as of January 3, 1994.

Adjustments to General Ledger Data
(Debits Only, $ in Billions)

	Number	Dollar Value
Universe	602	$2,364.9
Sample	89	238.8

Sample of DBOF Status Data

The universe of DBOF status data was divided into 2 populations, consisting of 56 bulk adjustments and 364 individual adjustments. Since the universe was relatively small and included only four journal vouchers, we reviewed all of the bulk adjustments and took a judgmental sample of the individual adjustments. The individual adjustments were selected from largest to smallest amounts so that we would cover at least 97 percent of the dollar value.

Adjustments To Status Data
($ in Billions)

	Bulk		Individual	
	Number	Dollar Value	Number	Dollar Value
Universe	56	$1.3	364	$8.2
Sample	56	1.3	143	8.0

Sample of DBOF General Ledger Data

The universe of DBOF general ledger data consisted of 48 manual vouchers that were extracted from the data base of manual vouchers provided by the DFAS Indianapolis Center. Since the universe consisted of only 48 manual vouchers, we reviewed the entire universe.

Adjustments to General Ledger Data
(Debits Only, $ in Billions)

	Number	Dollar Value
Universe	48	$157.4
Sample	48	157.4

Appendix C. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1.	Internal controls. Designing and implementing reasonableness checks of financial data will improve the accuracy of the Army's financial statements.	Nonmonetary.
A.2.	Internal controls. Implementing automated interfaces between the departmental source systems and the general ledger will improve the reliability of the Army's financial data.	Nonmonetary.
A.3.	Internal controls. Establishing edit checks will improve the accuracy of the Army's financial statements.	Nonmonetary.
A.4.	Internal controls. Researching and adequately resolving abnormal general ledger balances will improve the reliability of the Army's financial data.	Nonmonetary.
B.1.	Internal controls. Implementing proposed policies will improve the reliability of the Army's financial statements.	Nonmonetary.
B.2.	Internal controls. Strengthening separation of duties to enforce documentation standards will improve the reliability of the Army's financial statements.	Nonmonetary.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
B.3.	Internal controls. Implementing proposed procedures will improve the accuracy and reliability of the DBOF inventory balances on the financial statements.	Nonmonetary.
B.4.	Internal controls. Implementing proposed procedures will improve the accuracy and reliability of the DBOF inventory accounts.	Nonmonetary.
B.5.	Internal controls. Improving procedures for recording uncleared transactions as inventory in transit will improve the accuracy and reliability of the DBOF inventory accounts.	Nonmonetary.
B.6.	Internal controls. Implementing proposed procedures will improve the reliability and accuracy of the Army's financial statements.	Nonmonetary.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Comptroller of the Department of Defense

Department of the Army

Assistant Secretary of the Army (Financial Management)
U.S. Army Audit Agency

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Arlington, VA
  Defense Finance and Accounting Service, Indianapolis Center, Indianapolis, IN
  Defense Finance and Accounting Service, Columbus Center, Columbus, OH
Defense Information Systems Organization, Indianapolis Information Processing Center, Indianapolis, IN

Non-Defense Organizations

Department of the Treasury, Washington, DC
General Accounting Office, Washington, DC
Office of Management and Budget, 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

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Inspector General, Department of the Army
Auditor General, Army Audit Agency

Defense Agencies

Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service, Indianapolis Center

Non-Defense Organizations

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

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 Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

JUN 20 1994

DFAS-HQ/GC

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE
INSPECTOR GENERAL, DoD

SUBJECT: Draft Audit Report on DFAS Work on the Army FY 93 Financial Statements (Project Number 3FI-2007)

We have reviewed the above draft report and our management comments in response to the recommendations are attached. My point of contact for this audit response is Mr. Tom Tresslar, 703-607-1120.

for Arnold R. Weiss
Deputy Director for General Accounting

Attachment

DEFENSE FINANCE AND ACCOUNTING SERVICES
WORK ON THE ARMY'S FY 1993 FINANCIAL STATEMENTS
PROJECT NUMBER: 3FI-2007

Finding A. Sources of Departmental General Ledger Data

Corrective Action A-1: Design and implement procedures for reasonableness checks of general ledger account balances and financial statement line items to ensure that excessive and unjustifiable variances between fiscal years are not caused by errors in the financial data. At a minimum, address:

- the dollar and percentage levels of variances between fiscal years in balances and line items that will require research,

- how the variances will be identified,

- who will identify the variances, and

- who will perform the research and correct any errors.

DFAS Comments: Concur. We are currently performing some of the reasonableness checks of general ledger account balances and plan to review all fixed asset balances this fiscal year. We will document and implement the revised procedures and checks in time for FY 94 closing. The revised procedures will identify the dollar and percentage levels of variances between fiscal years in balances and line items that will require research, how the variances will be identified, who will identify the variances, and who will perform the research and correct any errors. Personnel working with variances and corrections will be identified in October 1994. Estimated completion date: October 1994.

Corrective Action A-2: Implement direct, accurate, automated interfaces between all departmental source systems and the departmental general ledger.

DFAS Comments: Concur. The Funds Distribution interface has been in place for several years and is properly working. The Expenditure interface has been completely rewritten and has been partially implemented. Full field implementation is scheduled for May 1994 processing. The Status interface is currently being rewritten. Estimated completion date: October 1995.

The auditor's statement on page 12 concerning accrued military leave is incorrect. Financial data related to

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- lists, spreadsheets, system queries, adding machine tapes, and other documentation needed to support amounts on adjustment vouchers.

DFAS Comments: Concur. DFAS-IN is developing procedures that will allow for an input control team. Additionally, the procedures will provide specific instructions for personnel who prepare and approve adjustment vouchers to ensure adequate supporting documentation is attached to adjustment vouchers and that the vouchers receive adequate technical review. Estimated completion date: October 1994

Corrective Action B-2: Strengthen separation of duties by establishing an independent review and input of all status and general ledger adjustments, at a minimum, address the need to:

- enforce documentation requirements for providing evidence for adjustment vouchers, and

- ensure that adjustment vouchers receive detailed technical review.

DFAS Comments: Concur. To enhance separation of duties, DFAS-IN will remove access to the input and error screens of our accounting system for all Departmental Accounting and Reporting Branch employees for the September 1994 accounting month, except for a few designated employees. Similarly, employees of the Defense Business Operating Fund will have access to input and error screens until the eleventh workday of October 1994. After that day, only those designated employees will have access. DFAS-IN is also developing procedures that will allow for an input control team. Estimated completion date: October 1994.

Corrective Action B-3: Develop and implement detailed procedures for making adjustments to revalue Defense Business Operations Fund supply management inventories. At a minimum, the procedures should address:

- general ledger accounts that are affected, and

- specific general ledger debits and credits to be made.

DFAS Comments: Concur in principle. DFAS will work with the Army materiel management community to develop these procedures. However, in accordance with DoD guidance, procedures for making adjustments to revalue inventories are the responsibility of the supply management community and not the responsibility of the financial community. Estimated completion date: October 1994.

Corrective Action B-4: Issue detailed guidance for adjusting Defense Business Operations Fund inventory general ledger balances based on inventory reports. At a minimum, the guidance should address:

- Comparison of inventory account balances in the departmental general ledger to inventory account balances on the appropriate inventory reports,

- identification of variances,

- required research, and

- coordination with field accounting activities.

DFAS Comments: Concur in principle. This is a joint effort with the logistics community. In accordance with guidance from Deputy Chief of Staff for Logistics (DCSLOG), the current systems in the supply management business area automatically adjust the general ledger balances to agree with the inventory balances in the logistics systems. However, as this automated balancing procedure is currently unavailable in the depot maintenance business area, DFAS will issue guidance for adjusting inventory balances until an automated adjustment system is available in the depot maintenance business area. Estimated completion date: October 1995.

Corrective Action B-5: Coordinate with field accounting activities to determine the amount of uncleared expenditures that should be recorded in the Defense Business Operations Fund general ledger accounts as inventory in transit.

DFAS Comments: Nonconcur. The uncleared expenditure, also known as undistributed disbursements, in accordance with DoD guidance, should be recorded against accounts payable and not against inventory in transit until the undistributed disbursements can be properly identified.

Corrective Action B-6: Develop and implement a sequential process for organization and control of all inputs and adjustments to the departmental general ledger.

DFAS Comments: Concur. As part of the after-action process, DFAS-IN will review its current procedures for preparing the CFO financial statements. DFAS-IN recognizes the need for a more sequential process for organization and control of all inputs and adjustments to the departmental general ledger. Revised procedures will be implemented. Estimated completion date: October 1994.

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