Audit Report

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS FOR THE FY 2000 FINANCIAL STATEMENTS FOR OTHER DEFENSE ORGANIZATIONS-GENERAL FUND

Report No. D-2001-060 February 28, 2001

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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
FFMIA	Federal Financial Management Improvement Act
IG	Inspector General
OMB	Office of Management and Budget
SFFAS	Statements of Federal Financial Accounting Standards
USD(C)	Under Secretary of Defense (Comptroller)

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

February 28, 2001

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

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds (Report No. D-2001-060)

We are providing this report for your information and use. We conducted the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Although no comments were required, the Office of the Under Secretary of Defense (Comptroller) provided comments. The complete text of the comments is in the Management Comments section of the report.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Charles J. Richardson at (703) 604-9582 (DSN 664-9582) (crichardson@dodig.osd.mil) or Ms. Sandra L. Fissel at (703) 604-9485 (DSN 664-9485) (sfissel@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Thomas F. Gimble
Acting
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-060 **February 28, 2001**
(Project No. D2001FA-0016)

Internal Controls and Compliance With Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds

Executive Summary

Introduction. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare annual audited financial statements. The FY 2000 DoD Agency-wide financial statements include financial statements for a reporting entity entitled "Other Defense Organizations-General Funds." The entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol, also referred to as Department 97. (See Appendix B for a listing of Other Defense Organizations-General Funds). Other Defense Organizations-General Funds reported $42 billion in assets, $201.6 billion in liabilities, and $58.1 billion in budget authority in the FY 2000 financial statements.

Objectives. The overall audit objective was to assess internal controls and compliance with laws and regulations used for accounting, reporting, and compiling financial data to support the FY 2000 financial statements of Other Defense Organizations-General Funds. In a future report, we will report on the adequacy of the procedures used to compile and make adjustments to the FY 2000 financial statements of Other Defense Organizations.

Review of Internal Controls. Overall, internal controls were inadequate. We identified inadequate controls related to the existence and quality of written procedures; budgetary reporting; trial balance reporting; preparation of the Military Retirement Health Benefits Liability estimate; and reporting of Department 97-funded Property, Plant, and Equipment. Our consideration of internal controls would not necessarily disclose all reportable conditions and would not necessarily disclose all reportable conditions that are material weaknesses.

Controls over the process used to compile the Reports on Budget Execution did not provide reasonable assurance that the reports were accurate and reliable. The Reports on Budget Execution, as compiled by the Defense Finance and Accounting Service Indianapolis (Sustaining Forces), included $2.6 billion of net abnormal balances for open appropriations and $95.3 million of net abnormal balances for appropriation accounts scheduled to close at the end of FY 2000. The Reports on Budget Execution contained unreconciled differences with U.S. Treasury Records of $5.8 billion for disbursements and $1.9 billion for collections.

Controls over the process used to prepare trial balances for inclusion in the financial statements did not provide reasonable assurance that the trial balances were accurate and reliable. The Defense Finance and Accounting Service Indianapolis (Sustaining Forces) used data from Reports on Budget Execution to manually create partial trial

balances for 16 sub-entities contained within 2 of the 51 Other Defense Organizations. The FY 2000 year-end trial balances included $3.9 billion of net abnormal balances. Additionally, the FY 2000 year-end trial balances and Reports on Budget Execution differed by $89.5 billion when reporting similar financial data.

In addition, controls over reporting the Military Retirement Health Benefits Liability and the Property, Plant, and Equipment did not ensure that amounts supplied to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) were accurate and reliable.

Review of Compliance With Laws and Regulations. We identified instances of noncompliance with laws and regulations related to the Federal Financial Management Improvement Act of 1996; section 3512, title 31, United States Code; and the Chief Financial Officers Act of 1990, and laws governing the claims of the United States government. Our limited review of the compliance with laws and regulations was performed in compliance with Office of Management and Budget Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000, and did not necessarily disclose all instances of potential noncompliance with laws and regulations that may be considered material to the financial statements for the Other Defense Organizations-General Funds reporting entity.

Management Comments. We provided a draft of this report on February 7, 2001. Although no comments were required, the Deputy Chief Financial Officer provided comments questioning citations and technical interpretations, and suggested omitting sections of the report on the internal controls components and the consistency of trial balances and Reports on Budget Execution.

Audit Response. Generally, we do not agree with the management comments on citations. For clarification of technical interpretations, we made minor word modifications to, but did not remove, sections of the report.

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Background

Reporting Requirements. Public Law 101-576, the "Chief Financial Officers [CFO] Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director, Office of Management and Budget (OMB), to prepare Government-wide financial statements. The Inspector General (IG), DoD, is not required to render a separate opinion on the financial statements for Other Defense Organizations. Information from audits of the financial statements of Other Defense Organizations contributed to the disclaimer of audit opinion on the DoD Agency-wide financial statements for FY 2000.

Other Defense Organizations. The entity "Other Defense Organizations" represents a consolidation of financial information from 51 Defense organizations and funds that use the Treasury Index 97 symbol. The DoD Agency-wide consolidated financial statements include two columns for Other Defense Organizations: an Other Defense Organizations-Working Capital Funds column that includes the financial activity of working capital funds not connected with the Military Departments, and an Other Defense Organizations-General Funds column that includes the financial activity of all remaining organizations and funds using the Treasury Index 97 symbol. This audit focused on Other Defense Organizations-General Funds, which reported $58.1 billion in budget authority in the FY 2000 financial statements. (Later references to Other Defense Organizations in this report will generally refer to the Other Defense Organizations-General Funds reporting entity.) Appendix B provides a list of the 51 Other Defense Organizations-General Funds for FY 2000.

Accounting Functions and Responsibilities. During FY 2000, Defense Finance and Accounting Service (DFAS) accounting offices provided accounting support for all Defense organizations that use Treasury Index 97 funds, except for the following:

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

Compilation Responsibilities. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 6B, "Form and Content of the Department of Defense Financial Statements," chapter 2, "General Instructions for the Financial Statements," October 2000, requires DFAS, in coordination with DoD Components, to prepare financial statements. Beginning in FY 1996, DFAS

Indianapolis (Sustaining Forces), was responsible for preparing the financial statements for Treasury Index 97 funds. Other Defense Organizations use the same DoD form and content guidance as the Military Departments.

The General Fund Branch[1] at DFAS Indianapolis (Sustaining Forces) received budgetary information from accounting offices and prepared required Reports on Budget Execution for submission to the Under Secretary of Defense (Comptroller) and the OMB. The General Fund Branch forwarded those Reports on Budget Execution to the Other Defense Organizations Audited Financial Statements Team,[2] hereafter referred to as the Audited Financial Statements Team, also located at DFAS Indianapolis (Sustaining Forces). The Audited Financial Statements Team used the Reports on Budget Execution, along with trial balances received from supporting accounting offices, to prepare financial statements required by the CFO Act.

Objective

The overall audit objective was to assess internal controls and compliance with laws and regulations used for accounting, reporting, and compiling financial data to support the FY 2000 financial statements of Other Defense Organizations-General Funds.

In a future report, we will evaluate the procedures used to compile and make adjustments to the FY 2000 financial statements of Other Defense Organizations. Appendix A discusses audit scope, methodology, and prior coverage; Appendix B lists the DoD organizations and funds that comprise the Other Defense Organizations-General Funds for FY 2000; and Appendix C lists the laws and regulations reviewed.

[1]The General Fund Branch was previously known as the Defense Agency Team.

[2]The Other Defense Organizations Audited Financial Statements Team is a new DFAS team formed during FY 2000 and is dedicated to preparing financial statements for the Other Defense Organizations.

Review of Internal Controls

Overview of Material Weaknesses

Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and to ensure reliable and accurate financial information for use in managing and evaluating operational performance. A material weakness is a reportable condition in which the design or operation of the internal controls does not reduce to a relatively low level the risk that error or irregularities could occur. Such errors or irregularities would be in amounts that would be material to the statements being audited and would not be detected in a timely manner by employees in the normal course of performing their functions.

We performed applicable tests of the internal controls to determine whether the controls were effective and working as designed. We identified inadequate controls related to the existence and quality of written procedures; budgetary reporting; trial balance reporting; preparation of the Military Retirement Health Benefits Liability estimate; and reporting of Department 97-funded Property, Plant, and Equipment. Our consideration of internal controls would not necessarily disclose all reportable conditions and would not necessarily disclose all reportable conditions that are material weaknesses.

Internal Control Components

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, implement section 3512, title 31, United States Code, which requires management to establish and maintain a comprehensive management control system, including internal controls, and to monitor and report on the system. Statement on Auditing Standards No. 78, "Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55," defines internal controls as a process performed by management or other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Statement on Auditing Standards No. 78 states that the internal control structure consists of the five interrelated components listed in Figure 1.

Figure 1. Five Elements of Internal Control Structure

Control Environment

The control environment includes factors that set the tone of an organization, influencing the control consciousness of its employees. The control environment includes several organizational factors, such as management's philosophy and commitment to competence. Although DoD is making progress in developing written procedures, audits continue to identify many opportunities for accounting offices to improve the control environment by developing and improving standard operating procedures.

Improvements in the Control Environment. DFAS Indianapolis (Sustaining Forces) took action to improve the controls over the process used to compile the financial statements prepared for the Other Defense Organizations by preparing a Journal Voucher Manual and documenting the consolidation and compilation processes.

Journal Voucher Manual. During FY 2000 the Audited Financial Statements Teams formed the Journal Voucher Working Group, with advisory members from the IG, DoD, and prepared the Recurring Journal Voucher Handbook, August 24, 2000. The handbook includes detailed written explanations to support 33 journal vouchers which the Audited Financial

Statements Teams routinely prepare when compiling the annual financial statements for the Army General Fund, Army Working Capital Fund, and Other Defense Organizations-General Funds.

Documentation of Consolidation and Compilation Processes. During the FY 2000 compilation cycle, the Audited Financial Statements Team initiated a systematic process of documenting each step in the consolidation and compilation processes. The documentation effort is ongoing and the team intends to complete a set of formal procedures after the compilation cycle concludes.

Deficiencies in the Control Environment. During FY 2000, audits identified multiple control deficiencies related to inadequate written procedures at accounting offices that perform accounting for the Other Defense Organizations, including those accounting offices shown in Table 1.

Table 1. Accounting Offices With Deficient Written Procedures*

	Accounting Offices			
Area of Control Deficiency	Defense Agency Financial Services Accounting Office	Washington Headquarters Services	DFAS Cleveland	DFAS St. Louis Operating Site
Trial balance reviews	√	√		
System instructions		√		
Review of undistributed disbursements			√	
Reporting property, plant, & equipment				√

*Areas without a checkmark indicate that the control area was not reviewed at the specific accounting office.

Defense Agency Financial Services Accounting Office. The Defense Agency Financial Services Accounting Office, an accounting office within DFAS Indianapolis (Sustaining Forces) which provided accounting support for 18 Other Defense Organizations in FY 2000, had a written procedure requiring accountants to review trial balances for abnormal balances. However, as written, the procedure did not provide detailed instructions for performing the review and was never fully implemented.

Washington Headquarters Services. The Washington Headquarters Services did not have written procedures requiring accountants to review trial balances and instructing accountants how to perform reviews. Further, as the owner and system support office for the Washington Headquarters Services Allotment Accounting System, which provides accounting support to multiple Defense organizations, Washington Headquarters Services published a design manual and a user's manual to assist users in operating the system. Neither manual provided adequate instructions so that accounting personnel could research, review, and correct trial balances produced by the accounting system.

DFAS Cleveland. DFAS Cleveland prepared quarterly trial balances for Department 97 funds allocated to the Navy but did not have procedures to research and resolve undistributed disbursements that contributed to abnormal balances of $711 million on the Department 97 trial balances.

DFAS St. Louis. DFAS St. Louis, one of many accounting offices responsible for reporting Property, Plant, and Equipment purchased with Department 97 funds, did not have standard operating procedures for reporting Property, Plant, and Equipment.

Risk Assessment

For financial reporting purposes, an entity's risk assessment is its identification, analysis, and management of risks relevant to the preparation of financial statements. The DFAS Indianapolis (Sustaining Forces) FY 2000 Federal Managers Financial Integrity Act Annual Statement of Assurance identified the following categories of material control weaknesses, which have a high risk of contributing errors to the financial statements prepared for the Other Defense Organizations:

- problem disbursements, and
- reconciliation of suspense accounts.

Problem Disbursements. When properly recorded in the accounting records, disbursements should liquidate obligations and accounts payable; however, DFAS Indianapolis (Sustaining Forces) acknowledged the existence of problem disbursements. Problem disbursements are grouped into the three categories shown in Table 2.

Table 2. Categories and Definitions of Problem Disbursements	
Category of Disbursements	Definition
In-transit	Disbursements paid by a disbursing office, but not yet received by the accounting station.
Unmatched	Disbursements paid by a disbursing office, but not yet matched to an obligation.
Negative unliquidated obligation	Disbursements paid by a disbursing office and, when applied to specific obligations, exceed the recorded obligation amounts.

Until corrected, problem disbursements continue to impair the reliability of balances reported for obligations and accounts payable.

Reconciliation of Suspense Accounts. DFAS Indianapolis (Sustaining Forces) uses suspense accounts, such as the Budget Clearing Account (Treasury symbol 3875), Deposits in Transit (Treasury symbol 3878), and Undistributed Intragovernmental Payments (Treasury symbol 3885), to record transactions awaiting research, correction, and reconciliation. The transactions in the suspense accounts, until fully resolved, pose a control risk to the balances on the financial statement.

Control Activities and Information and Communication

Control activities are the various policies and procedures that help ensure that the necessary actions are taken to address risks and to achieve the entity's objectives. The information system relevant to financial reporting objectives, which includes the accounting system, consists of the methods and records established to do the following:

- record, process, summarize, and report entity transactions, and
- maintain accountability of the related assets and liabilities.

Communication involves providing an understanding of individual roles and responsibilities for internal control over financial reporting. To be effective, the information and communication systems must identify and record all valid transactions on a timely basis; properly measure the value and record transactions in the proper time period; properly present and disclose transactions; and communicate responsibilities to employees.

Controls Over Budgetary Reporting. Controls used to compile departmental Reports on Budget Execution did not provide reasonable assurance that the information on those reports was accurate and reliable. Because the Audited

Financial Statements Team used data from the Reports on Budget Execution to prepare the financial statements, the reliability of the Reports on Budget Execution was essential. Figure 2 illustrates the flow of budgetary data from the Reports on Budget Execution to the financial statements.

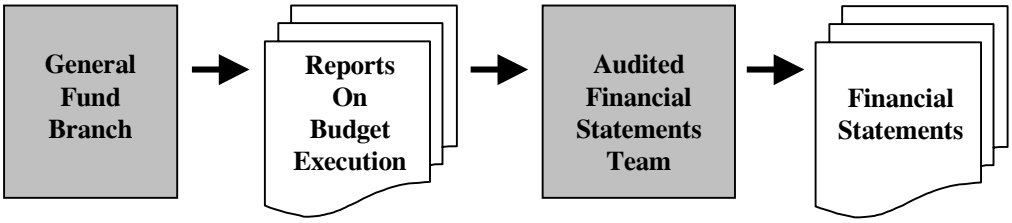

Figure 2. Flow of Budgetary Data to Financial Statements

Abnormal Balances on the Reports on Budget Execution for Open Appropriations. For the Other Defense Organizations open appropriation accounts, the General Fund Branch at DFAS Indianapolis (Sustaining Forces), prepared Reports on Budget Execution at the end of FY 2000 that contained $2.6 billion of net abnormal balances on 10 different lines. Of the $2.6 billion, at least $2.5 billion was not explained in required footnotes. The aggregated net abnormal balances for 2 of the 10 lines were material to the Other Defense Organizations financial statements:

- "Spending Authority From Offsetting Collections, Earned: Receivable from Federal Sources" (line 3A2) reported $1.9 billion, and

- "Obligated Balance, Net as of October 1" (line 12) reported $317 million.

The Audited Financial Statements Team used data from the Reports on Budget Execution prepared for open appropriations to compile the Statement of Budgetary Resources and Statement of Financing.

Abnormal Balances for Appropriation Accounts Scheduled to Close. Fifteen of the Other Defense Organizations appropriation accounts that were scheduled to close[3] in FY 2000 reported $95.3 million of abnormal balances in accounts payable. The existence of abnormal balances at the time an appropriation account is scheduled to close is indicative of control deficiencies in the procedures[4] for reviewing, reconciling, and managing accounts payable. Additionally, accounts payable for closed appropriation accounts are required to

[3]For fixed appropriations, section 1552, title 31, United States Code, requires that the "appropriation account" be closed on September 30 of the 5th fiscal year after the period of availability for obligation.

[4]DoD Regulation 7000.14-R, DoD Financial Management Regulation, volume 4, chapter 9, "Accounts Payable," requires DoD entities to annually reconcile reported accounts payable to supporting documentation, research differences, and fully document necessary adjustments.

be reported as a current liability on the Balance Sheet under "Other Liabilities;" therefore, the control deficiencies related to accounts payable for closed appropriation accounts impaired the reliability of the Balance Sheet.

Differences Between Reports on Budget Execution and U.S. Treasury Records. The Reports on Budget Execution prepared by the General Fund Branch contained unreconciled differences with U.S. Treasury records of $5.8 billion for disbursements and $1.9 billion for collections. DFAS Indianapolis (Sustaining Forces) was unable to reconcile the differences between budgetary data received from accounting offices and the data received from disbursing stations, as required by the Department of the Treasury.[5] To accomplish a full reconciliation, DFAS Indianapolis (Sustaining Forces) is implementing the Defense Cash Accountability System and the Cash Management Report process.

Defense Cash Accountability System. The Defense Cash Accountability System is a DoD-wide cash accountability system designed to standardize expenditure reporting and electronically transfer expenditure transactions from disbursing stations directly to accounting stations. DFAS is implementing the system incrementally and anticipates full implementation in FY 2005. If successfully implemented, the Defense Cash Accountability System should help to mitigate the Other Defense Organizations problems with undistributed[6] disbursements and collections.

Cash Management Report. The Cash Management Report is a reporting process that DFAS Indianapolis (Sustaining Forces) created to provide accounting offices with the necessary information to fully account for their portion of undistributed cash balances. DFAS Indianapolis (Sustaining Forces) attempted to implement the Cash Management Report process during FY 2000 but was not successful and had to suspend the program. DFAS Indianapolis (Sustaining Forces) intends to resume full use of the Cash Management Report during FY 2001.

Controls Over Trial Balance Reporting. The Audited Financial Statements Team primarily uses trial balances to prepare the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position. Therefore, the quality of the trial balances directly impacts the quality of the financial statements. Major control weaknesses are described below; however, specific details describing the extent and nature of the deficiencies and the actions taken by DFAS Indianapolis (Sustaining Forces) will be described in a subsequent audit report addressing the consolidation and compilation processes.

Manually Created Trial Balances. Because accounting offices supporting the Other Defense Organizations do not submit trial balances for all of the Other Defense Organizations entities and sub-entities, the Audited Financial Statements Team used data from the Reports on Budget Execution to

[5]Treasury Financial Manual, volume 1, part 2, chapter 5100, "Reconciling Fund Balance With Treasury Accounts," October 1999, requires Federal agencies to reconcile the Fund Balance With Treasury account in the general ledger to the disbursing data prepared by disbursing stations.

[6]"Undistributed" disbursements and collections are the amounts resulting from the differences between the respective amounts reported to the U.S. Treasury by disbursing stations and the respective amounts reported to DFAS by the accounting offices.

manually create 53 trial balances for 16 entities and sub-entities. The manually created trial balances were not complete because Reports on Budget Execution do not contain financial data for the entire scope of an entity's operations, such as accrued annual leave expenses; property, plant, and equipment; and related depreciation. Additionally, amounts reported for accounts payable and accounts receivable are not reported in separate intragovernmental and public categories, as required for the financial statements. The combined balances for the manually created trial balances were material to the financial statements of the Other Defense Organizations. For example, the combined balances for Appropriated Capital and Fund Balance With Treasury totaled $457 million and $445 million, respectively.

Abnormal Balances. The FY 2000 year-end trial balances used by the Audited Financial Statements Team to prepare the financial statements for the Other Defense Organizations included $3.9 billion of net abnormal balances. Net abnormal balances ordinarily indicate that control weaknesses existed in the processes accounting offices used to prepare the trial balances. During FY 2000, the IG, DoD, audited mid-year trial balances for two accounting offices and identified the control deficiencies listed in Table 3.

Table 3. Control Deficiencies Contributing to Net Abnormal Account Balances on Mid-Year Trial Balances

Control Deficiency	Defense Agency Financial Services Accounting Office	Washington Headquarters Services Accounting Office
Ending balances from one fiscal year were not transferred as the beginning balances of the next fiscal year.	N/A	√
Accruals and corresponding disbursements were not both recorded as either Government or non-Government transactions.	√	√
Accrual adjustments affecting prior periods were not posted to the correct general ledger account in the current year.	√	√

Both accounting offices took corrective action, reduced abnormal balances on the FY 2000 year-end trial balances, and anticipate fully implementing remedies to correct the control deficiencies during FY 2001.

Consistency of Trial Balances and Reports on Budget Execution. The FY 2000 year-end trial balances and Reports on Budget Execution supplied to the Audited Financial Statements Team contained unreconciled differences of $89.5 billion for categories of similar financial data, such as:

- fund balance with the U.S. Treasury,
- accounts payable,
- accounts receivable, and
- appropriated capital.

The differences should have been reconciled. DFAS Indianapolis (Sustaining Forces) did not have procedures in place to reconcile the differences between the two sets of data and attributed the differences to the lack of complete general ledger based systems supporting the Other Defense Organizations.

Quality of Other Data Included in the Financial Statements. In addition to the Reports on Budget Execution and trial balances, the Audited Financial Statements Team compiled the financial statements using data supplied by various sources. IG, DoD, audits have identified control deficiencies related to the quality of data used to calculate the Military Retirement Health Benefits Liability estimate and the processes for reporting Department 97-funded property, plant, and equipment.

Monitoring

Monitoring assesses the quality of internal control performance over time and involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. Monitoring activities are accomplished through ongoing activities, separate evaluations, or a combination of the two.

For FY 2000, the DFAS Indianapolis (Sustaining Forces) Project Assessment Team continued to monitor and track financial reporting deficiencies and corrective actions taken. The Project Assessment Team used a tracking document known as the "DFAS Indianapolis (Sustaining Forces) Implementation Strategies for Other Defense Organizations-General Fund." The team included representatives from each working group within DFAS Indianapolis (Sustaining Forces) responsible for initiating corrective actions, along with representatives from the IG, DoD. The Project Assessment Team continues to be an active and useful mechanism for monitoring the quality of the internal controls over financial reporting procedures at DFAS Indianapolis (Sustaining Forces).

Management Comments on the Finding and Audit Response

Although not required to comment, the Under Secretary of Defense (Comptroller) [(USD(C)] provided the following comments on the finding. For the full text of the USD(C) comments, see the Management Comments section of the report.

USD(C) Comments. The Deputy CFO stated that for the finding section titled "Internal Control Components," the report cites an incorrect reference. The Deputy CFO stated that OMB Circular A-127, "Financial Management Systems," is the correct reference for this section of the finding because it incorporates the Joint Financial Management Improvement Program (JFMIP) systems concepts and requirements. As such, the DFAS centers and the Washington Headquarters Services should not be cited for not meeting the "Control Environment" requirement since no such requirement exists in the OMB circular and the JFMIP Core Financial Systems Requirements.

Audit Response. The Inspector General, DoD, is required to audit according to the Government Auditing Standards and, by extension, the Statements on Auditing Standards. In accordance with these standards, we evaluated the DoD internal control structure using the five elements in Statement on Auditing Standards No. 78, "Consideration of Internal Control in a Financial Statement Audit: An Amendment of Statement on Auditing Standards No. 55."

USD(C) Comments. The Deputy CFO stated that in the finding section titled "Abnormal Balances for Closed Appropriations," the report uses the wrong term. He stated that according to OMB Circular A-34, "Report on Budget Execution and Budgetary Resources," technically, accounts are "closed," while appropriations and balances are "canceled."

Audit Response. We agree and modified the title of the section and the report to state "appropriation account," the exact term described in Section 3512, title 31, United States Code.

USD(C) Comments. The Deputy CFO stated that in the finding section titled "Differences Between Reports on Budget Execution and U.S. Treasury Records," the report cites an incorrect reference. He stated that the correct reference is OMB Circular A-34, "Report on Budget Execution and Budgetary Resources."

Audit Response. The citation in the report is correct. The Treasury Financial Manual, volume 1, part 2, chapter 5100, "Reconciling Fund Balance with Treasury Accounts," was released in Treasury Transmittal Letter No. 588, "Heads of Government Departments, Agencies, and Others Concerned, October 18, 1999. The Treasury Financial Manual provides specific guidance on the detailed reconciliations that agencies should perform between expenditure records provided to U.S. Treasury and accounting records maintained by the agency. The inability of DoD to fully implement the required reconciliations contributed to the unreconciled discrepancies between the Other Defense Organizations Reports on Budget Execution and the U.S. Treasury records.

USD(C) Comments. The Deputy CFO stated that in the finding section titled "Consistency of Trial Balances and Reports on Budget Execution," the report is incorrect and the entire paragraph should be deleted. The Deputy CFO stated that the general ledger balances cited in the audit report should not be reported consistently based on OMB form and content instructions (the management side) or OMB Circular No. A-34, instruction for the preparation of the SF-133, "Report on Budget Execution and Budgetary Resources," (the budget side).

Audit Response. We modified the report to add clarification. An agency reports data that are common to both the trial balances and Reports on Budget Execution. These sets of records should report data consistently and where differences exist, the records should be reconciled to ensure that the differences are legitimate.

Review of Compliance With Laws and Regulations

Reportable Noncompliance

Reportable instances of noncompliance are failures to follow requirements, laws, or regulations that cause us to conclude that the aggregation of the misstatements resulting from those problems is either material to the financial statements, or that the sensitivity of the matter would cause others to perceive it as significant.

Our objective was to assess the compliance with laws and regulations related to the FY 2000 financial statements for Other Defense Organizations, and not to express an opinion. We performed our review in accordance with OMB Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000. Our review of DFAS Indianapolis (Sustaining Forces) identified noncompliance issues related to the Federal Financial Management Improvement Act of 1996 (FFMIA); section 3512, title 31, United States Code; and the CFO Act of 1990, and laws governing the claims of the United States government. Our limited review of the compliance with laws and regulations did not necessarily disclose all instances of potential noncompliance with laws and regulations that may be considered material to the financial statements for the Other Defense Organizations-General Funds reporting entity. (Appendix C shows laws and regulations reviewed.)

Federal Financial Management Improvement Act of 1996

The FFMIA requires us to report whether the agency's financial management systems substantially comply with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. We performed our review on compliance with FFMIA in accordance with OMB Memorandum, "Revised Implementation Guidance for the Federal Financial Management Improvement Act," January 4, 2001.

Federal Financial Management System Requirements. Federal financial management system requirements were established in OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, which requires financial management systems to provide complete, reliable, consistent, timely, and useful information. The Joint Financial Management Improvement Program has published a series of Federal Financial Management System Requirements that establishes standard requirements for Federal agencies' integrated financial management systems.

DoD-Wide Systems. The Department of Defense Financial Management Improvement Plan, September 2000, acknowledges that the

majority of the DoD-wide critical finance and accounting systems are not compliant with Federal financial management systems requirements and accounting standards. Because a large portion of Department 97 funds are allocated to the Military Departments, many of the DoD-wide systems support financial reporting for Department 97, and the deficiencies associated with those DoD-wide systems affect the quality of the Other Defense Organizations financial statements.

DFAS Indianapolis (Sustaining Forces) Systems. Although the FFMIA requires each agency to implement and maintain integrated financial management systems, DFAS Indianapolis (Sustaining Forces) did not employ an integrated financial management system for departmental financial reporting. For example, DFAS Indianapolis (Sustaining Forces) used the Program Budget Accounting System to account for funding; the "TI [Treasury Index] 97 Application" to prepare Reports on Budget Execution; miscellaneous systems to report on expenditures; and an entirely separate set of systems for compilation.

Federal Accounting Standards. Federal agencies reporting under the Government Management Reform Act of 1994 are required to follow the Statements of Federal Financial Accounting Standards (SFFAS) agreed to by the Director, OMB; the Comptroller General of the United States; and the Secretary of the Treasury. Several examples of non-compliance are described below.

Fund Balance With Treasury. The DFAS Indianapolis (Sustaining Forces) could not reconcile differences of $5.8 billion for disbursements and $1.9 billion for collections between the Reports on Budget Execution and the U.S. Treasury Records because the financial statements are not in compliance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993. When reporting Fund Balance With Treasury, SFFAS No. 1 requires Federal entities to explain discrepancies between the entity's records; reconcile discrepancies resulting from time lag; and correct discrepancies resulting from error.

Reliability of Financial Reports. The DFAS Indianapolis (Sustaining Forces) could not reconcile $89.5 billion of differences between the trial balances and Reports on Budget Execution because the financial reporting process and financial statements did not comply with Statement of Federal Financial Accounting Concepts No. 1, chapter 6, "Qualitative Characteristics of Information in Financial Reports," September 2, 1993. Concept No. 1 establishes the following six objectives for financial reporting: understandability, reliability, relevance, timeliness, consistency, and comparability. Until the material differences between the trial balances and Reports on Budget Execution are reconciled, the financial statements will not meet the objective of being reliable.

U.S. Government Standard General Ledger. The OMB requires Federal agencies to implement the U.S. Government Standard General Ledger in their financial systems at the transaction level. Federal agencies are permitted to supplement their application of the U.S. Government Standard General Ledger to meet agency-specific information requirements, but those general ledgers must maintain consistency with the U.S. Government Standard General Ledger. The accounting offices supporting the Other Defense Organizations continue to

use multiple general ledgers and, as shown previously in this report, material portions

of the financial statements, including $445 million in Fund Balance With Treasury, were prepared from Reports on Budget Execution, rather than from standard general ledgers.

Section 3512, Title 31, United States Code

The evaluation and reporting requirements of the Federal Managers' Financial Integrity Act of 1982 for an agency's internal accounting and administrative control systems were incorporated in section 3512, title 31, United States Code (31 U.S.C. 3512). That section requires DoD to evaluate the systems and to annually report whether those systems are in compliance with 31 U.S.C. 3512.

DFAS FY 2000 Statement of Assurance. In FY 2000, DFAS reported material internal control weaknesses involving noncompliance with accounting principles, standards, and other requirements. Specifically, DFAS reported 35 open material weaknesses in its FY 2000 Annual Statement of Assurance. Of the 35 weaknesses, 17 weaknesses directly affected the accounting data that DFAS Indianapolis (Sustaining Forces) used to prepare the FY 2000 financial statements of Other Defense Organizations and the FY 2000 DoD Agency-wide financial statements. The weaknesses, according to the DFAS FY 2000 Annual Statement of Assurance, included the following topics:

- general ledger control and financial reporting,
- abnormal departmental report balances,
- accounting system compliance,
- fund balance with the U.S. Treasury,
- system interfaces and system access,
- controls over travel payments, and
- expenditure authority for foreign military sales disbursements.

Department of Defense Financial and Feeder Systems Compliance Process. In January 2001, the Under Secretary of Defense (Comptroller) formally implemented the Department of Defense Financial and Feeder Systems Compliance Process, hereafter referred to as the compliance process, and established the Senior Financial Management Oversight Council to oversee the process. The purpose of the compliance process is to ensure that all critical accounting, finance, and feeder systems[7] are compliant with Federal financial management systems requirements. If the compliance process functions as

[7]Program feeder systems are automated or manual information systems operated by the Military Departments and the Defense agencies, which contain day-to-day operating information that require translation into financial information which is then processed in the finance and accounting systems.

intended, DoD should make progress on resolving open material weaknesses and improving the quality of financial management systems.

Chief Financial Officers Act of 1990

The CFO Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare audited financial statements and to submit them to OMB no later than March 1 of each year. In the DoD Financial Management Improvement Plan, September 2000, DoD management acknowledged that major financial reporting deficiencies contributed to DoD not receiving an audit opinion and presented implementation strategies focused on correcting deficiencies in the following areas:

- inventory;
- property, plant, and equipment;
- future liabilities;
- U.S. Treasury fund balances; and
- intragovernmental eliminations.

DoD acknowledged that many accounting systems and feeder systems were not compliant with established regulatory requirements or had not been reviewed. Until DoD corrects ongoing deficiencies and develops fully compliant systems, financial reporting for the Other Defense Organizations will contribute to the Defense Agency-wide financial statements not receiving a favorable audit opinion.

Provisions Governing Claims of the United States Government

Public Law 89-508, "Federal Claims Collection Act of 1966," (codified as 31 USC 3711(a)(1)) requires DoD to attempt to collect all claims of the United States for money or property arising out of DoD activities or activities referred to DoD. Public Law 97-365, "Debt Collection Act of 1982," (codified as 31 USC 3716 and 3717) allows DoD to collect a claim by means of administrative offset within 10 years, to charge a minimum annual rate of interest on outstanding debts, and to assess charges to cover the costs of processing and handling delinquent claims. Additionally, Public Law 104-134, "Debt Collection Improvement Act of 1996," (codified as 31 USC 3711(g)(1)(A)) requires DoD to transfer to the Treasury Department any debts delinquent for at least 180 days. The Treasury Department is then responsible to either take action to collect the debt or to terminate collection actions on the debt or claim.

During FY 2000, DoD had 204 open debts totaling $47.2 million with 37 large DoD contractors, some of which have remained open since the mid-1980s. Specifically, 29 claims for $8.6 million were apparently invalid, and the collection period had apparently lapsed for 9 claims valued at $0.4 million.

Debts remained open for these DoD contractors because DoD did not identify all debts in a timely manner and did not actively work to collect or resolve these debts. As a result, DoD had not collected $38.2 million in contractor debt. These claims included an undetermined number of contracts funded with Department 97 funds.

Appendix A. Audit Process

Scope

Financial Information, Procedures, and Controls Reviewed. We are not expressing an opinion on the FY 2000 financial statements for Other Defense Organizations. Our audit was designed to support the FY 2000 DoD Agency-wide financial statements, and we focused on Other Defense Organizations-General Funds. We reviewed the Reports on Budget Execution, and we specifically looked at abnormal balances, differences between the Reports on Budget Execution and U.S. Treasury Records, and differences between the Reports on Budget Execution and trial balances. We also reviewed data supporting the Balance Sheet, the Statement of Net Cost, the Statement of Net Position, the Statement of Budgetary Resources, the Statement of Financing, and notes to the financial statements. We reviewed the procedures and controls to accumulate financial data; produce appropriation-level reports submitted to the OMB, the Under Secretary of Defense (Comptroller), and DFAS; and to prepare the financial statements. We also reviewed the FY 2000 DoD Financial Management Improvement Plan, the DFAS Arlington and DFAS Indianapolis (Sustaining Forces) FY 2000 Annual Statements of Assurance, and prior audit reports. In a later audit, we plan to evaluate specific procedures that DFAS used to compile and report on the FY 2000 financial statements for Other Defense Organizations. We did not review supporting financial data and financial reports related to the Other Defense Organizations-Working Capital Funds.

Accounting Principles. Accounting principles and standards for the Federal Government have been issued and are undergoing further development and refinement. The Federal Accounting Standards Advisory Board was established by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. On October 19, 1999, the American Institute of Certified Public Accountants recognized the Federal Accounting Standards Advisory Board as the body to establish generally accepted accounting principles for Federal governmental entities. Therefore, Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board are recognized as generally accepted accounting principles for applicable Federal governmental entities.

Agencies are required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended on September 11, 2000. The hierarchy is as follows:

- standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States;

- interpretations of the Statements of Federal Financial Accounting Standards issued by OMB;

- requirements for the form and content of financial statements outlined in OMB Bulletin No. 97-01; and

- accounting principles published by other authoritative sources.

DoD-Wide Corporate–Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**

- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**

- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and financial systems. **(01-DoD-2.5.1)**

- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Objectives and Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

- **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the DoD Financial Management high-risk area.

Methodology

Auditing Standards. This audit was performed in accordance with auditing standards issued by the Comptroller General of the United States and OMB, as implemented by the IG, DoD, based on the objectives of the audit and the limitations to the scope described in the report. Accordingly, we included such tests of internal controls as we considered necessary.

Computer-Processed Data. We used computer-processed data in this audit; however, we did not confirm the reliability of the data because the accounting systems used to prepare the financial statements for Other Defense Organizations had serious limitations. The lack of reliable financial information was described as a material management control deficiency in the DFAS Annual Statements of Assurance for FY 2000. The lack of reliable information did not adversely affect our analysis.

Audit Period and Location. We performed this financial-related audit from October 2000 through February 2001 at DFAS Indianapolis (Sustaining Forces).

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

Prior Coverage

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

Appendix B. Other Defense Organizations-General Funds

The list of 51 Other Defense Organizations-General Funds for FY 2000 compiled in this appendix includes trust funds and revolving funds not included in Treasury basic symbol 4930, Defense Business Operation Funds (known as "Defense Working Capital Fund"). DoD Regulation 7000.14-R, "DoD Financial Management Regulation," volume 6B, chapter 2, "General Instructions for the Financial Statements," October 2000, identifies most of the Other Defense Organizations. Additional Other Defense Organizations funded with Department 97 funds, but not listed in the DoD Regulation 7000.14-R, are included in the list below and distinguished by footnotes.

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

Defense Commissary Agency
Defense Contract Audit Agency
Defense Contract Management Agency
Defense Emergency Response Fund
Defense Finance and Accounting Service

Defense Health Program
Defense Homeowners Assistance Fund
Defense Information Systems Agency
Defense Intelligence Agency
Defense Legal Services Agency

Defense Logistics Agency
Defense Manpower Data Center Facility[1]
Defense Medical Program Activity
Defense Prisoner of War/Missing Persons Office
Defense Security Cooperation Agency

Defense Security Service
Defense Threat Reduction Agency
DoD Component Level Accounts
DoD Education Activity
DoD Education Benefits Fund

[1]This Department 97-funded organization is not listed in DoD Regulation 7000.14-R.

DoD Human Resources Activity
Federal Energy Management Program
Foreign National Employees Separation Pay Accounts Trust Fund[2]
Joint Chiefs of Staff
Joint Logistics Systems Command

National Defense Stockpile Transaction Fund
National Imagery and Mapping Agency
National Security Agency
National Security Education Trust Fund
Office of Economic Adjustment

Office of the Inspector General, DoD
Office of the Secretary of Defense (OSD)[3]
Other Prior Year Residual "97" Funds
Other "97" Funds Provided to the Air Force by OSD
Other "97" Funds Provided to the Army by OSD

Other "97" Funds Provided to the Navy by OSD
Other "97" Funds Provided to Washington Headquarters Services by OSD
Pentagon Reservation Maintenance Revolving Fund
Ready Reserve Mobilization Income Insurance Fund
Technical Research Institute

Tricare Management Activity
U.S. Court of Appeals of the Armed Forces
U.S. Special Operations Command
Uniformed Services University of the Health Sciences[2]
Voluntary Separation Incentive Trust Fund

Washington Headquarters Services

[2]This Department 97-funded organization is not listed in DoD Regulation 7000.14-R.

[3]"OSD" is the acronym for Office of the Secretary of Defense.

Appendix C. Laws and Regulations

Anti-deficiency Act (sections 1341(a)(1)(A) and (C), and section 1517(a), title 31, United States Code).

Pay and Allowance System for Civilian Requirements (sections 5332 and 5343, title 5, United States Code; and section 206, title 29, United States Code).*

Public Law 104-208, "Federal Financial Management Improvement Act of 1996," September 30, 1996.

Public Law 104-134, "Debt Collection Improvement Act of 1966," April 26, 1996, (section 3711(g)(1)(A), title 31, United States Code).

Public Law 103-356, "Federal Financial Management Act of 1994," October 13, 1994 (section 65, title 31, United States Code).

Public Law 101-576, "Chief Financial Officers Act of 1990," November 15, 1990 (section 501, title 31, United States Code).

Public Law 101-508, "Federal Credit Reform Act of 1990," November 5, 1990, (section 661(b) and (e), title 2, United States Code).

Public Law 97-365, "Debt Collection Act of 1982," October 25, 1982, (sections 3701(a)(1), 3716, 3717, title 31, United States Code).

Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982," September 8, 1982 (section 3512, title 31, United States Code).

Public Law 97-177, "Prompt Payment Act," May 21, 1982, (sections 3901(a), (b), and (f), and 3904, title 31, United States Code).*

Public Law 89-508, "Federal Claims Collection Act of 1966," July 19, 1966, (section 3711(a)(1), title 31, United States Code).

OMB Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000.

OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended September 11, 2000.

OMB Circular No. A-34, "Instructions on Budget Execution," December 1995, revised November 7, 1997.

*The scope of the audit primarily addressed control deficiencies identified at the compilation level; therefore, we did not review these requirements as listed in OMB Bulletin No. 01-02.

OMB Circular No. A-127, “Financial Management Systems,” as revised July 23, 1993.

OMB Memorandum “Revised Implementation Guidance for the Federal Financial Management Improvement Act,” January 4, 2001.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Indianapolis (Sustaining Forces)

Non-Defense Federal Organizations

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member (cont'd)

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

Office of the Under Secretary of Defense (Comptroller) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Proposed Draft Audit Report, "Internal Controls and Compliance With Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds," dated Februaty 7, 2001, Project No. D20001FA-0016

This is the response to the subject draft report. Specific comments on the findings are contained at the attachment. The Department appreciates the opportunity to review and provide comments on the draft report.

The audit report correctly points out that the Chief Financial Officer financial statements were prepared from inadequate information obtained from budget execution reports. However, included within the "Review of Internal Controls" section, certain assumptions and parallels have been drawn which this office believes to be either misleading or erroneous. The concerns of this office are at the attachment.

My point of contact for this matter is Mr. Oscar G. Covell. He may be reached by e-mail: covello@osd.pentagon.mil or by telephone at (703) 697-6149.

for Nelson Toye
Deputy Chief Financial Officer

Attachment

Comments on

DoDIG Draft Audit Report, Project No. D2001FA-0016,

"Internal Controls and Compliance With Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds

IG,DoD Finding: **Internal Control Components (page 3).** The Draft Audit Report cites the Statement on Auditing Standards No. 78, "Consideration of Internal Control in a Financial Statement Audit," as containing five elements of internal control and states that (first paragraph, last sentence, page 4); "Although DoD is making progress in developing written procedures, audits continue to identify many opportunities for accounting offices to improve the control environment by developing and improving standard operating procedures."

DoD Response: The audit report is citing an incorrect reference. The Joint Financial Management Improvement Program (JFMIP) is a joint undertaking of the Office of Management and Budget (OMB), the Department of the Treasury, the General Accounting Office, and the Office of Personnel Management to improve financial management practices throughout the federal government. The JFMIP publishes financial management systems concepts, framework and requirements. The OMB incorporates JFMIP's systems concepts and requirements by reference in OMB Circular A-127, "Financial Management Systems," thereby making the concepts and requirements applicable to all federal agencies. **Control Environment** does not appear to be an internal control requirement in the OMB circulars or the JFMIP Core Financial Systems Requirements (JFMIP-SR_99-4, February 1999), as such, the Defense Finance and Accounting Service (DFAS) centers and Washington Headquarters Services should not be cited for not meeting the requirement nor should there be a deficiency reported (page 5) under **Deficiencies in the Control Environment**.

IG,DoD Finding: **Abnormal Balances for Closed Appropriations** (page 8, second sentence) states, "The existence of abnormal balances at the time an appropriation is closed...."

DoD Response: The OMB Circular A-34, "Report on Budget Execution and Budgetary Resources," paragraph 30.9 notes that: Technically, accounts are "closed," while appropriations and balances are "canceled."

IG,DoD Finding: **Differences Between Reports on Budget Execution and U.S. Treasury Records** (page 9, next to last sentence) states that "DFAS Indianapolis (Sustaining Forces) was unable to reconcile the differences between budgetary data received from accounting offices and data received from disbursing stations, as required by the Department of the Treasury[5]."

DoD Response: The reference is incorrect. The OMB establishes the requirements and footnote disclosure requirements for the Standard Form (SF) 133, Report on Budget Execution in OMB Circular A-34, "Report on Budget Execution and Budgetary Resources."

IG,DoD Finding: **Consistency of Trial Balances and Reports on Budget Execution** (page 11, carryover from page 10). The audit report states that data for fund balance with Treasury, accounts payable, accounts receivable, and appropriated capital should be reported consistently, i.e., the same amounts should be shown in both the proprietary and budgetary reports.

DoD Response: The following lists some of the reasons that the general ledger balances cited in the audit report should not be reported consistently based upon OMB (management side) Form and Content instructions or OMB (budget execution side) Circular A-34, instructions for the preparation of the SF 133, "Report on Budget Execution and Budgetary Resources." Suggest that the entire paragraph be omitted.

Fund Balance With Treasury. The OMB in its Form and Content instructions requires that fund balance (Standard General Ledger (SGL) account 1010) be reported as recorded by allotment holders. The difference between the balance reported by allotment holders and that recorded at the appropriation level is the amount of disbursements received through the Treasury finance chain but not yet distributed to allotment holders. The OMB in its Circular A-34, requires that in the preparation of the SF 133, that the sum of lines 15A and 15B must agree with the outlays reported to Treasury on the SF 224, "Statement of Transactions." In addition, discrepancies between the Treasury balance and the amount reported in the financial statements are footnoted.

Accounts Receivable. The anticipated recovery of a refund receivable would result in a proprietary posting increasing the accounts receivable balance by the amount of the potential recovery, however, a budgetary entry would not be made until the refund was received. The reason for waiting until the refund is received is to preclude allotment holders from obligating anticipated refunds when the refund may not be received, causing a potential Antideficiency Act violation.

Appropriated Capital. If the appropriation(s) reported receive or use either contract or borrowing authority, the unused availability reported on the SF 133 will not match SGL account 3100. Appropriation holders using contract or borrowing authority do not receive funding for those amounts authorized but can spend funds, use obligational authority, to purchase goods and services or resale items. Actual funding is received via a warrant liquidating contract authority or when borrowing authority is converted to cash.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

F. Jay Lane
Salvatore D. Guli
Charles J. Richardson
Sandra L. Fissel
Jonathan R. Witter
Juana R. Smith
Karen J. Lamar
Jennifer R. Siwula
Dwayne A. Coulson
Carol J. Gresham