Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL MANAGEMENT OF THE DEFENSE BUSINESS OPERATIONS FUND - FY 1992

Report No. 94-082 April 11, 1994

Department of Defense

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Acronyms

CFO	Chief Financial Officers
DAO	Defense Accounting Office
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DISO	Defense Information Services Organization
GAO	General Accounting Office
JLSC	Joint Logistics Systems Center
OMB	Office of Management and Budget
SF	Standard Form
SGL	Standard General Ledger

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884

April 11, 1994

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

SUBJECT: Audit Report on Financial Management of the Defense Business Operations Fund - FY 1992 (Report No. 94-082)

We are providing this final report for your review and comments. This final report makes recommendations to correct deficiencies identified during our financial audit of the Defense Business Operations Fund and complements our report on that audit, Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund for FY 1992," June 30, 1993. Comments were received from the Defense Finance and Accounting Service on a draft of this report and were considered in preparing the final report. However, comments requested from the Comptroller of the Department of Defense were not received.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Comptroller of the Department of Defense provide comments on the final report. We also ask that the Director, DFAS, provide comments on unresolved issues. Specific requirements for comments are in a chart at the end of each finding. Comments must be received by June 10, 1994.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. F. Jay Lane, Program Director, at (703) 693-0430 (DSN 223-0430) or Mr. Kent E. Shaw, Project Manager, at (703) 693-0440 (DSN 223-0440). Appendix D lists the distribution of this report. 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. 94-082 **April 11, 1994**
(Project No. 2FG-2008.01)

FINANCIAL MANAGEMENT OF THE DEFENSE BUSINESS OPERATIONS FUND - FY 1992

EXECUTIVE SUMMARY

Introduction. The Defense Business Operations Fund was established on November 26, 1991 by 10 U.S.C. 2208. The Chief Financial Officers Act of 1990 (31 U.S.C. 501) requires an annual financial audit of working capital funds such as the Defense Business Operations Fund (DBOF). On April 1, 1993, the Comptroller of the Department of Defense (DoD Comptroller) issued the FY 1992 financial statements for funds and activities included in the DBOF, which had been prepared by the Defense Finance and Accounting Service (DFAS). On June 30, 1993, we issued a report on those financial statements. Our report identified significant instances of weak internal controls and noncompliance with relevant laws and regulations. As a result of those instances and other relevant factors, we issued a disclaimer of opinion on the financial statements. This report complements our previous report and makes recommendations to correct the deficiencies identified in our audit of the DBOF financial statements.

Shortly after our audit field work was completed, the Office of the Secretary of Defense initiated a review of the implementation of the DBOF. In September 1993, as a result of that review, the Secretary of Defense and the secretaries of the Military Departments approved the "Defense Business Operations Fund Improvement Plan." The improvement plan calls for implementation of the U.S. Government Standard General Ledger and improvements in policies and procedures and automated systems, as well as in other areas not addressed by our report. The initiatives taken by the Secretary of Defense are commendable and, if properly implemented, should result in correction of many of the problems identified during our audit. We will continue to monitor the success of those efforts during ongoing and future audits.

Objective. The overall objective of the audit was to assess the internal control structure and compliance with applicable laws and regulations that could have a material effect on the DBOF financial statements.

Audit Results. Significant instances of weak internal controls relating to cash management and accounting systems existed. Also, transactions were not always executed in compliance with laws and regulations.

o Internal controls were not in place to ensure that cash transactions were correctly recorded and accounted for (Finding A).

o Internal controls were not in place to ensure that intrafund transactions were properly identified or eliminated. Audit trails were generally inadequate for substantive testing, a general lack of uniformity of accounting systems existed, and the U.S. Government Standard General Ledger had not been implemented. Additionally, not all recorded transactions were supported with adequate documentation (Finding B).

o The DBOF was not operating in compliance with all existing laws and regulations (Finding C).

Collectively, the weak internal controls and noncompliance with laws and regulations had a material effect on the reliability of the FY 1992 financial statements, and, if not corrected, could significantly affect future financial statements of the DBOF, its daily operations, and its potential for success.

Internal Controls. The audit identified internal control weaknesses that we considered to be material and reportable. Cash transactions were not verified or recorded in a timely manner (Finding A). Internal controls over accounting systems, for recording intrafund transactions, and for documenting recorded transactions needed improvement (Finding B). The DFAS had implemented an Internal Management Control program and had performed the required reviews; however, many of the deficiencies noted during the audit had not been reported. See Part I, "Internal Controls," for details of controls assessed.

Compliance with Laws and Regulations. Material instances of noncompliance with laws and regulations existed. Accounting systems used for the DBOF were not in compliance with requirements of Title 2 of the General Accounting Office's "Policies and Procedures Manual for Guidance of Federal Agencies." The DBOF financial statements were not prepared in full compliance with the Chief Financial Officers Act of 1990 as implemented by Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992. Reports to the Department of the Treasury required by the Debt Collection Act were inaccurate, and a system to monitor and report debts from contractors required by that Act had not yet been implemented. A subaccount for recording and reporting $1.1 billion in capital assets had not been established as required by the DoD Appropriations Act. New activities were added to the DBOF in violation of the Defense Authorization Act for FYs 1992 and 1993. Real property facilities, which by law are under the jurisdiction of the Military Departments, were reflected as assets on the DBOF financial statements. Findings B and C provide details on instances of noncompliance with laws and regulations.

Potential Benefits of Audit. The audit did not identify potential monetary benefits; however, correction of the problems identified in the report could result in better financial management and improved accuracy in financial reporting, which should improve the operations of the DBOF. For details of benefits associated with each recommendation, see Appendix B.

Summary of Recommendations. We recommended internal reconciliation procedures for disbursements and collections and procedures to separate DBOF suspense account transactions, better documentation and justification for accounting adjustments, improved audit trails, revised capital asset guidance, full implementation of the U.S. Standard General Ledger and compliance with applicable laws and regulations, including the removal of the Defense Information Systems Organization from the DBOF.

Management Comments. Comments were received from the Deputy Director for Business Funds of the Defense Finance and Accounting Service. The Deputy Director agreed with most of our findings and recommendations, but did not agree with our recommendation to separate DBOF suspense accounts from Air Force suspense accounts. Also, proposed corrective actions and planned completion dates were not provided for all findings. Therefore, we have requested additional comments from the DFAS to address those items. See Part II for a full discussion of management comments received and Part IV for the complete text of those comments. The Comptroller of the Department of Defense did not provide comments for inclusion in this report. Comments on this final report are required from the Comptroller of the Department of Defense and the Defense Finance and Accounting Service by June 10, 1994.

Table of Contents

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

Part I - Introduction

Background

The Defense Business Operations Fund (DBOF) was created by Section 8121 of Public Law 102-172, "Department of Defense Appropriations Act of 1992," on November 26, 1991, by establishing a fund on the books of the Treasury to which were transferred all assets and balances of working capital funds established under the provisions of 10 U.S.C. 2208. This fund would consolidate the activities previously funded in the existing stock and industrial funds. In addition, the Defense Finance and Accounting Service (DFAS), the Defense Commissary Agency, and three Defense Logistics Agency functions (the Defense Technical Information Center, the Defense Reutilization and Marketing Service, and the Defense Industrial Plant and Equipment Center) were included in the DBOF. Functional and cost management responsibilities relating to the DBOF rest with the Military Departments and Defense agencies. Proposed benefits to creating the DBOF included the accumulation of costs of services provided to DBOF customers, including all support costs. By identifying the support costs, the DoD would be better able to control and reduce them as the size of the Military Departments declined. In addition, the DBOF would enable the DoD to determine the cost of operating each individual DoD Component, such as a military base or a fighter squadron.

The Comptroller of the Department of Defense (DoD Comptroller) is responsible for the management of DBOF cash. The DFAS is responsible for performing the accounting for the DBOF and preparing the financial statements required by the Chief Financial Officers (CFO) Act. Responsibility by DFAS Center for accounting for the Defense and Military Department Components of the DBOF are shown in Table 1.

Table 1. Location of DBOF Accounting Responsibilities Within the DFAS

Defense Component	Responsible DFAS Center
Army	Indianapolis, Indiana
Navy	Cleveland, Ohio
Air Force	Denver, Colorado
Defense Agencies	Columbus, Ohio

At the end of FY 1992, the DBOF was made up of 33 business areas. Appendix A identifies those business areas and shows the financial statement reporting structure for FY 1992. Responsibility for the overall management of the DBOF is unclear. The DFAS reported revenues of $118.8 billion, expenses of $118.7 billion, and assets of $118.1 billion on the DBOF's principal financial statements for 1992.

On April 30, 1993, at the direction of the Secretary of Defense, a comprehensive and detailed review of all aspects of the DBOF was conducted by a financial team made up of representatives of the Office of the Secretary of Defense, the Military Departments, and the Defense agencies, as well as outside experts. In addition, a steering group of senior financial and function officials from the DoD, the Office of Management and Budget (OMB), and the General Accounting Office (GAO) was formed to evaluate the findings of the review team. The review group chartered eight review teams to evaluate the following major areas of concern: organization, education and training, budget, policy, central system development (acquisition process for hardware and software capital assets), financial management systems, cash management, and financial reporting.

On July 30, 1993, the group issued its "Defense Business Operations Fund Implementation Review Group Report" containing recommendations in all areas of concern. In September 1993, as a result of the review group's report, the Secretary of Defense and the respective Secretary of each of the Military Departments approved the "Defense Business Operations Fund Improvement Plan."

The improvement plan concluded that the DBOF concept was pushed too far, too fast, and provided a strategy and milestones for correcting DBOF's problems. The strategy included the following:

o establishing a strong management team, including a Corporate Board, to oversee the development of policies, procedures, and systems to support the DBOF;

o ensuring that incentives and controls balance with cost performance measures, at all levels;

o revising policies and procedures for the DBOF, and ensuring that appropriate organizations within the DoD play an integral part in development and implementation of those policies and procedures;

o developing the accounting systems necessary to support the DBOF; and

o removing from the DBOF activities that are not suitable.

The initiatives taken by the Secretary of Defense are commendable and, if properly implemented, should result in correction of many of the problems identified during our audit. We will monitor the implementation of the plan during ongoing and future audits.

Objective

The overall objective of the audit was to assess the internal control structure and compliance with applicable laws and regulations that could have a material effect on the FY 1992 financial statements of the DBOF.

Scope and Methodology

Time Periods and Locations. This financial related audit began on January 10, 1992, and was completed April 30, 1993. Our tests were performed on DBOF events and transactions that occurred during FY 1992. The organizations visited or contacted are identified in Appendix C.

Methodology. We considered the internal control structure before expressing our opinion on the FY 1992 financial statements in Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund for FY 1992," June 30, 1993. We obtained an understanding of the internal control policies and procedures and assessed the level of control risk relevant to all significant cycles, classes of transactions, and account balances. For those significant internal control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed. Our consideration of the internal control structure, however, would not necessarily disclose all matters that might be reportable and, accordingly, would not necessarily disclose all conditions that are also considered to be material weaknesses. Conditions discussed, as reported in our prior financial audit report, had a material effect on the FY 1992 DBOF Principal and Combining Financial Statements and may impact DBOF operations. This report highlights weaknesses in internal controls and instances of noncompliance with laws and regulations identified during that financial statement audit.

Computer-Processed Data. Management's financial statements were produced using data processed on mainframe computer systems, data from spreadsheets generated on microcomputers, and data derived from manual calculations. We were not always able to rely upon computer-processed financial reports generated by the DFAS due to the lack of adequate audit trails and the lack of standard general ledger structures within the DBOF. Our review of those processes indicated that significant improvement was needed in current systems before they could be regarded as reliable. Finding B, Accounting Systems and Procedures, discusses those deficiencies in detail.

Auditing Standards. We conducted our audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993.

Internal Controls

Controls Assessed. We reviewed internal control policies and procedures for recording and accounting for transactions, safeguarding assets against loss from unauthorized use, and executing transactions in compliance with existing regulations. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires each Federal agency to establish a program to identify significant internal control weaknesses. The Defense Finance and Accounting Service, which was responsible for the preparation of the DBOF financial statements, had established an Internal Management Control program and performed the required reviews. The internal control weaknesses identified by the DFAS only focused on DFAS operations and did not address internal control weaknesses in the DBOF except for the DBOF accounting system.

Internal Control Weaknesses. The audit identified internal control weaknesses that we considered to be material and reportable under standards established by OMB Bulletin No. 93-06. Reportable conditions are material weaknesses in the design or operation of the internal control structure that result in transactions not being properly recorded or accounted for.

Specifically, cash transactions could not be verified, and transactions made for or by others were not recorded in a timely manner. The lack of reconciliations between the disbursement and collection reports and the Statement of Transactions resulted in inconsistencies between reporting and financial presentation (Finding A). Recommendations A.1. and A.2., if implemented, will correct those weaknesses.

Intrafund transactions were not properly identified or eliminated. Audit trails were inadequate for substantive testing, a general lack of uniformity of accounting systems existed, and the U.S. Government Standard General Ledger had not been implemented. We were unable to verify that assets were safeguarded against loss from unauthorized use because the transactions recorded were not supported with adequate documentation (Finding B). Recommendations B.1. and B.2., if implemented, will correct the weaknesses.

In its Annual Statement of Assurance, issued on December 16, 1992, the DFAS reported the DBOF accounting system as a nonconforming system with weaknesses in general ledger control and financial reporting, property accounting, accounting for receivables, military and civilian payroll procedures, system controls, audit trails, system documentation, system operations, user information needs, and budgetary accounting.

Although the DFAS had an aggressive plan to reduce the number of DFAS automated systems for 8 financial areas from 70 to 9 by FY 1996, the DBOF cost accounting systems were still under study for consolidation. The report stated that the Management Systems Support Office, under the direction of the DoD Comptroller, was developing a strategy for enhancing the implementation of the Defense Business Management System. The report showed several weaknesses, including the following:

o inadequate debt collection procedures for deferred contractor debt,[1]

o general ledger reconciliation resulting in erroneous balances and an inability to research identified problems due to inadequate or no audit trail, and

o uncleared undistributed disbursements and collections for transactions as far back as FY 1984.

The DFAS had established milestones for correcting the deficiencies. Copies of this report will be provided to the senior officials responsible for internal controls within the Office of the DoD Comptroller and the DFAS.

Prior Audit Coverage

As of March 2, 1994, there were six General Accounting Office (GAO) audit reports, one Air Force Audit Agency audit report, and two Inspector General, Department of Defense, audit reports that included reportable conditions similar to the conditions we found. Overall, the reports indicated pervasive internal control problems within all the Military Departments. In addition, the Inspector General, Department of Defense, is auditing the FY 1993 DBOF financial statements and the GAO is monitoring DBOF improvements.

GAO Reports. GAO Report No. GAO/AFMD-93-18 (OSD Case No. 9287), "Financial Management: Navy Industrial Fund Has Not Recovered Costs," March 23, 1993, stated that the DoD had not developed a cash management policy. The GAO recommended a cash management policy be developed to prescribe the minimum and maximum amounts of cash the DBOF needs to operate. Management comments were not solicited at the request of the Chairman, Subcommittee on Readiness, Committee on Armed Services, House of Representatives.

GAO Report No. GAO/AFMD-92-83 (OSD Case No. 8674-M), "Examination of the Army's Financial Statements for Fiscal Year 1991," August 7, 1992, stated that tests of internal controls affecting or potentially affecting the Army's Principal Statements showed the tests could not be relied upon to achieve their intended objectives. The GAO identified material weaknesses not reported by the Army in the Annual Statement of Assurance; however, the Army nonconcurred, stating that the areas needing additional management attention did not materially affect the Statement. The disagreement reflects a difference of opinion between the Army and the GAO on what constitutes materiality. The large overall number of internal control weaknesses prevented the GAO from expressing an overall opinion on the Army's Principal Statements.

[1]We were unable to review compliance with the Debt Collection Act for contractor debt because no system had been developed to track contractor debt (see page 33).

Another GAO report, Report No. GAO/AFMD-92-82 (OSD Case No. 8674-L), "Immediate Actions Needed to Improve Army Financial Operations and Controls," August 7, 1992, stated that a primary cause of the breakdown of internal control systems was the lack of sufficient commitment on the part of operational managers to first identify internal control weaknesses and then ensure the weaknesses were corrected within a reasonable period of time. The GAO identified weaknesses that it considered material but that were not reported by the Army in its Annual Statement of Assurance and, consequently, were not included in the Secretary of Defense's FY 1991 Annual Statement of Assurance. The weaknesses the GAO identified included failure to investigate or resolve abnormal and unusual account balances, failure to reconcile differences between general ledger and detailed records, and failure to monitor accuracy of inventory records. Recommendations were made to clarify responsibilities for accuracy of financial data, ensure that reports are accurate, ensure that expertise and resources are available to accomplish financial management improvement projects, identify changes needed to improve the accuracy of existing accounting systems, ensure consistency of accounting policies and practices and their applications, and ensure compliance with existing asset control procedures. Of the report's 30 recommendations, the Acting DoD Comptroller concurred with 19, partially concurred with 9, did not concur with 1, and was still reviewing 1 when the report was issued.

GAO Report No. GAO/AFMD-92-79 (OSD Case No. 9089-A), "Status of the Defense Business Operations Fund," June 15, 1992, stated that key policies and systems necessary to run the DBOF in a businesslike manner had not been fully developed and implemented. Policies involving cash management, intrafund transactions, and capital asset accounting were needed, but had not been completed. In addition, accounting systems would not be fully operational for 3 years. The report made no recommendations; however, the GAO suggested that if Congress extended the DBOF beyond the April 1994 date called for in the National Defense Authorization Act for FYs 1992 and 1993, the DoD should not be permitted to add any new activities to the DBOF in FY 1994.

GAO Report No. GAO/AFMD-92-12 (OSD Case No. 8376-L), "Financial Audit: Aggressive Actions Needed for Air Force to Meet Objectives of the CFO [Chief Financial Officers] Act," February 19, 1992, noted pervasive internal control weaknesses throughout the Air Force that resulted from failure to follow established procedures for reviewing accounts for abnormal balances and for reconciling control accounts with subsidiary accounts and supporting records. The GAO recommended reconciling disbursements with obligations and promptly correcting errors, as well as documenting adjustments to subsidiary records and control accounts. The GAO also suggested that internal control problems, both with reconciliations and with inadequate documentation for adjustments, be included in future Annual Statements of Assurance reports. The OSD partially concurred with seven of the recommendations and non-concurred with two of the recommendations.

GAO Report No. GAO/AFMD-90-23 (OSD Case No. 8193-A), "Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources," February 23, 1990, stated the Air Force had significant internal control weaknesses. By not performing reconciliations and by making unsupported adjustments, the Air Force lost accountability and the opportunity to determine and address the causes of possible instances of mismanagement, fraud, or abuse. The GAO recommended improving the accuracy of existing financial information, performing reconciliations, and documenting adjustments. The DoD Comptroller concurred with the recommendations. The GAO did not express an opinion on the Air Force financial statements because of the existing conditions.

Air Force Audit Agency Report. The Air Force Audit Agency report, "Report of Audit on the Management of Budget Clearing Accounts" (Report No. 9265314), May 24, 1990, found the internal controls were not adequate to ensure compliance with established procedures. Some budget clearing accounts were not certified semiannually. Budget clearing account balances remained in suspense accounts for periods in excess of 1 year because controls and reconciliations were not effectively implemented. Recommendations included establishing controls to monitor the receipt of the semi-annual certifications, establishing procedures to age clearing account balances, and following up on overaged accounts. Management concurred and revised Air Force regulations to correct the weaknesses noted.

Inspector General, Department of Defense, Reports. The Office of the Inspector General, Department of Defense, Report No. 94-048, "Uncleared Transactions by and for Others," March 2, 1994, stated that the DFAS needed to improve its systems and procedures for resolving uncleared transactions by and for others. Increased management oversight was needed to eliminate excessive clearing transactions, and to reduce net undistributed disbursements valued at about $34.6 billion. Furthermore, managers at Headquarters, DFAS, were not given complete and accurate information on the status of undistributed disbursements, including uncleared transactions, and DFAS Centers had understated the undistributed disbursements by about $7.2 billion. The Inspector General, Department of Defense, recommended improved guidance, procedures, and controls over transactions that are not promptly cleared and over reporting undistributed disbursements. The Deputy Comptroller of the Department of Defense (Management Systems) generally concurred with the findings and recommendations.

The Office of the Inspector General, Department of Defense, Report No. 92-021, "Debt Collection and Deposit Controls," December 13, 1991, stated the DoD Components had not implemented prompt or aggressive collection strategies to pursue delinquent payments and that the policies and procedures for collecting delinquent debt were not consistent with Federal laws and regulations. The Inspector General, Department of Defense, recommended that the DFAS centralize control over the DoD's debt collection and develop uniform operating procedures. The DFAS concurred and began implementing the recommendations. For the results of our followup on that report, see Finding C, section entitled "Followup on Audit Report No. 92-021," page 34.

Ongoing Audit. The Inspector General, Department of Defense, is currently auditing the DBOF FY 1993 financial statements. The final report will be issued by June 30, 1994.

Part II - Findings and Recommendations

Finding A. Cash Management

Many cash transactions were incorrect as recorded and accounted for on the financial statements. Primary causes for the misstatements were that the DoD Comptroller had not issued written guidance on cash management of the DBOF and had not established oversight to verify that established accounting policies were followed. Several specific causes existed for the incorrect amounts on the financial statements.

o Procedures were not in place for ensuring the reconciliations of cash transactions among DFAS Centers.

o The DFAS-Denver Center improperly included DBOF transactions in an Air Force suspense account, thus precluding adequate separation of funds between appropriations.

o Suspense accounts at the DFAS Centers were not being cleared as required by existing accounting policies.

o The DFAS-Denver Center based reports to the Department of the Treasury (Treasury) on the Statement of Transactions on estimates of cash balances rather than on actual balances.

o Adjustments of $649.0 million to the DBOF Principal financial statements were made without written supporting documentation.

As a result, information derived from the financial statements cannot be considered reliable.

Background

The Fund Balance with Treasury of the Defense Business Operations Fund is managed at the Office of the DoD Comptroller, while the authorization and execution of cash transactions occur at the DBOF business areas. The Fund Balance with Treasury for the end of FY 1992 was $4.1 billion, and net disbursements against the DBOF appropriation during FY 1992 totaled $3.16 billion.

The DFAS Centers, certain overseas disbursing offices, some Defense Logistics Agency activities, and other non-Defense activities report disbursements and collections against the DBOF appropriation directly to the Treasury. Most transactions, however, are reported to the appropriate DFAS Centers. Each cash transaction that is reported to a DFAS Center includes a sublimit that identifies the business area that should record the transaction.

Cash Management Policy

The Financial Policies Board was established to review DBOF policy and procedure proposals submitted by the DoD Comptroller, the DFAS, and DoD Components.

The Principal Deputy Comptroller issued one cash management policy, "Fiscal Year 1992 DBOF Financial Management Guidance," August 19, 1991, which stated that the DBOF was to operate under the financial policies and responsibilities in effect for stock and industrial funds until subsequent policy was issued; that the procedures in effect for existing revolving funds were unchanged in FY 1992; and that financial reports and statements should be prepared in the formats prescribed by DoD guidance.

Although the "Defense Business Operations Fund Implementation Plan," May 1992, established a milestone of July 1992 for issuance of a more comprehensive cash management policy, no policy was issued. A new milestone of March 31, 1994, was subsequently set, as discussed under Corrective Actions Initiated. The new policies are needed to ensure that responsibilities for management of cash are clearly delineated and uniform accounting procedures are used.

Cash Transaction Recording and Accounting

Reconciliation Procedures. The August 1991 guidance from the DoD Principal Deputy Comptroller concerning cash management policy stated that disbursement and collection reports shall be reviewed and reconciled to the Statement of Transactions before the reports are submitted to the next reporting level or to the Treasury. No evidence existed at the DFAS Center that such reconciliations were being made at any level.

Each DFAS Center submits the Statement of Transactions to the Treasury for all disbursements and collections by the Defense Component the Center supports. The reports provided to the Treasury include reporting of all cash transactions made "for" the individual Military Department and "for" others (such as the General Services Administration or the State Department. To prepare DBOF financial statements, the DFAS Centers depend on information from the other Centers, including information on all cash transactions made "by" the individual Military Departments and "by" others. Transactions by and for other occurs when one Defense component performs transactions on behalf of another Defense company or agency. No procedure currently exists to verify these types of transactions are accurately reported or presented in the appropriate DBOF business area.

A lack of reconciliation between amounts the DFAS Centers reported to the Treasury and amounts presented on the financial statements resulted in misstatements, not only on the business areas' financial statements, but also on the Consolidating Financial Statements.

Suspense Accounts. Suspense accounts are used by all the DFAS Centers to record disbursements and collections when the disbursement or collection cannot be properly identified to the DBOF business area that made the disbursement or collection. An entry to a suspense account is recorded for each disbursement or collection that has no valid sublimit. (A sublimit identifies the disbursement or collection to a particular DBOF business area.) To maintain appropriation integrity, however, suspense accounts should be identified to the appropriation to which the transaction pertains. We found that the DFAS-Denver Center improperly recorded transactions for which the reported sublimit to the DBOF appropriation account was not valid to an Air Force suspense account rather than to a DBOF suspense account. The amounts reported in the Air Force suspense account to the Treasury during FY 1992 were \$6.508 billion in collections and \$6.494 billion in disbursements. We were unable to determine the DBOF portion of those amounts; therefore, the actual DBOF appropriation balance with the Treasury is misstated, potentially materially.

The DFAS had not established milestones for its Centers to clear suspense accounts (by correcting identified errors in the reported sublimits). The Centers were not making significant progress in clearing the suspense accounts. Therefore, the financial statements for the business areas were misstated because disbursements and collections that should have been recorded to the business areas were still in suspense accounts.

Estimates. The DFAS-Denver Center reported estimated Statement of Transactions information (including disbursement and collection data) to the Treasury when the DFAS-Denver Center had not received the required monthly transaction information from its disbursing offices in time to prepare its report to the Treasury. The use of estimates is not authorized by the DoD or by the Treasury guidance and use of estimates did not provide an accurate presentation of cash transactions. Such use distorted balances for cash balances at the Treasury.

Fund Balance Reported to Treasury. We identified a material discrepancy between yearend cash balances presented on the DBOF Combining Financial Statement of Position and those on the records of the Treasury. According to "DoD Guidance on Form and Content of Financial Statements for FY 1992 Financial Activity," December 30, 1992, the Fund Balance with Treasury account on the financial statements should equal the difference between cash disbursements and cash collections during the fiscal year (net disbursements).

We identified a variance of approximately \$649.0 million between net disbursements the Treasury reported as a reduction to the DBOF appropriation (\$3.160 billion) and net disbursements the Combining Financial Statement of Position reported as disbursements and collections for each of the Consolidating Financial Statements of Position (\$2.511 billion). Coincidentally, a \$649.0 million variance also existed between the amount the Treasury reported as Current Year Appropriations available for FY 1992 ($7.295 billion) and the amount the DBOF Combining Statements presented as a Fund Balance with Treasury, Departmental ($6.646 billion).

The disbursement and collection information that was prepared by the DFAS Centers was adjusted by the DFAS-Cleveland Defense Accounting Office (DAO), Arlington, Virginia (see Table 2). The adjustments made by the DAO were not supported by adequate documentation, and the rationale provided verbally by personnel at the DAO for the adjustments was not clear. The net effect of the adjustments was to make the overall DBOF net disbursements on the Status of Budget Execution reports for FY 1992, presented to the OMB, agree with the dollar amounts that the Treasury had reported as net outlays for FY 1992. The DAO personnel indicated, again verbally, that a $183.4 million adjustment was for net disbursements made by the Army for the Defense Commissary Agency, Resale Stocks; a $92.4 million adjustment for the Navy was due to a DAO error made during the year; a $799.7 million adjustment for the Air Force was made based on a phone call from the DoD Comptroller; and a $242.0 million variance for the Defense agencies was basically a "plug" number to balance the adjustments.

Table 2 shows the variance between net disbursements reported on Combining Financial Statements and net disbursements reported to the OMB resulting from unsupported adjustments to financial statement information.

Table 2. Variance Between Net Disbursements Reported on Combining Financial Statements and Net Disbursements Reported to the OMB
($ millions)

Consolidated Business Areas	Reported on Combining Financial Statements	Reported to the Office of Management and Budget	Variance
Army	$(1,070.3)	$(1,253.7)	$(183.4)
Navy	272.2	364.6	92.4
Air Force	(1,172.4)	(1,972.1)	(799.7)
Defense Agencies	(399.0)	(157.0)	242.0
DISA[1]	50.4	50.4	
DFAS	120.9	120.9	
DeCA[2]	(298.8)	(298.8)	
Joint Logistics	(14.3)	(14.3)	
Total	$(2,511.3)	$(3,160.0)	$(648.7)

[1]DISA = Defense Information Systems Agency
[2]DeCA = Defense Commissary Agency

Corrective Actions Initiated

The "Defense Business Operations Fund Improvement Plan," September 1993, tasked the Deputy Comptroller of the Department of Defense (Program/Budget) with developing comprehensive policies and procedures for Cash Management during second quarter, FY 1994. Additionally, the plan tasked the Office of the DoD Comptroller and the DFAS to develop a standard approach and methodology for cash reporting by second quarter FY 1994. Also, the DoD Comptroller, the CFO, the DoD Components, and the DFAS were tasked to establish policy and procedures for adjustments to financial reports.

The proposed improvements should result in better management of cash and better overall management of the DBOF. As a result, we are not making recommendations for developing cash policies and cash reporting. We will monitor the progress made on those initiatives during ongoing and future audits.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service:

1. Develop internal reconciliation procedures for disbursements and collections that will ensure that all Defense Business Operations Fund reports and accounts reflect consistent accounting information and that all disbursement and collection transactions are presented accurately on the appropriate business area's financial statements.

DFAS Comments. The Deputy Director for Business Funds of the Defense Finance and Accounting Service concurred in principle. The Deputy Director stated that the DFAS does have internal reconciliation procedures for collections and disbursements. The DoD Accounting Manual [(DoD 7220.9-M, "DoD Accounting Manual," Chapter 93, paragraph. B.8)] requires DFAS Centers to reconcile amounts reported on the DD Form 1176, "Report on Budget Execution," with the amounts reported to Treasury.

The Deputy Director stated that, due to time constraints at the end of FY 1992, the reconciliation procedures and the final reports for yearend had not been completed at the time of the audit. Subsequently, the DFAS revised the DD Forms 1176 for the DBOF. After those changes were made, the Air Force did not have a variance between amounts on the DD Forms 1176 and amounts reported on the financial statements. The Deputy Director explained the changes and adjusted variances between amounts on the DD Forms 1176 and amounts reported on the financial statements as follows:

o The Air Force amount should be negative $1,172.4 million instead of negative $1,972.1 million. The Defense agencies' amount should be negative $956.6 million instead of negative $157.0 million. The net effect on the overall total is 0.

o The Army difference of negative $183.4 million related to the reporting of transactions for the Defense Commissary Agency.

o The Navy difference of $92.4 million resulted from an incorrect total on the Navy consolidated Accounting Report (M) 1176.

o The remaining (adjusted) variance for the Defense Agencies is the total Undistributed Disbursements at the Departmental level and is computed by subtracting the total net outlays as reported by all business areas from the total amount reported as outlays on the Treasury Trial Balance. Because the Treasury Trial Balance outlays are reported at appropriation level only and cannot be identified to a particular business area, the DFAS was directed by the DoD Comptroller's Office to post the total Undistributed amount against the Defense agencies' Supply Management business area. The procedure was changed for FY 1993, and the undistributed amount will be reported against the Corporate account.

Audit Response. We believe each DFAS Center DBOF variance can be identified to a particular business area if reconciliation procedures are performed at each reporting level. The DoD Accounting Manual reference cited in the management response pertains to the preparation of the DD Form 1176 and not to reconciliation of any variances. The adjustments for undistributed amounts should be recorded against the appropriate business area. Any variances should be reconciled to the supporting General Ledger accounts maintained by the Centers. A difference between total net outlays by business area and the Treasury Trial Balance is not adequate documentation, and the rationale for making one adjustment to one business area is not justified. We consider management comments nonresponsive and request that the DFAS reconsider its position and provide comments to the final report for this recommendation.

2. Establish procedures at the Defense Finance and Accounting Service-Denver Center to keep suspense account transactions of the Defense Business Operations Fund separate from other appropriations.

DFAS Comments. The DFAS nonconcurred with the recommendation. The DFAS stated that the DFAS-Denver Center sets up cash suspense accounts to reflect out-of-balance conditions, not bad limitations. When out-of-balance conditions exist, DFAS Denver Center procedures are to contact the reporting station, verify the data, and make necessary corrections. When the data cannot be verified in time, the amounts are placed in a central cash suspense account. Separate suspense accounts for DBOF and non-DBOF transactions are impractical because such distinctions cannot be made. The DFAS-Denver Center believed the cash suspense figures presented for reporting to the Treasury were misstated by the auditors because they incorrectly included detail suspense data with cash suspense data. Detail suspense data are not reported to the Treasury and are only used to track and clear undistributed data within the Air Force network.

Audit Response. All DFAS Centers except the Denver Center segregate the DBOF appropriation suspense amounts and separately report DBOF transactions to the Treasury, even though the sublimit may not be known. The DBOF suspense should be segregated from other accounts because the DBOF transactions in an Air Force suspense account affect both the Air Force and the DBOF cash balance reported to the Treasury. The Treasury account 57X6875, titled, "Suspense Account, Department of Air Force" was used by the DFAS-Denver Center as a suspense account for both the DBOF and the Air Force. We totaled the cash suspense figures from a DFAS-Denver Center Appropriation Control schedule dated September 1992. The totals we reported were the cumulative FY 1992 year-to-date balances for Treasury account 57X6875. We also totaled account 57X6875 for the current month (September 1992), and that total was the same as that reported on the Statement of Transactions (DD Form 1247) reported to the Treasury for the same month. Therefore, we believe that the figures cited in our report are correct. The DFAS is requested to reconsider its position and provide comments to the final report for this recommendation.

3. Follow procedures to establish milestones for researching and clearing suspense accounts.

DFAS Comments. DFAS management concurred with the recommendation. The DFAS stated that the DFAS-Indianapolis Center followed normal operating procedures that require uncleared transactions for and by others, uncleared cross-disbursing, and uncleared interfund transactions to be cleared in 60 to 180 days. The station will be graded on the expeditious corrective action via the Performance Measurement Plan. The DFAS-Columbus Center reports through the DFAS-Indianapolis Center to Treasury.

Audit Response. We request that DFAS management provide us with proposed actions in response to the recommendation and a planned completion date for those actions.

4. Direct its Defense Finance and Accounting Service-Denver Center to use only actual cash balances on its reports to the Treasury.

DFAS Comments. DFAS concurred with the recommendation. DFAS stated that this would be done by April 1994.

Audit Response. DFAS comments to Recommendation 4 were responsive.

5. Establish procedures for authorization, full documentation, and justification of all adjustments made to the financial statements by its accounting personnel.

DFAS Comments. DFAS concurred in principle, but pointed out that the DFAS already requires authorization, full documentation, and justification of all adjustments made to the financial statements. Management also discussed the presentation of the variance between the DD Form 1176 and the Treasury Trial Balance on the FY 1992 DBOF financial statements. Management believed that the total DBOF transactions at the Departmental level for the DBOF combining statements was accurately reflected as $6,645,976,731.

Audit Response. We believe the procedures for authorization, full documentation, and justification of all adjustments made to the financial statements exist for the Military Departments. However, until the DFAS establishes universal procedures for the Centers, the current procedures will either be ignored until updated DFAS procedures are received or applied inconsistently by the various DFAS Centers providing service to different Military Department customers. The initial financial management guidance from the Principal Deputy Comptroller of the Department of Defense that was provided for the DBOF at its inception was that it should continue using current Defense guidance until new guidance was issued. This statement sufficed for business areas that were still operating under Military Department management; however, the DFAS Centers are now Defense activities providing accounting services for the Military Departments. DFAS Centers are trying to distinguish between when to use Defense guidance and when to use DoD Component-unique guidance.

We believe that the total DBOF transactions at the Departmental Level should have been $7.295 billion as reported by Treasury as Current Year Appropriations available for FY 1992. According to the DoD Comptroller, the definition of cash is all disbursements and collections. The $648.5 million of undistributed outlays (undistributed disbursements and collections) should not have been reported on the DBOF Statement of Operations, where it was reported as Excess (Shortage) of Revenues and Financing Sources Over Total Expenses. Rather, the $648.5 million should have been reported on the Statement of Financial Position as part of the Fund Balance with Treasury. Although we disagree on these issues, we consider managements comments to be responsive to the recommendation.

For the complete text of management comments received in response to the draft, see Part IV. All comments to the final report should be received by June 10, 1994.

Response Requirement for Each Recommendation

Responses to the final report are required from the addressee shown for the items indicated with an "X" in the chart below.

		Response Should Cover:			
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
A.1.	DFAS	X	X	X	IC
A.2.	DFAS	X	X	X	IC
A.3.	DFAS		X	X	IC

*IC = Material internal controls weakness.

Finding B. Accounting Systems and Procedures

The various automated accounting systems in use by the DFAS Centers were not uniform and did not provide consistency in financial reporting or comparability of operations information for the Defense Business Operations Fund. Those conditions existed because the DFAS Centers were using accounting systems designed and developed separately over the years by military finance centers to satisfy DoD Component-unique information requirements, with little regard for ensuring uniformity of accounting reports throughout the DoD. Specific causes were the following.

o A uniform standard general ledger was not used.

o Audit trails were not sufficient to trace or certify transactions.

o Intrafund transactions of approximately $17.7 billion were not properly identified or eliminated.

o A subaccount for recording and reporting capital asset transactions for the $1.2 billion Capital Budget had not been established.

o The Monthly Report of Operations was inconsistent, incomplete, and inaccurate.

As a result of the lack of comparability among data generated by the various DFAS accounting systems, as well as the lack of universal accounting procedures at DFAS Centers, DBOF information included on standard reports provided by the DFAS to the OMB and the Treasury disagreed with DBOF information the DFAS Centers included on the DBOF financial statements.

Background

The Chief Financial Officers (CFO) Act of 1990 (31 U.S.C. 501) required each agency CFO to develop and maintain an integrated agency accounting and financial management system, including financial management and internal controls, to the following:

> " . . . (A) complies with applicable accounting principles, standards, and requirements, and internal control standards; (B) complies with such policies and requirements as may be prescribed by the Director of the Office of Management and Budget; (C) complies with any other requirements applicable to such systems; and (D) provides for – (i) complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial

> information needs of agency management; (ii) the development and reporting of cost information; (iii) the integration of accounting and budgeting information; and (iv) the systematic measurement of performance.

Also, the Joint Financial Management Improvement Program's publication, "Core Financial System Requirements," January 1988, requires that those systems at each agency provide audit trails that trace transactions from source documents through successive levels of summarization to the financial statements. The audit trail should also be traceable in reverse.

To standardize Federal accounting and to meet the basic Federal financial statement and budget execution reporting requirements, the U.S. Government Standard General Ledger (U.S. SGL) was mandated by the Treasury Financial Manual in 1987. During October 1987, the DoD implemented the revised U.S. SGL chart of accounts by incorporating it into DoD 7220.9-M, "DoD Accounting Manual" (DoD Accounting Manual). Appendix III to Title 2 of GAO's "Policy and Procedures Manual for Guidance of Federal Agencies" made the use of the U.S. SGL mandatory for all Federal agencies. Additionally, the Revised Transmittal Memorandum No. 1 to OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, requires agency financial management systems to use a financial management classification structure that is consistent with the U.S. SGL.

Consistency and Comparability

Standard General Ledger. A financial management classification structure consistent with the U.S. SGL has not been fully implemented by the DFAS Centers for the DBOF business areas as required. In FY 1992, only one of the DBOF activities, the Defense Commissary Agency Resale Stocks business area, used the DoD Uniform Chart of Accounts, which is consistent with the U.S. SGL. The Communications Information Systems Activity business area has contracted with the accounting firm of KPMG Peat Marwick to convert its accounting system to the U.S. SGL for FY 1993.

We identified eight different general ledger structures in use by DBOF activities:

- o U. S. Army Standard General Ledger Chart of Accounts,
- o Navy's Industrial Fund General Ledger Chart of Accounts,
- o Air Force General Ledger Account Codes,
- o Air Force Stock Fund Chart of Accounts,
- o Defense Logistics Agency Chart of Accounts,

o Defense Information Systems Agency Uniform Chart of General Ledger Accounts,

o Defense Stock Funds Chart of Accounts, and

o DoD Uniform Chart of Accounts.

The lack of a uniform general ledger structure within the DBOF unnecessarily increases the potential for consolidation errors and increases the level of effort required to prepare and audit financial statements or routine reports for the use of other Government parties, such as the Treasury and the OMB.

DoD Component-Unique Charts of Accounts. The Military Departments and the other DoD Components are using unique charts of accounts and are crosswalking (translating between accounting systems) the financial data from the activities' general ledger accounts to the U.S. SGL for preparation of management reports and financial statements.

A major obstacle to implementation of the U.S. SGL within the DoD has been the conflicting accounting policies issued by the Military Departments on the structure to be used for the general ledger. Although the DoD Accounting Manual and Army Regulation 37-1, "Army Accounting and Fund Control," have implemented an accounting structure consistent with the U.S. SGL, the Navy Comptroller Manual; the Department of the Navy Staff Offices' P-3062, "Financial Management of Resources - Research, Development, Test & Evaluation;" Air Force Regulations 170-25, "Procedures in Support of Air Force Stock Fund;" and the Defense Logistics Agency Manual 7000.1, "Accounting Manual for the Defense Logistics Agency;" have not.

We discussed the matter with DFAS management and DoD Comptroller personnel and were told that the DFAS is now responsible for any changes to guidance on accounting policies. Therefore, we are recommending that the DFAS revise the Navy, Air Force, and Defense Logistics Agency guidance to require a financial classification structure consistent with the U.S. SGL.

New Agency Requirements for Financial Management Systems. On July 23, 1993, the OMB issued its Revised Transmittal Memorandum No. 1 to OMB Circular No. A-127, "Financial Management Systems." The Circular replaced OMB Circular No. A-127, dated December 19, 1984. The revised guidance involving financial management systems, prescribed policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The circular requires each agency to establish and maintain a single integrated financial management system that complies with the following:

o applicable accounting principles, standards, and related requirements as defined by the OMB and the Treasury;

o internal control standards as defined in OMB Circular No. A-123;

o information resource management policy as defined in OMB Circular No. A-130; and

o operating policies and related requirements prescribed by the OMB, the Treasury, and the agency.

OMB Circular No. A-127 also establishes specific requirements that financial management systems must meet, including an agency-wide financial information classification structure and use of the SGL.

Paragraph 8(b) of OMB Circular No. A-127 prescribes that a custom software development approach for financial management systems shall be used as a last resort and only after consideration of all appropriate software options, including the use of the following:

- o the agency's existing system with enhancements and upgrades,
- o another system within the agency,
- o an existing system at another agency,
- o commercial "off-the-shelf" software,
- o a system under development at another department, or
- o services of a private vendor.

Implementing the requirementsof OMB Circular A-127 should result in improved financial management of the DBOF.

Audit Trails. The accounting systems and internal controls at the sites we visited did not provide or maintain sufficient financial transaction formation to provide audit trails to trace transactions to determine whether the accounting information reported to the Treasury was accurate and reliable. The accounting systems at the DFAS Centers in Columbus and Indianapolis did not include document or voucher numbers for DBOF transactions. The DFAS Centers reported DBOF disbursements and collections to the Treasury based on information supplied by disbursing offices of each Military Department. For example, at the DFAS-Indianapolis Center, the data is summarized by the disbursing offices and batch processed (daily by the Air Force and weekly for all other Military Departments) to the DFAS Center with a batch number reference instead of a document or voucher number. A sample of 50 summarized transactions selected from the DFAS-Indianapolis Center's accounting system included more than 7,000 detailed transactions. Automated copies of the transactions were not retained.

Even though a suitable integrated agency accounting system has not been developed, we believe that auditability of DFAS records can be improved by retaining automated copies of accounting transactions. The records retained should, at a minimum, identify the source document, date of the transaction, the amount of the transaction, and other pertinent accounting information.

Intrafund Transactions. The intrafund transactions among business areas of the DBOF were not properly identified on or eliminated from the FY 1992 DBOF Combining or Consolidated financial statements. The DoD Comptroller estimated there was $17.7 billion in intrafund transactions for the DBOF during FY 1992. Generally accepted accounting principles require that those transactions be identified or eliminated from the financial statements in order to prevent distortion of financial statement accounts resulting from internal transactions. Transactions to be eliminated include, among others, sales and purchases, receivables and payables, unrealized profits in inventory, and unrealized profit in long-lived assets.

The intrafund transactions were not properly disclosed on the financial statements. Specific policies regarding the treatment of those transactions had not been developed. In addition, the present accounting systems used to record disbursements and collections were not designed to identify and retain the intrafund data when both the buyer and seller are DBOF activities. Since the data is not being identified, it is impossible for each business area to determine the total dollar values of transactions made to each of the other business areas within the DBOF. If the data are not collected and accumulated, appropriate yearend adjusting entries or identification of the transactions cannot be made on the principal and combining financial statements. Due to the lack of guidance governing intrafund transactions, as well as inadequate accounting systems and lack of supporting documentation, we were unable to determine the dollar value of intrafund transactions that should have been eliminated or disclosed in the DBOF financial statements.

Capital Asset Subaccount. Policy managers for the DBOF did not take adequate steps to establish a separate subaccount for DBOF capital reserve funds. Public Law 102-172, Department of Defense Appropriations Act of 1992," Sections 8121(c) and (d), effective November 26, 1991, states:

> (c) Amounts charged for supplies and services provided by the Fund shall include capital asset charges which shall be calculated so that the total amount of the charges assessed during any fiscal year shall equal the total amount of (1) the costs of equipment purchased during that fiscal year by the Fund for the purpose of providing supplies and services by the Fund and (2) the costs, other than costs of military construction, of capital improvements made for the purpose of providing services by the Fund.
>
> (d) Capital asset charges collected pursuant to the provisions of subsection (c) shall be credited to a subaccount of the Fund which shall be available only for the payment of: (1) the costs of equipment purchased by the Fund for the purpose of providing supplies and

> services by the Fund and (2) the costs other than costs of military construction, of capital improvements made for the purposes of providing services by the Fund.

Capital assets are long-lived assets such as buildings, equipment, and improvements. Capital asset transactions are those that generate funds and recognize revenue from capital asset depreciation, as well as those that generate minor construction surcharges included in customer rates, obligations for capital asset purchases, and outlays for capital assets. The money for future capital asset investments is generated from depreciation and surcharges included in customer rates. A capital surcharge was applied by the DoD Comptroller for FY 1992 as a means of providing the initial funding for future capital asset investments. This initial funding totaled $1.3 billion.

The DoD Comptroller issued capital asset guidance on July 21, 1992, that established new general ledger accounts to distinguish operating funds from capital asset funds. The guidance, however, was not issued until about 8 months after the Act became effective. The new accounts were not established by the business area managers even after the guidance was issued. However, the ability of the business areas to implement the guidance is questionable, since only 1 of the 33 business areas is using the U.S. SGL.

Each fiscal year, each business activity's annual operating budget identifies the capital assets to be bought during the year and the ceiling limitations for those assets. Each business activity is permitted to buy capital assets as long as the business activity does not exceed its capital budget ceiling limitations. The DBOF's Capital Budget for FY 1992 was $1.2 billion. It was assumed by the business activities that since the capital assets were in their capital budgets, the money was available to be spent on capital investments. However, because separate subaccounts have not been established for disbursements or collections for capital expenditures, capital expenditures were not always identified as such, and compliance with capital budget limitations could not be assured.

Additionally, the accounting systems used by the activities were not updated to include the new general ledger account codes; therefore, operating funds and capital funds were not separately recorded. Until the capital reserve subaccount is established in the various accounting systems used by the DBOF, the DoD cannot be assured that capital funds are not used for other than capital expenditures. As an alternative to the existing policy for accounting for the capital transactions, we believe that the establishment of new appropriation sublimits for capital transactions would result in improved tracking of the capital transactions. Tracking would be improved because the existing DBOF accounting systems could collect accounting transactions at the sublimit level until a uniform accounting classification structure can be implemented within the DBOF.

Monthly Report of Operations. The required financial information for the Monthly Report of Operations submitted by the business areas of the DBOF to the DoD Comptroller was inconsistent, incomplete, and inaccurate. The guidance in the DoD Accounting Manual for the preparation of the report was outdated because it did not acknowledge that the DoD Uniform Chart of Accounts had been revised. It did not provide a crosswalk to the general ledger accounts. As a result, the DoD was unable to use the Monthly Report of Operations to effectively track the true cost of operations or monitor the capital budget.

The Monthly Report of Operations is a cumulative summary operating report. Until early FY 1992, each DoD Component having one or more industrial fund activities was required to submit the Monthly Report of Operations to the DoD Comptroller, and DoD Components having one or more stock fund activities were required to submit the Monthly Management Report (DD Form 1302). Since December 1991, however, the Monthly Report of Operations has been the only report used to monitor operations within all activities of the DBOF.

The report is similar in design to an income statement, depicting revenues, expenses, and net results. Revenue is divided into areas that identify the source of each activity's revenues: operations, surcharges, and other revenue. Expense is divided into six categories that, when totaled, equal the cost of sales. Net results, net operating results, and unfunded costs are also parts of the report. In addition, activities are to report the amount obligated for capital asset purchases for the year and net outlays for capital assets for the year to date. Chapter 95 of the DoD Accounting Manual provides guidance for preparing the Monthly Report of Operations.

Current guidance in the DoD Accounting Manual states that the report is to be submitted within 45 days after the end of each month. Chapter 95, page 95-28, states that if all financial data is not available at the required submission time, activities are to "provide the best estimate of any incomplete data and identify data as estimated." The guidance in the DoD Accounting Manual does not provide a crosswalk indicating the general ledger accounts that should be used to prepare the monthly report. The financial data used to prepare the report is supposed to be taken from the same accounting systems that generate the trial balances used in preparing the yearend financial statements for each of the business activities. We performed a comparison of the Purchases of Property, Plant, and Equipment shown on the Statement of Cash Flows from Non-Operating Activities statement, part of the FY 1992 financial statements with the Obligations and Net Outlays for capital equipment shown on the Monthly Report of Operations.

Our comparison, shown in Table 3, identified significant differences between the two reports.

Table 3. Comparison of the Statement of Cash Flows with Obligations and Net Outlays by Military Component ($ millions)

DBOF Component	FY 1992 Financial Statements -- Statement of Cash Flows[1]	Monthly Report of Operations -- Obligations and Net Outlays	Difference
Army	$ 519.1	$ 106.0	$(413.1)
Navy	86.6	205.0	118.4
Air Force	3.2	403.0	399.8
DeCA[2]	0.0	2.0	2.0
DISA[3]	0.4	0.0	(0.4)
DLA[4]	85.7	298.0	212.3
Totals	$ 695.0	$1,014.0	$ 319.0

[1]These amounts were derived from line 17, "Purchases of Property, Plant, and Equipment," in the Cash Flows from Non-Operating Activities section of the Statement of Cash Flows.
[2]DeCA = Defense Commissary Agency
[3]DISA = Defense Information Systems Agency
[4]DLA = Defense Logistics Agency

The amounts on the Statement of Cash Flows and amounts in the Monthly Report of Operations--Obligations should be equal if the same general ledger accounts are used for both financial documents. The Monthly Report of Operations is used by the DoD Comptroller to determine if each business area is operating within its operating and capital budgets.

Personnel in the Office of the DoD Comptroller agree that financial information on the Monthly Report of Operations is not very reliable. That is true especially of the information received from the old stock fund business activities, since those business areas were not required to prepare the Monthly Report of Operations until the early part of FY 1992. As an extra precaution, the DoD Comptroller requires business area managers to verbally inform the DoD Comptroller's office if a business area anticipates it is going to exceed its budget. In addition, Headquarters, DFAS, is revising the guidance on the preparation of the Monthly Report of Operations. The revised guidance will include a crosswalk indicating the general ledger accounts used for each line on the report. Until that guidance is issued, however, preparation of the Monthly Report of Operations will continue to follow the current guidance in the DoD Accounting Manual; therefore, problems may persist.

Corrective Actions Initiated

The "Defense Business Operations Fund Improvement Plan," September 1993, established a DBOF Corporate Board and required the Board, the DoD Comptroller, and the CFO to review, improve, clarify, or rescind policies that impact the DBOF. The requirement pertains to capital asset accounting, capital budgeting, and intrafund transactions. The plan listed several actions to implement the U.S. SGL for financial management information reporting, improve its accounting systems, and improve accounting for DBOF capital assets.

o The DFAS was tasked with evaluating the use of a translator device or data dictionary approach to effect a standard crosswalk between general ledgers in use and the U.S. SGL and with documenting manual crosswalks between the general ledgers used and the U.S. SGL.

o The CFO was tasked with reviewing and improving the Monthly Report of Operations, DD Form 1307 report.

o the DBOF Corporate Board and the DoD Comptroller were tasked with reviewing the previous selection of the Defense Business Management System as its migratory system and with consolidating all documents pertaining to system requirements into one functional document that would include standards for the general ledger.

o The DFAS was tasked with preparing crosswalks from existing data structures to the DoD's standards.

Actions initiated by the Office of the Secretary of Defense should correct deficiencies we noted in the areas of accounting for intrafund transactions, implementation of the U.S. SGL, and improvements in accuracy of the Monthly Report of Operations. During current and future DBOF audits, we will monitor the progress made.

It was not made clear, however, that the initiatives taken would correct problems with capital asset accounting, the conflicting guidance on general ledger structures, and the need for enhancing or replacing existing systems to provide adequate audit trails. Therefore, we have made recommendations in those areas.

Recommendations, Management Comments, and Audit Response

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

a. Revise capital asset guidance issued on July 21, 1992, to establish additional appropriation sublimits for each business area in the Defense Business Operations Fund to use to account for its capital asset expenditures.

b. Perform follow-up reviews to verify that Defense Finance and Accounting Service accounting personnel are following any prescribed procedures developed by the Comptroller of the Department of Defense involving accounting for capital assets.

DoD Comptroller Comments. Comments were not received from the DoD Comptroller.

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

a. Revise all Military Department and DoD instructions and accounting regulations that are in conflict with the U.S. Government Standard General Ledger to resolve those conflicts.

b. Modify existing accounting systems or develop new accounting systems to provide complete, reliable, consistent, and timely information prepared on a uniform basis that is responsive to the financial information needs of agency management. Also, the systems should provide audit trails that trace transactions from source documents through successive levels of summarization to the financial statements. The audit trail should also be traceable in reverse.

c. Establish procedures, until accounting systems with adequate audit trails have been implemented, for Defense Finance and Accounting Service Centers to retain copies of its transactions in an automated form for at least 2 years. The records retained should, at a minimum, identify the source document, date of the transactions, accounting information, and the amount of the transaction.

DFAS Comments. The DFAS concurred with the recommendation to revise all Military Department and DoD instructions and accounting regulations that are in conflict with the U.S. Government Standard General Ledger to resolve those conflicts. DFAS management stated that DFAS uses the DoD Uniform Chart of Accounts, which crosswalks to the U.S. Government Standard General Ledger.

DFAS management concurred with the recommendation to modify existing accounting systems or develop new accounting systems to provide complete, reliable, consistent, and timely information that provides good audit trails. DFAS management stated that it agrees with the philosophy of the recommendation to modify existing accounting systems or develop a new system for the DBOF, and that efforts are ongoing to identify specific problems with current systems and the costs to correct them.

DFAS management concurred with the recommendation to retain its accounting records in an automated form to serve as an audit trail until better accounting systems have been developed.

Audit Response. Concerning management comments to the recommendation to revise instructions that are in conflict with the standard general ledger, our reviews of the DoD Accounting Manual concluded that the DoD Accounting Manual generally conforms to the Standard General Ledger account structure. Our finding, however, concluded that guidance provided by the Navy, the Air Force, and most of the Defense agencies with DBOF business areas, used different accounting structures which did not conform to the DoD Accounting Manual, and therefore did not conform to the Standard General Ledger. A description of actions proposed by the DFAS to revise or rescind this nonconforming guidance and a planned completion date are still required.

The DoD Comptroller is asked to comment on the final report. The DFAS is asked to respond on the unresolved issues. For the complete text of management comments received in response to the draft, see Part IV. All comments to the final report should be received by June 10, 1994.

Response Requirement for Each Recommendation

Responses to the final report are required from the addressee shown for the items indicated with an "X" in the chart below.

		Response Should Cover:			
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
B.1.a	Comptroller	X	X	X	IC
B.1.b	Comptroller	X	X	X	IC
B.2.a	DFAS		X	X	IC
B.2.b	DFAS		X	X	IC
B.2.c	DFAS			X	IC

*IC = Material internal control weakness.

Finding C. Compliance With Laws and Regulations

The DBOF was not in compliance with several laws and regulations.

o The DBOF Principal and Combining Financial Statements were incomplete as submitted and, therefore, not in full compliance with the CFO Act of 1990 as implemented by OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992.

o Reports to the Treasury required by the Debt Collection Act were inaccurate, and a system to monitor and report debts from contractors, also required by the Debt Collection Act to be included in the reports to Treasury, had not yet been implemented.

o Real property facilities financed by appropriations for the Military Departments, and under their jurisdiction, were reflected as DBOF capital assets on the DBOF financial statements.

o New activities were added to the DBOF in violation of the Defense Authorization Act for FYs 1992 and 1993.

The incomplete financial statements occurred because of flawed accounting systems and inexperienced personnel. Inaccurate reporting of debts under the Debt Collection Act occurred because required procedures for preparing the report were not followed. Section 2682 of 10 U.S.C. was not followed because DBOF managers were not aware of restrictions against inclusion of real property facilities. However, there is some uncertainty as to the accounting implications in light of the legal restrictions. Finally, the DBOF managers did not believe that addition of the new activities to the DBOF violated the restrictions of the Defense Authorization Act. Collectively, the violations have resulted in the DBOF financial statements being materially misstated, incomplete, and inconsistent with reports provided to the Treasury. Violations of restrictions placed on DBOF by the Defense Authorization Act for FYs 1992 and 1993 can invite continued congressional criticism of the DBOF program.

Responsibility for Compliance Issues

Compliance with laws and regulations applicable to the DBOF is the responsibility of DBOF management. OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires auditors to observe and report instances of noncompliance with laws and regulations that could have a material effect on the DBOF financial statements.

Chief Financial Officers Act of 1990

The Office of the DoD Comptroller did not fully comply with OMB Bulletin No. 93-02 when it submitted incomplete financial statements. The statements were incomplete because they lacked the required Notes to the Principal Statements and the Supplemental Financial and Management Information. Those are integral parts of the financial statements necessary to fairly present the results of operations. OMB Bulletin No. 93-02 requires each agency to prepare, for each reporting entity governed by the CFO Act, the following:

- Overview of the Reporting Entity,
- Principal Statements,
- Combining Statements (if applicable), and
- Supplemental Financial and Management Information.

The Notes to the Principal Statements are also a required part of the Principal Statements. Several factors contributed to the incomplete condition of the financial statements submitted by the DoD Comptroller to the OMB.

o Many of the DFAS personnel tasked with preparing financial statements had no prior experience preparing financial statements.

o The accounting systems used were not always able to generate accurate accounting information in the proper form for use in preparing the statements, so accounting personnel had to rely on manual methods, electronic spreadsheets, and estimates to prepare the statements.

o Final OMB and DoD guidance on form and content of the financial statements was not issued until after the end of the fiscal year.

o Management indecision during the year as to who was responsible for preparing the statements and at what reporting levels the statements should be prepared impeded planning for statement preparation.

Debt Collection Act

Quarterly and annual reports to the Treasury on Accounts and Loans Receivable Due from the Public (Standard Form [SF] 220-9) were not accurately prepared. Quarterly reports were understated by about $60.0 million because the DFAS did not require that reports be prepared and submitted to the DFAS for all DBOF business areas. The annual report was understated by $4.8 million due to a $29.6 million understatement for the business areas for the DoD components and a $24.8 million overstatement for the Air Force business areas. The errors in the annual report occurred because the DFAS did not reconcile the amounts reported to the Treasury with the Accounts Receivable, Net Non-Federal amount shown on the financial statements and because a $12.3 million error identified by the DFAS was not corrected before submission of the report to the Treasury. No accounting systems were in place to manage the collection of debts from contractors.

The Debt Collection Act of 1982 expanded the rights given to Federal agencies by the Federal Claims Collection Act of 1966. The Debt Collection Act authorizes Federal agencies to assess interest, penalties, and administrative charges on debts owed by the public. The Debt Collection Act also authorized the Federal Government to use such tools as credit bureaus and debt collection agencies. In addition, the Act authorized the assessment and collection of interest, penalties, and administrative costs against debtors with respect to debts owed to the United States. A debt is considered delinquent if it has not been paid by the date specified in the agency's initial demand letter, unless satisfactory payment arrangements have been made by that date, or if, at any time thereafter, the debtor fails to satisfy his obligations under the payment agreement. Once the penalty has been assessed and the appeal period has lapsed, interest, penalties, and administrative costs should be added to the penalty amount.

Submission of SF 220-9, Report on Accounts and Loans Receivable Due From the Public, is required on an annual basis by the Treasury Financial Manual for all reporting entities, including those with no receivables. Entities with receivables of less than $50.0 million are required to submit annually, and entities having receivables of $50.0 million or more are required to submit quarterly. OMB Bulletin No. 93-02 requires that amounts shown as Accounts Receivable, Net Non-Federal, agree with information on the SF 220-9 report. The DFAS is responsible for collecting debts; charging the prescribed interest, administrative fees, and penalties for the DBOF; and preparing and submitting the required reports to the Treasury.

Annual Reports to the Treasury. The amounts shown as Accounts Receivable, Net Non-Federal, on the financial statements for the DBOF did not agree with the amounts submitted to the Treasury on the SF 220-9, Report on Loans and Accounts Receivable Due from the Public for Fiscal Year 1992. That occurred because the two amounts had not been compared, and made to agree, as required by Appendix C of OMB Bulletin No. 93-02. Table 4 shows the differences between the two amounts.

Table 4. Variances Between Accounts Receivable Due from the Public Shown on the DBOF Financial Statements and DBOF Accounts Receivable Reported to Treasury on SF 220-9 Annual Report
($ millions)

DoD Component	Financial Statements	SF 220-9 Reports	SF 220-9 Reports Overstated	SF 220-9 Reports Understated
Army	$ 7.6	$ 7.9	$ 0.3	$ 0.0
Navy	117.7	117.5	0.0	0.2
Air Force	93.0	117.5	24.5	0.0
DoD	125.8	96.5	0.0	29.3
DISA[1]	0.6	0.6	0.0	0.0
DeCA[2]	124.7	124.6	0.0	0.1
Total	$469.4	$464.6	$24.8	$29.6

[1]DISA = Defense Information Systems Agency
[2]DeCA = Defense Commissary Agency

Quarterly Reports to the Treasury. Managers for four of the five Air Force business areas did not submit required feeder reports to the DFAS-Cleveland DAO, Arlington, VA, needed to prepare the quarterly DBOF consolidated SF 220-9 Reports on Loans and Receivables Due from the Public. As a result, we estimated that quarterly reports for the second and third quarters of FY 1992 were understated by about $60.0 million. We were unable to review the feeder reports for the first quarter because the DAO had lost the reports. Personnel at the DFAS-Denver Center did not submit the feeder reports because they had misunderstood the $50.0 million reporting threshold: they did not submit the required information because the business area's receivables were below $50.0 million. Because the DAO prepared a consolidated report and the $50.0 million threshold applied to the DBOF as a whole rather than the individual business areas, however, the consolidated quarterly reports were understated. Also, the DAO should have ensured that all business areas had been included in the consolidated reports before submitting the reports to the Treasury. The SF 220-9 feeder reports for all five of the Air Force business areas did not report the collection of interest, penalties, or administrative costs. The trial balances for those business areas did not indicate that such items were being collected as required by the Debt Collection Act.

Contractor Debts. Management of contractor debt is the responsibility of the DFAS-Columbus Center. At the time of our audit, no system had been implemented to track debts from contractors. As a result, we could not determine whether such debts were being properly managed and reported. We also could not determine the magnitude of contractor debt. Subsequently, the DFAS-Denver Center developed a system to manage contractor debt and installed the system during December 1993. We examined the documentation for the proposed system and it appeared to meet requirements of the Debt Collection Act.

Followup on Audit Report No. 92-021. Although the DFAS agreed to centralize management of DoD's debt collection function and to develop uniform operating procedures, it had not issued guidance to its Centers to implement such procedures. Specifically, the DFAS agreed by the end of FY 1992 to do the following.

o Establish time frames for carrying out each procedure in the debt collection strategy.

o Require collection activities to periodically report whether they meet the time frames.

o Identify and write off all delinquent debts that are unlikely to be collected.

o Require aggressive pursuit of all delinquent debts and standardize the implementation of all procedures required by laws and regulations, including procedures for assessing interest, penalties, and administrative fees and for reporting uncollectible debts to the Internal Revenue Service.

As of the end of our field work, April 30, 1993, those uniform operating procedures had not been issued. The Assistant Inspector General for Followup requested an update on the status of this recommendation from the DFAS on February 1, 1994, but has not yet received a response.

Improvements to Debt Collection. A standard debt collection system called the Defense Debt Management System has been developed by the DFAS-Denver Center and was fully implemented at all DFAS Centers on October 29, 1993. The system features on-line processing, single-source data entry, automated interfaces with pay systems from which debts originate, and interfaces with other organizations. Documentation for the system showed that the system will satisfy requirements of the Debt Collection Act. In addition, the DFAS has arranged for a centralized lockbox for its debt collections. A lockbox is a collection and processing service provided by a financial institution to accelerate the flow of funds to the Treasury's General Account. The service includes collecting the agency's mail from a specified post office box; sorting, totaling, and recording the payments; processing the collections; and depositing the collections to a financial institution on behalf of the DFAS.

Ownership and Presentation of Real Property

Real property facilities that are assets of the Military Departments and under the jurisdiction of the Military Departments by law, are used by the DoD activities or agencies. These real property facilities are now included in the DBOF.

These real property facilities were improperly reflected as DBOF assets on the financial statements of the DBOF, and depreciation for those real property facilities was shown as a source of DBOF revenue. That occurred because the guidance on criteria for capitalization of assets issued by the Office of the DoD Comptroller on July 21, 1992, did not provide for proper accounting for real property facilities. As a result, DBOF assets were overstated by $4.9 billion and depreciation expenses for real property facilities were overstated by about $508.2 million.

Section 2682 of title 10. U.S.C., "Facilities for Defense Agencies," provides:

> The maintenance and repair of a real property facility for an activity or agency of the Department of Defense (other than a military department) financed from appropriations for military functions of the Department of Defense will be accomplished by or through a military department designated by the Secretary of Defense. A real property facility under the jurisdiction of the DoD which is used by an activity or agency of the DoD (other than a military department) shall be under the jurisdiction of a military department designated by the Secretary of Defense.

The DBOF was established under Section 8121 of Public Law 102-172, "Department of Defense Appropriations Act of 1992." Section 8121(a) provided that certain existing DoD organizations operate as part of the fund but it did not transfer any assets of the Military Departments or other DoD activities or agencies to those organizations. Section 8121(b) of Public Law 102-172 transferred to the DBOF "all assets and balances of working capital funds heretofore established under the provisions of [10 U.S.C. 2208]." Real property facilities of the Military Departments were not transferred to the DBOF.

Furthermore, Section 8121(c) of Public Law 102-172 states that:

> Amounts charged for supplies and services provided by the Fund shall include capital asset charges which shall be calculated so that the total amount of the charges assessed during any fiscal year shall equal the total amount of (1) the cost of equipment purchased during that fiscal year . . . and (2) the costs, **other than costs of military construction**, of capital improvements made for the purpose of providing services by the Fund [emphasis added].

To implement Section 8121 of Public Law 102-172, the Office of the DoD Comptroller issued the "Capital Asset Accounting Guidance for the Defense Business Operations Fund," July 21, 1992. The guidance stated that ownership of capital assets used by the DBOF activities in providing goods or services must be recognized in the property and financial records of that business area. Additionally, the guidance required the DBOF activities to charge depreciation expenses on their capital assets, including real property. Capital assets were said to include, but not be limited to, property, plant, and equipment items (including Government-owned facilities, property, and improvements to property acquired under a capital lease), equipment, and software. Real property includes land, buildings, and other facilities attached to the land. The guidance did not discuss real property facilities of the Military Departments or state, as provided by law, that costs of military construction could not be included in DBOF capital asset charges.

Our review of the financial statements disclosed real property facilities of the Military Departments shown as assets of the DBOF. The real property facilities used by the former Air Force and Army industrial and stock fund activities had been capitalized to the Component business areas of the DBOF. We could not determine, however, if real property facilities used by the former Navy industrial and stock fund activities had been capitalized as DBOF assets because the financial statements for those DBOF business areas were incomplete. Accordingly, under DBOF we believe that neither capitalization nor depreciation by DBOF of real property facilities or improvements financed from appropriations for military functions of the Department of Defense, including military construction funds, is appropriate.

Although we believe that real property facilities under the jurisdiction of the Military Departments should not be shown as assets on the financial statements of the DBOF, we realize there is some uncertainty as to the accounting implications as a result of the legal requirements. To resolve those uncertainties, we have requested that the GAO review the issue. Therefore, we are not making recommendations in this report regarding real property facilities, but will address the issue in the report on the audit of the FY 1993 DBOF financial statements.

New DBOF Business Areas

During FY 1992, two new activities were added to the DBOF, the Defense Information Services Organization (DISO)[2] and the Joint Logistics Systems Center (JLSC). We believe making those additions violated the prohibition of Section 316 of Public Law 102-190, "National Defense Authorization Act for FYs 1992 and 1993," which provided that except for the funds and activities specified in subsection (b), no other function, activities, funds, or accounts of the Department of Defense may be managed through the DBOF.

Defense Information Services Organization. On May 18, 1992, the DISO was established as an activity governed by the Defense Information Services Agency. The mission of the DISO is to design, engineer, develop, test, field, maintain, and operate information systems and networks for the business activities within the DoD. Those products and services are to be provided on a fee-for-service basis. The DISO's FY 1992 customers included the DFAS Centers and selected portions of the Defense Logistics Agency. The DoD Comptroller provided a funding allocation of $1.8 million from the DBOF, enabling the DISO to be established with no net increase in overall DoD resources.

Joint Logistics Systems Center. On February 11, 1992, the JLSC was chartered as a Corporate Management Center to facilitate the development of standard systems within the DoD, to manage systems development and

[2]Originally, Defense Information Technology Services Organization.

integration, and to oversee the development of systems changes for the supply management and depot maintenance business activities of the DBOF. The JLSC will issue reimbursable orders to the central design activities of the Military Departments and the Defense Logistics Agency to perform work on approved supply management and depot maintenance system support projects, which will be funded through the JLSC capital budget. The capital budgets that were intended for logistics systems were transferred to the JLSC for administration to ensure coordinated development efforts affecting logistics systems. Operating budget authority of $11.1 million was provided to cover JLSC's initial start-up costs and operating costs for the fiscal year. The DoD Components will continue to request and justify their capital budgets with oversight and approval of the requests and related projects provided by the JLSC.

Corrective Actions Initiated

The "Defense Business Operations Fund Improvement Plan," September 1993, requires the DBOF Corporate Board to remove the JLSC from the DBOF during the first quarter of FY 1994. The decision to remove the JLSC from the DBOF was made for reasons other than the restrictions imposed by the National Defense Authorization Act for Fiscal Years 1992 and 1993, section 316. The plan also tasked the DoD Comptroller, the DoD Components, and budgetary personnel with the removal of real property depreciation from customer rates in FY 1995.

The removal of the JLSC from the DBOF will satisfy our concerns that its inclusion in the DBOF may violate section 316 of the National Defense Authorization Act for Fiscal Years 1992 and 1993. As a result, we are not making a recommendation to exclude the JLSC from DBOF. We have recommended, however, that the DISO be removed from the DBOF to comply with the Act. Based upon our review of the legality of real property facilities ownership within the DBOF, we believe that action on removal of depreciation from rates should be immediate rather than delayed to FY 1995. Depreciation of assets by an entity that can not legally own them is not an acceptable accounting practice, and the inclusion of depreciation in the DBOF customer rates during FY 1994 may negatively impact our opinion of the financial statements for that year. We will monitor the progress made on the initiatives during ongoing and future DBOF audits. The initiatives did not address the other problems pertaining to planning for CFO statement preparation, compliance with 10 U.S.C. 2682 on ownership of real property, and compliance with the Debt Collection Act.

Recommendations, Management Comments, and Audit Response

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

a. Establish milestones, assign responsibilities, and define the levels at which the financial statements required by Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, and its successor would be prepared. The plan should be developed early in each fiscal year and be designed to ensure that the financial statements are completed by the dates required by the Office of Management and Budget.

b. Remove the Defense Information Systems Organization from the Defense Business Operations Fund, and

c. Obtain a legal review and approval by the Office of General Counsel, DoD, before adding any new entities to the Defense Business Operations Fund.

DoD Comptroller Comments. Comments were not received from the DoD Comptroller.

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

a. Include all financial statement information required by Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, when compiling the DBOF financial statements. The statements should include an Overview of the Reporting Entity, Principal Statements and Footnotes, Combining Statements (if applicable), and Supplemental Financial and Management Information for both the overall Defense Business Operations Fund and DBOF reporting entities.

b. Issue guidance to ensure procedures are followed in preparing its reports to the Treasury required by the Debt Collection Act that would:

(1) Report all interest, penalties, and administrative costs collected on the Standard Form No. 220-9, "Report on Loans and Accounts Receivable Due for the Public," as required by the Treasury Financial Manual.

(2) Include all business areas in the consolidated Standard Form No. 220-9, "Report on Loans and Accounts Receivable Due for the Public," reports before submission of the to Treasury.

(3) Compare the amounts shown as Accounts Receivable, Net Non-Federal on the financial statements to the amounts reported to the Department of the Treasury on the SF 220-9, "Report on Loans and

Accounts Receivable Due for the Public" as required by Appendix C of Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, and resolve any differences.

DFAS Comments. DFAS concurred with the recommendation to include all financial statement information required by office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, when compiling the DBOF financial statements. The DFAS stated that the OMB Bulletin 93-02 requirement to provide an Overview of the Reporting Entity, Principal Statement and Footnotes, Combining Statements, and Supplemental Financial and Management Information for all business areas did not clearly define responsibility for preparing the reports. In regard to the preparation of the Principal Financial Statements and Combined Statements, DFAS takes the lead in preparation. In regard to the Overview, Footnotes, and Supplemental Financial and Management Information, the DoD Component is responsible for their preparation.

DFAS concurred with the recommendation to issue guidance to ensure procedures are followed in preparing its reports to the Treasury required by the Debt Collection Act that would require its Centers to report all interest, penalties, and administrative costs collected on the SF 220-9, "Report on Loans and Accounts Receivable Due for the Public" as required by the Treasury Financial Manual. DFAS provided a planned completion date of April 1994. DFAS management pointed out that the $.3 million difference between the Army's financial statements and the SF 220-9 report submitted to the Treasury was the difference in the allowance for estimated uncollectible accounts. The Army reported Accounts Receivable, Net Non-Federal, net of allowances, as required by OMB Bulletin No. 93-02. The gross amounts of accounts and interest receivable for the financial statements and the SF 220-9 report submitted to the Treasury agree.

Audit Response. DFAS comments to the recommendations were responsive. For the complete text of those comments, see Part IV. We ask that the Comptroller of the Department of Defense comment on the final report by June 10, 1994.

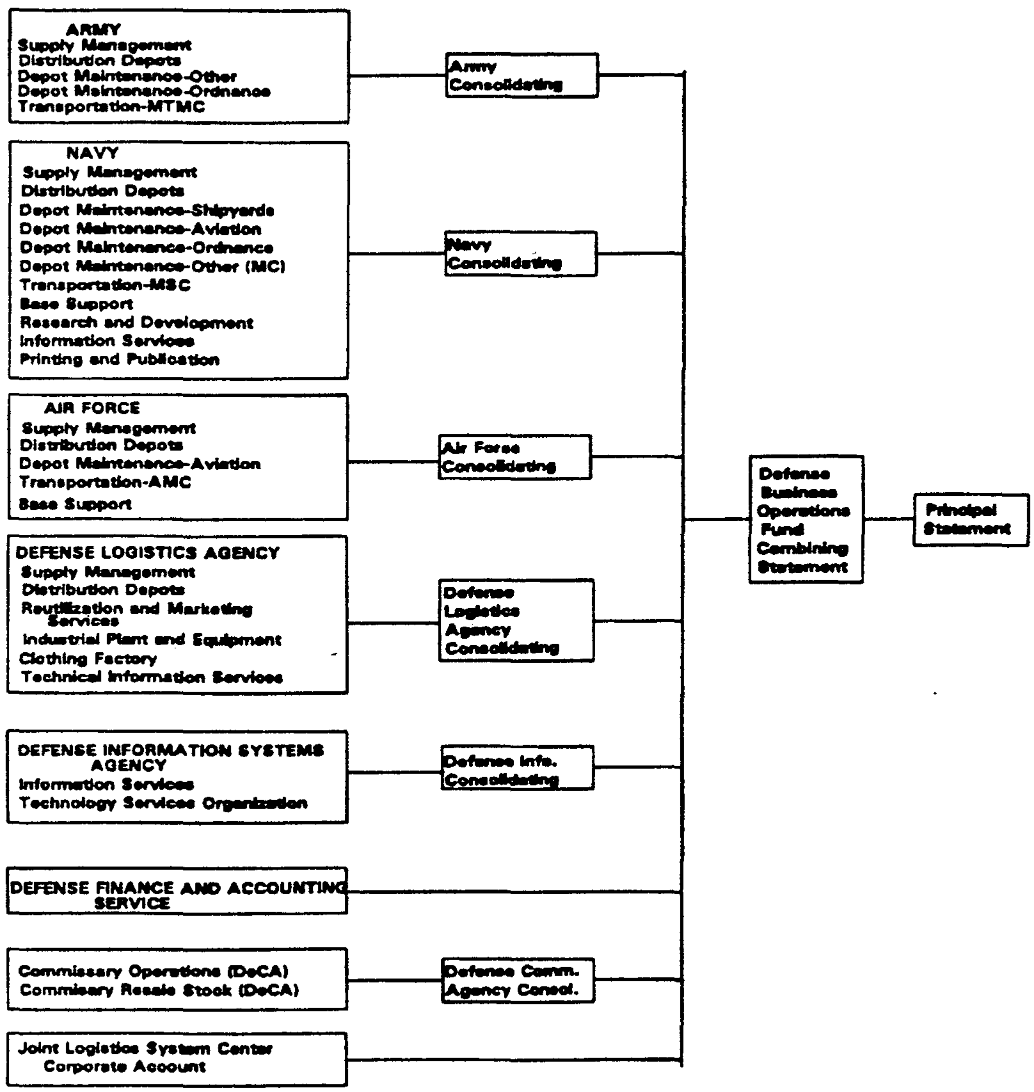
Response Requirement for Each Recommendation

Responses to the final report are required from the addressee shown for the items indicated with an "X" in the chart below.

		Response Should Cover:		
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date
C.1.a	Comptroller	X	X	X
C.1.b	Comptroller	X	X	X
C.1.c	Comptroller	X	X	X

Part III - Additional Information

Appendix A. Reporting Structure for the Defense Business Operations Fund



Acronyms

AMC	Army Materiel Command
DeCA	Defense Commissary Agency
MC	Marine Corps
MSC	Military Sealift Command
MTMC	Military Traffic Management Command

Appendix B. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
A.1.	Internal Controls. Better accuracy in reporting of disbursements and collections.	Nonmonetary
A.2.	Internal Controls. Better segregation of DBOF cash from Air Force General Fund.	Nonmonetary
A.3.	Internal Controls. Better accuracy and accountability by reducing number of suspense accounts.	Nonmonetary
A.4.	Internal Controls. Better accuracy of cash reporting.	Nonmonetary
A.5.	Internal Controls. Improved accountability over accounting adjustments.	Nonmonetary
B.1.a.	Compliance. Compliance with requirements of Defense Appropriations Act (Public Law 102-172) for separate accounting for capital transactions.	Nonmonetary
B.1.b.	Internal Controls. Improved accuracy in reporting of capital transactions.	Nonmonetary
B.2.a.	Compliance. Improved accuracy of financial reporting and compliance with Treasury and GAO requirements through implementation of the U.S. Standard General Ledger.	Nonmonetary

Recommendation Reference	Description of Benefit	Type of Benefit
B.2.b.	Compliance. Improved auditability and compliance with accounting standards promulgated by GAO and OMB by accounting system enhancement.	Nonmonetary
B.2.c.	Internal Controls. Improved auditability by retention of automated records.	Nonmonetary
C.1.a.	Compliance. Compliance with OMB Bulletin No. 93-02 and improved reporting of operations.	Nonmonetary
C.1.b. C.1.c.	Compliance. Ensure future compliance with National Defense Authorization Act for FY 1992 and 1993, Section 316, by performing legal reviews before adding new entities to DBOF.	Nonmonetary
C.2.a.	Compliance. Improvement in planning for financial statement preparation to ensure compliance with OMB Bulletin No. 93-02.	Nonmonetary
C.2.b.	Compliance. Improved procedures to ensure compliance with the Debt Collection Act.	Nonmonetary

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Comptroller of the Department of Defense, Arlington, VA

Department of the Navy

Headquarters, U.S. Marine Corps, Arlington, VA
Office of the Comptroller, Department of the Navy, Washington, DC
Naval Regional Finance Center, Navy Accounting and Finance Center[1]
Financial Information Processing Center, Naval Education and Training Program Management Support Activity2

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Center, Cleveland, OH
Defense Accounting Office, Cleveland Center, Arlington, VA
Defense Finance and Accounting Service Center, Columbus, OH
Defense Finance and Accounting Service Center, Denver, CO
Defense Finance and Accounting Service Center, Indianapolis, IN
U.S. Transportation Command, Scott Air Force Base, Belleville, IL
Defense Information Systems Agency, Arlington, VA
Defense Information Technology Services Organization,[3] Denver, CO
Defense Information Technology Services Organization,[3] Columbus, OH
Defense Logistics Agency, Arlington, VA

Non-Defense Federal Organizations

Department of the Treasury, Washington, DC
Office of Management and Budget, Washington, DC
General Accounting Office, Washington, DC
Federal Accounting Standards Advisory Board, Washington, DC

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[1]Currently the Defense Accounting Office, Cleveland Center, Washington, DC.
[2]Currently the Defense Accounting Office, Cleveland Center, Pensacola, FL.
[3]Currently the Defense Information Services Organization.

Appendix D. Report Distribution

Office of the Secretary of Defense

Assistant Secretary of Defense (Public Affairs)
Comptroller and Chief Financial Officer of the Department of Defense
Deputy Chief Financial Officer of the Department of Defense

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Research, Development and Acquisition)
Inspector General, Department of the Army
Auditor General, Army Audit Agency

Department of the Navy

Secretary of the Navy
Commandant of the Marine Corps
Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Auditor General, Naval Audit Service

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Acquisition)
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Air Force Audit Agency

Defense Organizations

Defense Finance and Accounting Service
- Defense Finance and Accounting Service-Cleveland Center
  - Defense Accounting Office, Pensacola, FL
  - Defense Accounting Office, Washington, DC
- Defense Finance and Accounting Service-Columbus Center
- Defense Finance and Accounting Service-Denver Center
- Defense Finance and Accounting Service-Indianapolis Center

Defense Organizations (cont'd)

U.S. Transportation Command
Defense Information Systems Agency
Defense Information Technology Service Organization
Defense Logistics Agency

Non-Defense Federal Organizations

Department of the Treasury
Office of Management and Budget
U.S. General Accounting Office
  Accounting and Financial Management Division
  National Security and International Affairs Division Technical Information Center
Federal Accounting Standards Advisory Board
Joint Financial Management Improvement Program

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

FEB 14 1994

(Business Funds)

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE
INSPECTOR GENERAL, DOD

SUBJECT: DoD(IG) Draft Report, "Financial Management of the Defense Business Operations Fund - FY 1992," (Project No. 2FG-2008.01)

We have reviewed the subject report and attached are responses to the findings related to the Defense Finance and Accounting Service.

My point of contact is Mr. Bill deBardelaben. He may be reached at (703) 607-1581/1579 or DSN 327-1581/1579.

Daniel Turner
Deputy Director for Business Funds

Attachment

Final Report Reference

DoD(IG) Draft Report, "Financial Management of the Defense Business Operations Fund - FY 1992," (Project No. 2FG-2008.01)

Finding A. Cash Management

- **Recommendation 1, Page 15:** We recommend that the Director, Defense Finance and Accounting Service (DFAS) develop internal reconciliation procedures for disbursements and collections that will ensure that all Defense Business Operations Fund reports and accounts provide the same types of information and that all disbursement and collection transactions are presented on the appropriate business area's financial statements. 15

  DFAS Position: Concur in principle. DFAS does have internal reconciliation procedures for collections and disbursements. Prior to submitting DD 1176 Reports on Budget Execution, DFAS Centers are required to reconcile the DD 1176 amounts with the amounts reported to Treasury (see DoD Accounting Manual 7220.9M, Chapter 93, para.B.8). Any differences should be posted to General Ledger Account Code (GLAC) 4950-Accrued Expenditures-Paid-Undistributed, or GLAC 4255-Reimbursements Earned-Collected-Undistributed. At DFAS-HQ the DD1176 is compared with the Statement of Transactions and the Treasury feed-back to ensure at the end of the fiscal year the Net Outlays are in agreement with Treasury for all DoD appropriations.

  Due to time constraints at the end of fiscal year 1992, the reconciliation procedures and the final reports for year-end had not been completed at the time of the audit. The following additional information is provided for your consideration in resolving and/or clarifying the variance amounts reported on page 14 under Finding A. Cash Management--Table 2: (1) The amounts reported to OMB on the DD 1176 should be revised as follows: the Air Force amount should be (1,172.4) vs. (1,972.1) and the Defense Agencies amount should be (956.6) vs. (157.0) the net effect on the overall total is -0-. These changes would then change the variance column for the Air Force to -0- and the Defense Agencies to (557.6). The changes to the DD 1176 amounts are supported by revised DD 1176's.

  The audit report also indicated that the variance amounts which were caused by adjustments made by Defense Accounting Office, Arlington, Virginia (DAO-Arlington) were not documented by the DAO and the rationale provided was not clear. The Army difference of (183.4 million) related to the reporting of transactions for the Defense Commissary Agency (DeCA). The Army was to reflect disbursements and collections related to preexisting accounts payable and accounts receivable related to items transferred to DeCA upon the establishment of DeCA. The Acct Rpt (M) 1176 properly reflected these net outlays of ($183.4 million) as

1 Attachment

part of Army Supply Management. The CFO Statements erroneously included the net outlays as part of departmental undistributed. The FY 1993 CFO statements will be adjusted to reflect prior period adjustments for this item. The Navy difference of $92.4 million resulted from an incorrect total on the Navy consolidated Acct Rpt (M) 1176. The individual Navy business area Acct Rpt (M) 1176 net outlays totaled to the $272.2 million net outlays reflected on the CFO statements. This error misstated the departmental undistributed net outlays by $92.4 million but did not affect the total DBOF cash balance. The remaining variance for the Defense Agencies of (557.6) is also well documented and the rationale fully definitive. This amount is the total Undistributed Disbursements at the Departmental level, and is computed by subtracting the total net outlays as reported by all business areas from the total amount reported as outlays on the Treasury Trial Balance. The Treasury Trial Balance outlays are reported at appropriation level only and cannot be identified to a particular business area. Therefore, DFAS was directed by the DoD Comptroller's Office to post the total Undistributed amount against the Defense Agencies Supply Management business area. This procedure was changed for FY 1993, and the Undistributed amount will be reported against the Corporate account.

- **Recommendation 2, Page 15:** We recommend that the Director, Defense Finance and Accounting Service establish procedures at the Defense Finance and Accounting Service - Denver Center to keep suspense account transactions of the Defense Business Operations Fund separate from other appropriations.

DFAS Position: Nonconcur. DFAS-DE does not generally place DBOF transactions in cash suspense due to bad limitations. Cash suspense is usually generated by an out-of-balance condition with reporting stations' cash data, which is not resolved before consolidation is sent to Treasury. When a cash out-of-balance condition exists, our procedures are to contact the reporting station, verify the data, and make necessary corrections. However, there are instances when an answer is not received in time for reporting to Treasury; when no answer is received, a central account is used to collect cash suspense.

Information is not available in cash suspense to distinguish between DBOF or non-DBOF transactions. Therefore, separate suspense accounts are impractical. The cash suspense figures for reporting to Treasury were misstated by the auditors.

	AUDITORS	DFAS-DE
Disbursements	6.494 billion	25.807 million
Collections	6.508 billion	5.48 million

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DFAS-DE believes the auditors incorrectly included detail suspense data (listed by appropriation thus DBOF items can be identified) with cash suspense data. However, detail suspense data are not reported to Treasury and are only used to track and clear undistributed data within the Air Force network.

- **Recommendation 3, Page 15:** We recommend that the Director, Defense Finance and Accounting Service follow procedures to establish milestones for researching and clearing suspense accounts. 17

  DFAS Position: Concur. DFAS-DE and DFAS-CL concur with the recommendation. DFAS-IN follows normal operating procedures which require uncleared transactions for/by others, uncleared cross-disbursing, and uncleared interfund transactions to be cleared in 60 to 180 days. The station will be graded on the expeditious corrective action via the Performance Measurement Plan. DFAS-CO reports through DFAS-IN to Treasury.

- **Recommendation 4, Page 15:** We recommend that the Director, Defense Finance and Accounting Service direct its Defense Finance and Accounting Service - Denver Center to use only actual cash balances on its reports to the Treasury on the Status of Funds. 17

  DFAS Position: Concur. Estimated completion date: April 1994.

- **Recommendation 5, Page 15:** We recommend that the Director, Defense Finance and Accounting Service establish procedures for authorization, full documentation, and justification of all adjustments made to the financial statements by its accounting personnel. 17

  DFAS Position: Concur in principle. DFAS already requires authorization, full documentation, and justification of all adjustments made to the financial statements. This recommendation is a result of adjustments to collection and disbursement information at DAO-Arlington. DBOF had an opening balance of zero as of October 1, 1992. The changes that affected the departmental DBOF cash (and changed the balance from zero to $6,645,976,731) are shown in the Departmental column of the DBOF Combining Statements for the Statement of Cash Flows. The $648.5 million of DBOF departmental level undistributed net outlays is reflected in the totals for the Statement of Operations line 22 "Excess (Shortage) of Revenues and Financing Sources Over Total Expenses" which is also line one on the Statement of Cash Flows.

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Finding B. Accounting Systems and Procedures

28 • **Recommendation 2A, Page 25:** We recommend that the Director, Defense Finance and Accounting Service revise all Military Department and DoD instructions and accounting regulations that are in conflict with the U.S. Government Standard General Ledger to resolve those conflicts.

DFAS Position: Concur. DFAS uses the DoD uniform chart of accounts which crosswalks to the U.S. Government Standard General Ledger.

28 • **Recommendation 2B, Page 25:** We recommend that the Director, Defense Finance and Accounting Service modify existing accounting systems or develop new accounting systems to provide complete, reliable, consistent, and timely information prepared on a uniform basis that is responsive to the financial information needs of agency management. Also, the systems should provide audit trails that trace transactions from source documents through successive levels of summarization to the financial statements. The audit trail should also be traceable in reverse.

DFAS Position: Concur. DFAS agrees with the philosophy of the recommendation to modify existing accounting systems or develop a new system for DBOF. Efforts are ongoing to identify specific problems with current systems and the costs to correct them.

28 • **Recommendation 2C, Page 25:** We recommend that the Director, Defense Finance and Accounting Service require, until accounting systems with adequate audit trails have been implemented, all DFAS centers to retain copies of its transactions in an automated form for at least 2 years. The records retained should, at a minimum, identify the source document, date of the transactions, accounting information, and the amount of the transaction.

DFAS Position: Concur. DFAS will keep transactions for a minimum of two years, and where necessary modify to retain adequate information for audit trails.

Finding C. Compliance with Laws and Regulations

39 • **Recommendation 2A, Page 34:** We recommend that the Director, Defense Finance and Accounting Service include all financial statement information required by Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, when compiling the DBOF financial statements. The statements should include an Overview of the Reporting Entity, Principal Statements and Footnotes, Combining Statements (if applicable), and Supplemental Financial and Management Information for both

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the overall Defense Business Operations Fund and for its business areas.

DFAS Position: Concur. The OMB Bulletin 93-02 requirement to provide an Overview of the Reporting Entity, Principal Statements and Footnotes, Combining Statements and Supplemental Financial and Management Information for all business areas did not clearly define responsibility for preparing the reports. In regard to the preparation of the Principal Financial Statements and Combined Statements, DFAS takes the lead in preparation. In regard to the Overview, Footnotes, and Supplemental Financial and Management Information, the DoD Component is responsible for their preparation.

- **Recommendation 2B(1), Page 35:** We recommend that the Director, Defense Finance and Accounting Service issue guidance to ensure procedures are followed in preparing its reports to the Treasury required by the Debt Collection Act that would require its Centers to report all interest, penalties, and administrative costs collected on the Standard Form No. 220-9, "Report on Loans and Accounts Receivable Due for the Public" as required by the Treasury Financial Manual. 39

DFAS Position: Concur. Estimated completion date: April 1994.

- **Recommendation 2B(2), Page 35:** We recommend that the Director, Defense Finance and Accounting Service issue guidance to ensure procedures are followed in preparing its reports to the Treasury required by the Debt Collection Act that would ensure that all business areas have been included in the consolidated Standard Form No. 220-9, "Report on Loans and Accounts Receivable Due for the Public" reports before submission of these reports to Treasury. 39

DFAS Position: Concur. Action closed.

- **Recommendation 2B(3), Page 35:** We recommend that the Director, Defense Finance and Accounting Service issue guidance to ensure procedures are followed in preparing its reports to the Treasury required by the Debt Collection Act that would require Defense Finance and Accounting Service Centers to compare the amounts shown as Accounts Receivable, Net Non-Federal on the financial statements to the amounts reported to the Department of the Treasury on the SF 220-9, "Report on Loans and Accounts Receivable Due for the Public" as required by Appendix C of Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992, and resolve any differences. 39

DFAS Position: Concur. It should be noted that DFAS-IN compared the amounts in question. The $.3 million difference between the Army's financial statements and the Treasury 220-9 report was the difference in the allowance for estimated uncollectible accounts. The Army reported Accounts Receivable, Net Non-Federal net of allowances, as required by OMB Bulletin No.93-02. The gross amounts of accounts and interest receivable for the financial statements and the Treasury 220-9 report agree.

6 Attachment

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