June 8, 2006

Financial Management

Controls over Abnormal Balances in Financial Data Supporting Financial Statements for Other Defense Organizations

(D-2006-092)

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Article I, Section 9

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Acronyms

CFO	Chief Financial Officer
CLRS	CFO Load Reconciliation System
CMR	Cash Management Report
DoD IG	DoD Inspector General
DFAS	Defense Finance and Accounting Service
FACTS II	Federal Agencies' Centralized Trial Balance System II
FMR	Financial Management Regulation
ODO	Other Defense Organizations
PBA	Proprietary to Budgetary Adjustment
SGL	Standard General Ledger

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

June 8, 2006

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Report on Controls over Abnormal Balances in Financial Data Supporting Financial Statements for Other Defense Organizations (Report No. D-2006-092)

We are providing this report for review and comment. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Comments provided by the Director, Defense Finance and Accounting Service Indianapolis to Recommendation B were nonresponsive. We request additional comments from the Director, Defense Finance and Accounting Service Indianapolis on Recommendation B by July 10, 2006.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Auddfs@dodig.mil. Copies of the management comments must contain the actual signature of the authorized official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Marvin L. Peek at (703) 325-5777 (DSN 221-5777) or Mr. Scott S. Brittingham at (703) 325-6104 (DSN 221-6104). See Appendix D for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing
Service

Department of Defense Office of Inspector General

Report No. D-2006-092 **June 8, 2006**
(Project No. D2005-D000FA-0262.000)

Controls over Abnormal Balances in Financial Data Supporting Financial Statements for Other Defense Organizations

Executive Summary

Who Should Read This Report and Why? Personnel at Defense Finance and Accounting Service (DFAS) and accounting offices supporting the Other Defense Organizations, and users of the DoD Agency-wide financial statements would benefit from the results of this audit. DFAS should use the results of this audit to improve processes related to identifying, disclosing, and correcting abnormal balances in trial balances supporting the financial statements for Other Defense Organizations. Process improvements will increase the accountability and reliability of the financial statements for the Other Defense Organizations.

Background. The Audited Financial Statements Division, DFAS Indianapolis provides financial reporting support for the Other Defense Organizations General Funds, a reporting entity on the DoD Agency-wide financial statements. Previous DoD Inspector General audits of the DFAS Indianapolis process for compiling and consolidating the Other Defense Organizations financial statements detected weaknesses in the identification, disclosure, and correction of abnormal balances. We performed this audit to assess the effectiveness of corrective actions taken by DFAS Indianapolis and the accounting offices in response to prior audits reports.

Results. The trial balance submissions used by DFAS Indianapolis to prepare the Other Defense Organizations financial statements contained unexplained abnormal balances. Specifically, trial balances submitted for inclusion in the third quarter FY 2005 Other Defense Organizations Financial Statements contained an absolute value of $21.3 billion in abnormal balances. Of the 15 trial balance submissions with abnormal balances, 14 did not include the required footnotes explaining the abnormal balances. As a result, DFAS Indianapolis did not have information necessary to assess the quantitative impact of anomalies in the data supporting the Other Defense Organizations financial statements or disclose the qualitative nature of the anomalies where appropriate. Explanatory footnotes will decrease the amount of time DFAS Indianapolis personnel need to invest in followup and resolution of trial balance submissions. DFAS Indianapolis should revise and improve guidance to the accounting offices supporting the Other Defense Organizations that requires them to provide explanations in the footnotes on the quarterly trial balance submissions. (See finding A for the detailed recommendation.)

DFAS Indianapolis did not disclose in the notes to the financial statements unresolved and uncorrected abnormal balances in the trial balance submissions and the Reports on Budget Execution supporting the third quarter FY 2005 Other Defense Organizations Financial Statements. In addition, DFAS Indianapolis did not disclose the nature of accounting entries made during the compilation and consolidation process to adjust and

eliminate abnormal balances in the trial balances and the Reports on Budget Execution. As a result, the notes to the third quarter FY 2005 Other Defense Organizations Financial Statements were inaccurate and misleading and failed to show the extent of potential problems associated with data in the financial statements. DFAS Indianapolis should establish and implement a process to identify abnormal balances in the financial data supporting the Other Defense Organizations financial statements and disclose the financial statement disposition of those anomalies. (See finding B for the detailed recommendations.)

Management Comments and Audit Response. The Director, DFAS Indianapolis agreed to revise the existing year-end guidance and establish separate quarterly guidance to specifically require accounting offices to provide explanatory footnotes for all abnormal balances in the quarterly trial balance submissions. The comments were responsive.

The Director, DFAS Indianapolis nonconcurred with the recommendation to establish and implement a process to identify abnormal balances in the financial data and to disclose the financial statement disposition of those anomalies. The Director stated that DFAS Indianapolis uses the DoD Financial Management Regulation guidance as a metric for the identification and disclosure of abnormal balances. However, the DoD Financial Management Regulation materiality does not extend to the disclosure of abnormal balances. In addition, without determining the cause or adjustment necessary to correct an abnormal balance, the materiality of an abnormal balance as it relates to the Other Defense Organization financial statements cannot be measured. The comments were not responsive. We request that the Director, DFAS Indianapolis reconsider his position and provide additional comments by July 10, 2006.

See the Finding sections for a discussion of management comments and the Management Comments section for the complete text of the comments.

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Background

Other Defense Organizations. Other Defense Organizations (ODO) cover the activities funded with Treasury Index 97 funds (also referred to as Department 97). The ODO financial information is aggregated into the ODO General and Working Capital Funds. The Office of Management and Budget does not require DoD to prepare audited financial statements for the ODO General and Working Capital Funds. However, ODO General and Working Capital Funds represent 2 of the 11 reporting entities in the DoD Agency-wide financial statements. This report focuses on the ODO General Funds. The ODO General Funds reported $130.5 billion in budgetary resources in the FY 2005 DoD Agency-Wide Financial Statements (15.4 percent of all budgetary resources shown on the FY 2005 DoD Agency-Wide Financial Statements).

Defense Finance and Accounting Service. The Audited Financial Statements Division, Defense Finance and Accounting Service (DFAS) Indianapolis is responsible for providing financial reporting support for the ODO. Specifically, DFAS Indianapolis is responsible for compiling and consolidating the financial information for 41 ODOs. Appendix C lists the ODOs that DFAS Indianapolis is responsible for and those that are compiled and consolidated at other DFAS centers.

ODO Accounting Offices. Accounting offices are responsible for recording, summarizing, verifying, and reporting accounting transactions submitted by serviced activities. The accounting offices are responsible for submitting general ledger trial balance information to DFAS Indianapolis on a monthly basis. Accounting offices provide trial balances to DFAS Indianapolis in both DoD Standard General Ledger (SGL) and the U.S. SGL.

Abnormal Balance. A general ledger account balance is abnormal when it does not match the normal debit or credit balance established in the general ledger chart of accounts. For example, an asset normally has a debit balance; therefore, a credit balance would be an abnormal balance.

Objectives

Our overall audit objective was to evaluate the DFAS Indianapolis procedures and controls for handling abnormal balances when compiling and consolidating financial data from supporting accounting offices to prepare the financial statements for ODO. We evaluated whether DFAS Indianapolis identified and disclosed abnormal balances. We also reviewed corrective actions taken in response to previous audits that showed internal control weaknesses and made recommendations related to abnormal balances in trial balances supporting the ODO financial statements. In addition, we reviewed internal controls and compliance with laws and regulations related to our objective. Appendix A discusses the audit scope and methodology. See Appendix B for prior coverage related to the audit objectives.

Managers' Internal Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. Effective January 4, 2006, DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," was implemented to replace the DoD Instruction 5010.40, August 28, 1996.

Scope of the Review of the Managers' Internal Control Program. We reviewed DFAS Management Control Program and internal controls over the identification, disclosure, and correction of abnormal balances when compiling and consolidating the financial statements for ODO. We did not identify a material weakness, as defined by DoD Instruction 5010.40, "Management Control (MC) Program," August 28, 1996, which was the effective instruction during the scope of our review, and we did not assess management's self-evaluation.

Adequacy of Management Controls. Although we did not identify material weaknesses as defined by DoD Instruction 5010.40, we did identify internal control weaknesses over the identification and disclosure of abnormal balances. Our report makes recommendations that if implemented will correct these internal control weaknesses.

A. Unexplained Abnormal Balances in Trial Balances

The trial balance submissions used by DFAS Indianapolis to prepare the ODO financial statements contained unexplained abnormal balances. Specifically, trial balances submitted by the accounting offices for inclusion in the third quarter FY 2005 ODO Financial Statements contained an absolute value of $21.3 billion in abnormal balances. Of the 15 trial balance submissions with abnormal balances, 14 did not include footnotes explaining the abnormal balances. The accounting offices and DFAS Indianapolis did not effectively implement prior DoD Inspector General (DoD IG) recommendations. Specifically:

- the accounting offices did not establish or implement standard operating procedures to ensure that the required detailed explanations for abnormal balances were included on the quarterly trial balance submissions to DFAS Indianapolis, and

- DFAS Indianapolis did not provide clear footnote requirements to the accounting offices for quarterly trial balance submissions.

As a result, DFAS Indianapolis did not have information necessary to assess the quantitative impact of anomalies in the data supporting the ODO financial statements or disclose the qualitative nature of the anomalies where appropriate. Explanatory footnotes will decrease the amount of time DFAS Indianapolis personnel need to invest in followup and resolution of trial balance submissions.

Trial Balance Submissions

DFAS Indianapolis receives trial balances from accounting offices responsible for the accounting of ODO. DFAS Indianapolis uses this financial data for preparing the ODO financial statements. The absolute value of abnormal balances in the third quarter trial balances submissions provided to DFAS Indianapolis was $21.3 billion. Of the 15 trial balance submissions containing abnormal balances,

only the DFAS Cleveland submission included footnotes for abnormal balances. Table 1 shows the absolute value of abnormal balances by trial balance submission.

Table 1. Third Quarter FY 2005 Abnormal Balances (in millions)

Trial Balance Submissions	Abnormal Balances
DFAS Indianapolis	$9,683.9
Component Level Accounts[1]	7,829.4
DFAS Denver	1,807.4
Military Housing Privatization Initiative[2]	1,124.1
Defense Agency Financial Services	595.0
DFAS Cleveland	85.6
DoD Education Activity	71.1
Manual Trial Balance[3]	41.4
Defense Information Systems Agency	35.0
Washington Headquarter Services	8.5
TRICARE Management Activity	4.6
Defense Threat Reduction Agency	3.8
White House Communications Agency	1.0
DFAS Columbus	0.1
Uniformed Services University of Health Sciences	0.1
Total	**$21,291.0**

[1]Component level accounts include information from classified trial balances.
[2]Of the total abnormal balances identified for the Military Housing Privatization Initiative, 98.6 percent is provided only to populate the note schedules. The amounts appear as abnormal balances because the Department of the Treasury guidance to record entries conflicts with the U.S. SGL chart of accounts. DFAS Indianapolis personnel stated that the Department of the Treasury is correcting this guidance.
[3]Certain information is not included in the trial balances submitted by the accounting offices. DFAS Indianapolis creates a manual trial balance for this information by using the Report on Budget Execution (DD Form 1176).

Procedures for Identifying and Explaining Abnormal Balances in Trial Balances

The ODO accounting offices did not have effective controls to ensure that they provided detailed explanations in footnotes to the trial balances for all abnormal balances included in quarterly submissions to DFAS Indianapolis. In addition, DFAS Indianapolis did not clarify the requirements in its year-end guidance or in a separate issuance for the accounting offices to provide explanatory footnotes for abnormal balances on the quarterly trial balances.

Accounting Office Standard Operating Procedures. DoD IG Report No. D-2000-0153, "Compilation of the FY 1999 Financial Statements for Other Defense Organizations-General Funds," June 23, 2000, identified weaknesses in controls over the identification and disclosure of abnormal balances in the trial balances provided to DFAS Indianapolis. The accounting offices[1] agreed to provide detailed explanations in footnotes to the trial balances for all abnormal balances included on quarterly submissions to DFAS Indianapolis. Some accounting offices had requested that DFAS Indianapolis provide specific guidance on the format to be used to submit the detailed explanations with the trial balances. However, the corrective actions taken by the accounting offices to address the identified weaknesses are not effective.

Personnel at the majority of the accounting offices stated that they do not have, or are unaware of, any written standard operating procedures for identifying, disclosing, and correcting abnormal balances on the trial balance submissions. While personnel at some of the accounting offices were able to describe the processes that are in place, only DFAS Cleveland was able to provide written standard operating procedures discussing the inclusion of footnote explanations of abnormal balances. In addition, there were inconsistent responses from personnel at the accounting offices on whether DFAS Indianapolis provided guidance regarding the requirements for quarterly footnote explanations of abnormal balances. A staff member at TRICARE Management Activity stated that office staff are aware of the abnormal balances submitted and try to remain knowledgeable regarding causes of abnormal balances. However, because of insufficient resources, they do not submit explanations for the abnormal balances unless asked by DFAS Indianapolis personnel. The accounting offices should implement procedures to explain all abnormal balances in trial balance submissions, even when the accounting office considers those balances appropriate.

Defense Finance and Accounting Service Indianapolis Guidance. DoD IG Report No. D-2000-0153 recommended that DFAS Indianapolis revise year-end guidance to include the data and format requirements for the explanatory

[1]The recommendation addressed: DFAS Cleveland, DFAS Columbus, DFAS Denver, DFAS Indianapolis, Defense Information Systems Agency, Defense Threat Reduction Agency, Washington Headquarters Service, DoD Education Activity, TRICARE Management Activity, and Uniformed Services University of Health Sciences.

footnotes to ensure reporting consistency by the accounting offices. DFAS Indianapolis concurred with this recommendation to provide detailed guidance to the accounting offices in the year-end guidance.

The "Fiscal Year-End Accounting and Reporting Instructions for Funds Executed by Defense Agencies" memorandum provides fiscal year-end instructions for accounting for Department 97 funds. The year-end guidance requires the accounting offices to properly footnote and explain all abnormal balances in the reports and general ledger trial balance submissions. The accounting offices should provide the following in the footnotes:

- the source,
- the circumstances involved,
- the actions underway to resolve the condition, and
- the estimated completion date.

The year-end guidance states that, prior to submitting the year-end trial balances, accounting offices should identify and correct abnormal balances in general ledger trial balances. The guidance acknowledges that accounting offices may consider some abnormal balances appropriate; however, it requires that the accounting office identify and explain all abnormal balances in the accompanying footnotes.

DFAS Indianapolis personnel stated that these instructions are also applicable to the quarterly reporting process. However, the applicability of the year-end guidance to the quarterly reporting process is not evident. DFAS Indianapolis should provide accounting offices with a quarterly issuance or expand the year-end guidance emphasizing the requirements for providing explanatory footnotes for abnormal balances on the quarterly trial balances. DFAS Indianapolis should establish procedures to verify that accounting offices follow the required guidance.

Conclusion

Because the trial balance submissions used by DFAS Indianapolis to prepare the ODO financial statements contained unexplained abnormal balances, DFAS Indianapolis did not have information necessary to assess the quantitative impact of anomalies in the data supporting the ODO financial statements or disclose the qualitative nature of the anomalies where appropriate. Implementation of the corrective actions will increase the accountability associated with the ODO trial balance submissions. Because we limited our audit to DFAS Indianapolis, except when noted otherwise, we are limiting our recommendation to DFAS Indianapolis. However, the accounting offices should implement procedures to explain all abnormal balances in trial balance submissions, even when the

accounting office considers those balances appropriate. Explanations in the footnotes will decrease the amount of time DFAS Indianapolis personnel need to invest in followup and resolution of trial balance submissions.

Recommendation and Management Comments

A. We recommend that the Director, Defense Finance and Accounting Service Indianapolis revise the existing year-end guidance or establish separate quarterly guidance to specifically require accounting offices to provide Defense Finance and Accounting Service Indianapolis explanatory footnotes for all abnormal balances in the quarterly trial balance submissions.

Management Comments. The Director, DFAS Indianapolis concurred with the recommendation and stated that they will revise the existing year-end guidance and establish separate quarterly guidance to specifically require accounting offices to provide DFAS Indianapolis explanatory footnotes for all abnormal balances in the quarterly trial balance submissions. The estimated completion date is June 30, 2006.

B. Procedures for Identifying and Disclosing Abnormal Balances

DFAS Indianapolis did not disclose in the notes to the financial statements unresolved and uncorrected abnormal balances in the trial balance submissions and the Reports on Budget Execution (DD Forms 1176). In addition, DFAS Indianapolis did not disclose the nature of accounting entries made during the compilation and consolidation process to adjust and eliminate abnormal balances in the financial data used to prepare the financial statements.

The processes used by DFAS Indianapolis to compile and consolidate the ODO financial statements inherently masked or eliminated abnormal balances that were in the trial balances and DD Forms 1176 used to prepare the financial statements. DFAS Indianapolis did not develop and implement standard operating procedures in the compilation and consolidation process for:

- identifying, assessing, and quantifying information about abnormal balances for disclosure, and
- evaluating and compiling information for disclosure about adjustments made by DFAS Indianapolis that eliminate abnormal balances.

As a result, the notes to the third quarter FY 2005 ODO Financial Statements were inaccurate and misleading and failed to show the extent of potential problems associated with data in the financial statements.[2]

Identification and Disclosure of Abnormal Balances

In accordance with Federal financial reporting requirements, note disclosures should convey the extent of potential problems in the data presented in the financial statements. DFAS Indianapolis guidance is not detailed enough to provide sufficient instruction on the identification and disclosure of abnormal balances in the notes to the financial statements.

Statement of Federal Financial Accounting Concepts. Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," September 2, 1993, states that information should be provided in the financial statements that is useful to internal and external users for assessing the accountability of the entity. The information should demonstrate that the Government is accountable for its integrity, performance, and stewardship, and

[2]DFAS Indianapolis did not make a distinction between the quarterly and year-end procedures for identifying and disclosing abnormal balances; therefore, the issues regarding identification and disclosure also affect the year-end financial statements. However, we reviewed only the third quarter FY 2005 information.

should help internal users of financial information improve the management of the Government. Statement of Federal Financial Accounting Concepts No. 2, "Entity and Display," June 5, 1995, states that management is responsible for the accuracy and fairness of the information presented on the financial statements and that the associated note disclosures are necessary so that financial statement users understand the context of the reported information.

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," (FMR) Volume 6B. In accordance with the requirements in the Office of Management and Budget Circular A-136, "Financial Reporting Requirements," August 23, 2005, the FMR requires the disclosure of any additional information that is necessary for understanding the nature of the amounts reported on the financial statements.

Until January 2006, the FMR, volume 6B, required the disclosure of accounting entries made to eliminate abnormal balances if:

- the line item or account containing the abnormal balance is material to the financial statements,
- the aggregate total is material,
- the accounting site was unable to correct the abnormal balance, or
- the accounting site was unable to determine materiality.

It also required the disclosure of abnormal balances in the notes to the financial statements for:

- abnormal accounts receivable balances resulting from undistributed collections, and
- any abnormal balances that exist in the amounts reported on the Statement of Budgetary Resources.

DoD IG Report No. D-2004-118, "Army General Fund Controls Over Abnormal Balances for Field Accounting Activities," September 28, 2004, recommended that the Under Secretary of Defense (Comptroller) update the FMR to require that all unresolved abnormal balances be disclosed in the notes to the financial statements. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer concurred with the recommendation.

In January 2006, the FMR, volume 6B, was updated to require that DoD disclose all abnormal account balances found in all financial statement lines and note schedules. The disclosures should include the following:

- the dollar amount of the abnormal balance,
- the business event that caused the abnormal balance,
- the reason the abnormality occurred,
- the fiscal time period in which the abnormal balance occurred, and
- when the abnormality will be corrected.

In addition, the FMR directs that all abnormal proprietary[3] and budgetary[4] U.S. SGL accounts must be researched and resolved, if possible. This update did not fully satisfy the intent of the recommendation made in DoD IG Report No. D-2004-118 because it does not address abnormal balances in accounting data below the financial statement line. As of April 18, 2006, the recommendation was still open pending negotiations between DoD IG and the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer.

Compilation and Consolidation Process for Data Supporting the Financial Statements

The processes used by DFAS Indianapolis to compile and consolidate the ODO financial statements inherently masked abnormal balances in the trial balances and DD Forms 1176. DFAS Indianapolis uses the trial balances, DD Forms 1176, and other financial documents, and uses multiple processes to prepare the financial statements. As such, visibility over abnormal balances is easily lost without

[3] Proprietary accounts are those accounts necessary to record changes in the basic accounting equation Assets = Liabilities + Equity.

[4] Budgetary accounts are those accounts necessary to track and control budgetary resources and the status of those resources in the basic budgetary equation: budgetary resources = status of budgetary resources.

procedures to identify and quantify abnormal balances, request correction by the accounting offices, and assess amounts for disclosure. Figure 1 depicts the financial data flow for the preparation of the ODO financial statements.

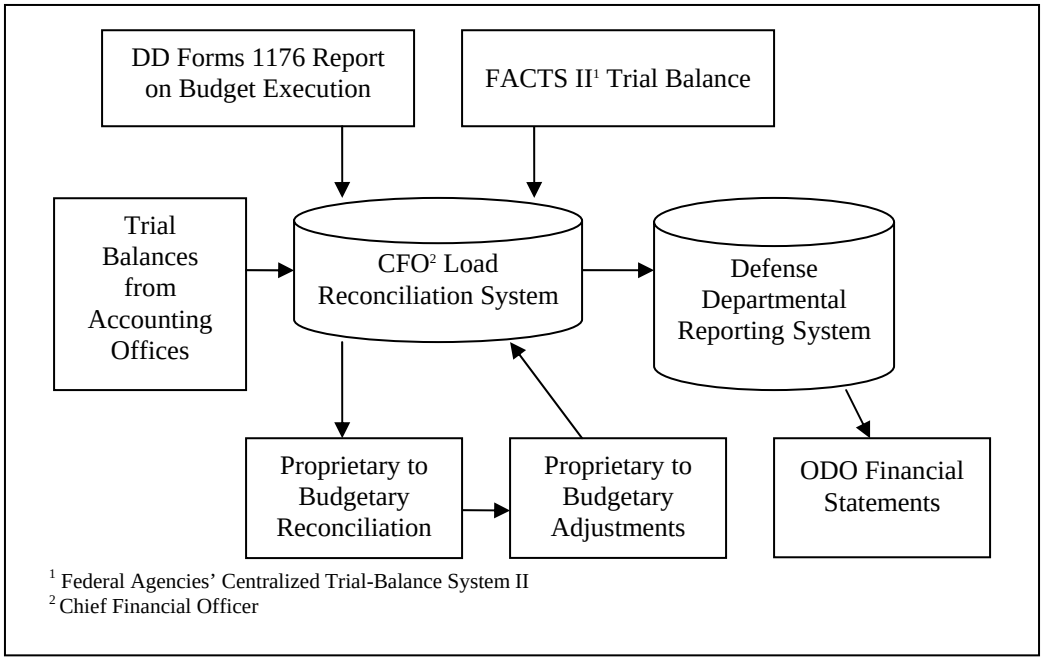


Figure 1. Compilation and Consolidation Process for ODO Financial Statements

The trial balances are considered the basis for the ODO financial statements; however, DD Forms 1176 and the Federal Agencies' Centralized Trial-Balance System II (FACTS II) trial balances are also source documents used by DFAS Indianapolis to prepare the ODO financial statements. The trial balances, DD Forms 1176, and FACTS II trial balances are imported into the CFO Load Reconciliation System (CLRS) where the data are consolidated to create the unadjusted CLRS trial balance. Because of system deficiencies, DFAS Indianapolis makes adjustments to the trial balance data submitted by the accounting offices for proprietary accounts to match the data to the DD Forms 1176 budgetary data where there is a relationship between the information. These adjustments are commonly referred to as proprietary to budgetary adjustments. Once DFAS Indianapolis makes other necessary adjustments in CLRS and the data are consolidated to the required format, the Defense Departmental Reporting System imports the necessary data to create the ODO financial statements.

Identification, Assessment, and Quantification of Abnormal Balances

DFAS Indianapolis did not develop and implement standard operating procedures in the compilation and consolidation process for identifying, assessing, and quantifying information about abnormal balances in the trial balances and DD Forms 1176 for disclosure on the financial statements. DoD IG Report No. D-2000-0153 recommended that DFAS Indianapolis establish and implement detailed procedures to review the trial balances submitted for the ODO at least quarterly, to include identifying abnormal balances and requesting that accounting offices correct the trial balances. In addition, DoD IG Report No. D-1999-0191, "Compilation of the FY 1998 Financial Statements for Other Defense Organizations," June 24, 1999, recommended that DFAS Indianapolis explain in the notes material abnormal balances absorbed into the normal balances reported on the financial statements.

DFAS Indianapolis visibility of abnormal balances is limited to summary-level abnormal balances in the adjusted CLRS trial balance using an informal application of materiality. As a result, unidentified and unexplained abnormal balances from the trial balances and DD Forms 1176 are consolidated into and masked by the compilation process. DFAS Indianapolis loses visibility of these abnormal balances and does not consider them for disclosure on the financial statements because procedures have not been established to identify the disposition of the data.

DFAS Indianapolis Identification and Assessment of Abnormal Balances. DFAS Indianapolis requires accounting offices to properly footnote and explain all abnormal balances in the reports and general ledger trial balance submissions. However, DFAS does not conduct an independent review of the trial balances and the DD Forms 1176 to identify abnormal balances. DFAS Indianapolis personnel stated that they have been unsuccessful in their attempt to get the required explanations from the accounting offices. As a result of time constraints caused by accelerated reporting requirements, DFAS Indianapolis conducts followup in the months succeeding the preparation of the financial statements. DFAS Indianapolis personnel stated that the earliest point in the compilation and consolidation process that they would consider abnormal balances for identification and disclosure would be during the review of the CLRS trial balance.

The CLRS trial balance provides the data from the trial balances and DD Forms 1176 by entity code. Each ODO that is consolidated into the financial statements has multiple entity codes that are determined by funding type. For instance, each ODO has a separate entity code for Military Construction funds; Operation and Maintenance funds; Procurement funds; Research, Development, Test, and Evaluation funds; and an entity code for other funds which captures all items that do not fall under the previous funding categories.

Each of the entity codes is a consolidation of different appropriations and limits[5] that may be reported to DFAS Indianapolis on separate trial balance submissions. Table 2 shows an excerpt of the entity code information for an ODO.

Table 2. TRICARE Management Activity Entity Codes

ODO	Entity Code	Funding Type	Basic Symbol and Limit		Submitter
TRICARE Management Activity	AT97AH6_1400	Military Construction	Military Construction	Army	DFAS IN
				Navy	DFAS IN
				Air Force	DFAS DE
				DMSA	DFAS IN
	AT97AG6_1400	Research, Development Test & Evaluation	Defense Health Program	Army	DFAS IN
				Navy	DFAS CL
				Air Force	DFAS DE
				TMA	DAFS
				USUHS	USUHS

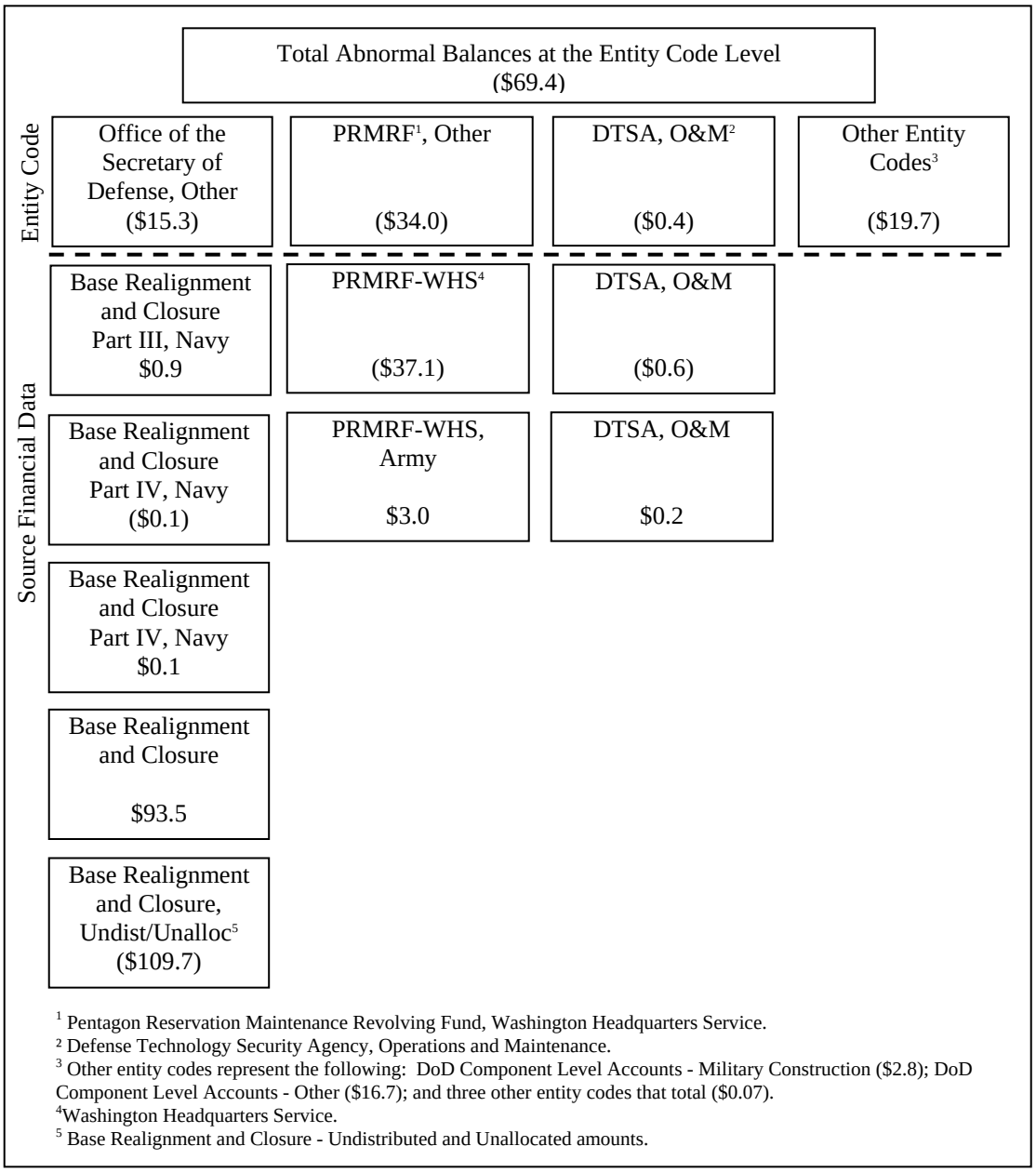
CL Cleveland
DAFS Defense Agency Financial Services
DE Denver
DMSA Defense Medical Support Agency
IN Indianapolis
TMA TRICARE Management Activity
USUHS Uniformed Services University of Health Sciences

For example, if a balance sheet account representing the reported value for Military Construction for TRICARE Management Activity was normal, DFAS Indianapolis would not assess the impact of any abnormal balances in the individual submissions. However, the total value is comprised of balances for the sub-elements that execute the appropriation. DFAS Indianapolis, DFAS Denver, and DFAS Cleveland are responsible for submitting the balances of the sub-elements—Army, Navy, Air Force, and Defense Medical Support Agency. Because of the nature of the information at the entity code level, the process of only identifying abnormal balances at this level masks the presence of abnormal balances that are in the trial balances and DD Forms 1176 related to the sub-elements. Further, because DFAS Indianapolis has not implemented procedures to identify (and document) abnormal balances in the trial balances and the DD Forms 1176, there is no impetus to contact the submitters and request correction and explanation (when not provided) unless the amount is considered material to the ODO financial statements as defined by DFAS Indianapolis.

DFAS Indianapolis Assessment of Abnormal Balances. DFAS Indianapolis personnel stated that their assessment for possible disclosure is limited to material abnormal balances at the entity code level. DFAS Indianapolis defines a material abnormal balance as the absolute value of the abnormal balances at the entity code level exceeding 2 percent of net assets or 10 percent of the line item based on the previous quarter's information. This application decreases the visibility of abnormal balances in the trial balances, DD Forms 1176, and specific entity

[5]A limit is a four-digit suffix to the U.S. Treasury account number (basic symbol). It is used to identify a subdivision of funds that restricts the amount or use of the funds for a certain purpose or identifies sub-elements in the account for management purposes.

codes, and decreases the associated accountability of the appropriation sub-element. Figure 2 depicts the layering of the information at the entity code level and demonstrates how DFAS Indianapolis may not be able to identify abnormal balances in the trial balances and DD Forms 1176.



[1] Pentagon Reservation Maintenance Revolving Fund, Washington Headquarters Service.
[2] Defense Technology Security Agency, Operations and Maintenance.
[3] Other entity codes represent the following: DoD Component Level Accounts - Military Construction ($2.8); DoD Component Level Accounts - Other ($16.7); and three other entity codes that total ($0.07).
[4] Washington Headquarters Service.
[5] Base Realignment and Closure - Undistributed and Unallocated amounts.

Figure 2. Abnormal Balances for Accounts Receivable at the Entity Code Level (in millions)

Figure 2 was created using third quarter FY 2005 accounts receivable data provided by DFAS Indianapolis to demonstrate that at the entity code level the account balances do not contain material abnormal balances as defined by DFAS Indianapolis. Based on DFAS Indianapolis application of materiality, it would consider only those abnormal balances that exceed $46.6 million[6] at the entity code level to be material. Our review of the accounts receivable for three entity codes showed abnormal balances totaling $147.5 million from data used to prepare the third quarter FY 2005 financial statements. Factoring all abnormal balances in accounts receivable (for those entity codes with abnormal balances at the entity code level) increases the total to $167.2 million.

Of the $147.5 million abnormal balances reviewed, $109.7 million represent undistributed disbursements and collections. We recognize that undistributed disbursements and collections represent a difference between the field records and those records maintained by the Department of the Treasury. DFAS Indianapolis provides a general disclosure in the notes to the ODO financial statements related to undistributed disbursements and collections. However, the balance is still abnormal and should not be excluded from assessments made regarding disclosure for abnormal balances.

Even when quantifying all of the abnormal balances in accounts receivable at the entity code level, the abnormal balances total $69.4 million, which exceeds the materiality level as defined by DFAS Indianapolis personnel. DFAS Indianapolis personnel stated they do not have a process in place to quantify all abnormal balances to determine the extent of the total abnormal balances on the financial statements or in particular line items. However, the Chief, Audited Financial Statements Division, DFAS Indianapolis, was receptive to determining and disclosing abnormal balance information but wanted to ensure that the information disclosed would be beneficial to the reader of the financial statements.

DFAS Indianapolis Disclosure of Abnormal Balances. DFAS Indianapolis written guidance for preparing the notes to the ODO financial statements states that staff should disclose material abnormal balances masked in financial statement figures. However, the guidance does not explain how staff should determine the masked material abnormal balances. DFAS Indianapolis personnel stated that they would limit such disclosures to material abnormal balances identified on the CLRS trial balance using the materiality threshold of 2 percent of net assets or 10 percent of the line item.

The FMR does not provide guidance for allowing the application of a materiality threshold when disclosing abnormal balances in the financial statements. In order to correctly apply a materiality threshold, DFAS Indianapolis would need to understand the relationship of the abnormal balance to the account balance. Specifically, DFAS Indianapolis would need to know the cause of the abnormal balance and the adjustment to correct the abnormal balance. However, because the abnormal balances are not explained by the accounting offices, it is not known

[6]DFAS Indianapolis bases materiality on the information from the prior quarter; therefore, the materiality is calculated based on 10 percent of accounts receivable of $466.2 million from the second quarter FY 2005.

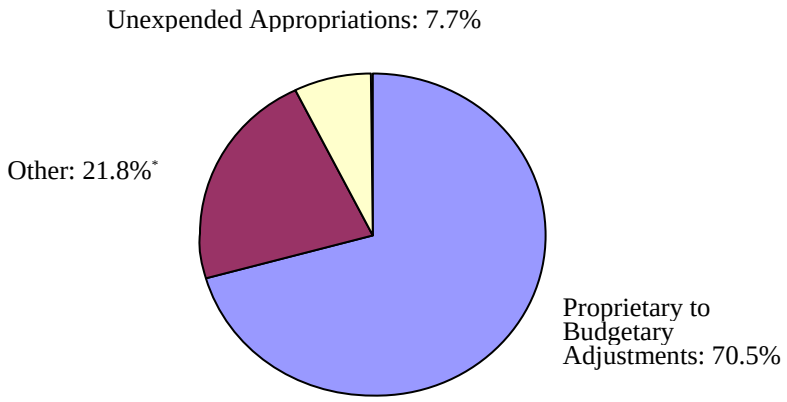
whether the misstatement is the absolute value of the abnormal balance; therefore, the application of a materiality threshold as it relates to the account balance is not logical.

DFAS Indianapolis does not appropriately apply the concept of materiality to the process of identifying and disclosing abnormal balances masked within normal balances. DFAS Indianapolis should establish procedures to quantify abnormal balances submitted in the financial data, develop an identification and disclosure metric, and make disclosures about the abnormal balances.

Adjustments and Eliminations of Abnormal Balances

DFAS Indianapolis makes entries during the compilation and consolidation process that adjust and eliminate abnormal balances existing in the trial balances and DD Forms 1176. They did not establish and implement standard operating procedures for evaluating and compiling information about these adjustments and eliminations for disclosure in the financial statements.

Abnormal Balance Adjustments. Because of system deficiencies, DFAS Indianapolis makes adjustments to financial data for presentation on the financial statements. Some of these adjustments result in summary-level adjustments to uncorrected abnormal balances. DFAS Indianapolis makes entries to adjust the trial balance data to budgetary data and prepares journal entries that eliminate abnormal balances resulting from these adjustments. Figure 3 depicts the processing of the $21.3 billion abnormal balances in the third quarter trial balance submissions.



*This includes $1,108 million from the Military Housing Privatization Initiative that is submitted only for inclusion in footnote schedules.

Figure 3. Compilation and Consolidation of Abnormal Balances Contained in Trial Balance Submissions

Proprietary to Budgetary Adjustments (PBA). DFAS Indianapolis makes journal entries to adjust the trial balance data to the DD Form 1176 where there is a relationship between budgetary data and the proprietary general ledger accounts. These journal entries include adjustments to unresolved and uncorrected abnormal balances. In addition, the entries could adjust proprietary abnormal balances to budgetary normal balances. Approximately $15.0 billion (70.5 percent) of the $21.3 billion of abnormal balances were in proprietary general ledger accounts that DFAS Indianapolis reconciled to match budgetary data during the PBA process. However, DFAS Indianapolis does not have procedures in place to disclose the nature and impact of the PBA on abnormal balances in the trial balance submissions.

Unexpended Appropriations Adjustments. DFAS Indianapolis personnel also make entries to adjust the unexpended appropriations data submitted because the legacy systems[7] used to generate the trial balances do not provide the necessary breakout of the unexpended appropriations component accounts. Of the $21.3 billion of abnormal balances identified, $1.6 billion (7.7 percent) were in the unexpended appropriations account. Transactions affecting unexpended appropriations are posted only to SGL 3100 in most trial balances. DFAS Indianapolis personnel indicated that because the data are combined in the SGL 3100 balances provided in the trial balances, they are unable to determine whether the balances are normal or abnormal. However, explanations from the accounting offices could alleviate this uncertainty.

Although DFAS Indianapolis adjusts abnormal balances in the trial balances to the DD Form 1176 data, the abnormal balances in source data are uncorrected and should be disclosed. We recognize that a general disclosure is provided in the notes to the ODO financial statements that states that the ODO financial data will be based on budgetary transactions until the current systems are updated. However, DFAS Indianapolis does not have procedures in place to quantify the anomalies that exist at the field level, disclose the nature and amounts of these adjustments, or to demonstrate the impact the adjustments have on the ODO financial statements.

Abnormal Balance Eliminations. DFAS Indianapolis procedures dictate that it reclassify abnormal accounts receivable balances resulting from differences between collections reported by the field sites and the Department of the Treasury. The Budget Execution Reports Division identifies these differences in the Cash Management Report (CMR) and makes entries to adjust collections (and the associated receivables) on the DD Forms 1176 to match the collections reported by the Department of the Treasury. When the CMR entry causes an abnormal accounts receivable balance and the field submitted balance is normal, DFAS Indianapolis adjusts the balance to match the field submitted receivable.

[7]The legacy systems used to generate the trial balances consist of financial and nonfinancial feeder systems that were not designed to comply with Federal generally accepted accounting principles but are used to derive the information used in the financial statements.

As shown in Figure 2, the third quarter FY 2005 accounts receivable consisted of abnormal balances totaling $69.4 million at the entity code level. DFAS Indianapolis made adjustments totaling $90.5 million that eliminated the abnormal intragovernmental accounts receivable balances. Instead of reporting and disclosing the abnormal balance resulting from the CMR entry, DFAS Indianapolis reclassified the abnormal balances to accounts payable and reported a normal balance of $21.1 million in accounts receivable on the balance sheet for these entity codes. The reclassification caused an increase to intragovernmental accounts receivable and intragovernmental accounts payable of 130 percent and 51 percent, respectively. We do not advocate making such adjustments that categorically eliminate abnormal balances; however, if DFAS chooses to eliminate abnormal balances, it should disclose those summary level adjustments.

Conclusion

While the scope of our review was limited to examples intended to determine how DFAS Indianapolis assesses abnormal balances for disclosure in the financial statements, we believe the results of our review are representative of the process DFAS Indianapolis uses. We will expand the scope of our review in our audit of DFAS processes for compiling and consolidating the ODO financial statements. Because DFAS Indianapolis did not recognize the extent of abnormal balances in the financial data supporting the ODO financial statements or the adjustment and elimination of the abnormal balances, the accountability associated with the identification, disclosure, and correction of abnormal balances is diminished. As a result, managers and responsible personnel reading the financial statements do not understand the extent of potential problems in the data shown in the financial statements.

Recommendation, Management Comments, and Audit Response

B. We recommend that the Director, Defense Finance and Accounting Service Indianapolis establish and implement a process to identify abnormal balances in the financial data supporting the Other Defense Organizations financial statements and disclose the financial statement disposition of those anomalies.

1. Develop an identification and disclosure metric for abnormal amounts in the entity code level supporting the financial statement account or line item.

2. Disclose in the notes to the financial statements the metric and the abnormal amounts when they exceed that metric, to include amounts that are eliminated as a result of reclassifications.

3. Disclose in the notes to the financial statements the nature of individual amounts in an entity code or at the entity code that individually exceed the metric to include the following:

- **the dollar amount of the abnormal balance,**
- **the business event that caused the abnormal balance,**
- **the reason the abnormality occurred,**
- **the fiscal time period in which the abnormal balance occurred, and**
- **when the abnormality will be corrected.**

Management Comments. The Director, DFAS Indianapolis nonconcurred with the recommendation and stated that they use the materiality threshold as identified in the DoD Financial Management Regulation. The Director stated that the DoD Financial Management Regulation disclosure metric is a materiality threshold of 2 percent of total assets or 10 percent fluctuation from prior year's balance. Because of the volume of data received to support the Other Defense Organizations General Fund financial data, DFAS Indianapolis summarizes the data at the entity code level and applies a materiality threshold.

The Director also stated that the metric for the identification and disclosure of abnormal balances is disclosed in Note 1, section 1.W, to the financial statements. The guidance from the DoD Financial Management Regulation is used to disclose in the notes to the financial statements the abnormal amounts when they exceed that metric. In addition, the amounts that are eliminated as a result of reclassifications are not disclosed because the reclassification is a corrective action or adjustment to better represent the financial position of the Other Defense Organization General Fund financial data, based on known system deficiencies. The impact of the reclassifications are disclosed in the footnotes if they are material.

Audit Response. The DFAS Indianapolis management comments are not responsive. The response centers around the implication that there is an understood association between materiality of account fluctuations and abnormal balances. The DoD Financial Regulation does require disclosure of differences between comparative periods when the variance equals or exceeds 10 percent of the same line item or 2 percent of the current period total assets for the purpose of disclosing fluctuations within a line item. However, the implied applicability of this guidance to the disclosure of abnormal balances is not evident. First, the DoD Financial Management Regulation materiality does not extend to the disclosure of abnormal balances. Second, to apply a *materiality* threshold as a percentage of an account balance to the abnormal balances in the account balances suggests that a determination of a specific anomaly or misstatement has been identified and the adjustment necessary to correct the abnormal balance is known. However, the anomaly or misstatement is not necessarily the absolute value of the abnormal balance. Therefore, without identifying the amount of the

anomaly or misstatement, the materiality of the abnormal balances cannot be measured as it

relates to the Other Defense Organizations financial statements. As such, DFAS Indianapolis needs to develop and document a metric specific to the identification and disclosure of abnormal balances.

In addition, Note 1, section 1.W, to the financial statements did not address a metric used for the disclosure of abnormal balances. Instead, Note 1, section 1.W to the 3rd Quarter FY 2005 Other Defense Organizations Financial Statements states:

> The financial statements and accompanying notes to the financial statements report the financial position and results of operations for the 3rd Quarter, FY 2005. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between the 3rd Quarter, FY 2004, and 3rd Quarter, FY 2005, are explained within the notes to the financial statements.

Again, the implication that there is a relationship between disclosing fluctuations between reporting periods and isolated anomalies within account balances is not evident. DFAS Indianapolis needs to clearly state in the notes to the financial statements how abnormal balances are identified for disclosure. Because of the volume of the financial data received by DFAS Indianapolis, the recommendation would require DFAS Indianapolis to disclose only those abnormal balances that exceed the metric. However, DFAS Indianapolis application of a materiality threshold at the individual entity code level results in the loss of visibility over individual abnormal balances on the trial balances and DD Forms 1176. The entire universe of abnormal balances needs to be collectively analyzed to demonstrate the quantity of abnormal balances within each account or line item.

We recognize that DFAS Indianapolis makes adjustments to better represent the financial position of the Other Defense Organizations financial data because of known system deficiencies. However, the adjustments made to eliminate the abnormal balances in accounts receivable that result from Cash Management Report entry is driven by the existence of the abnormal balance. DFAS Indianapolis would not have reclassified the amount if the balance were normal. We request that the Director, DFAS Indianapolis reconsider his position and provide additional comments by July 10, 2006.

Appendix A. Scope and Methodology

We evaluated the DFAS Indianapolis processes for identifying and disclosing abnormal balances when compiling and consolidating the ODO financial statements. We identified applicable standard operating procedures established by DFAS Indianapolis and interviewed DFAS Indianapolis personnel to understand the procedures for identifying and disclosing abnormal balances. We identified FMR guidance for the disclosure of abnormal balances in the notes to the financial statements. In addition, we examined the third quarter FY 2005 ODO trial balance data and compared the data to the normal balances for the accounts specified in the DoD SGL and the U.S. SGL charts of accounts. We reviewed only the proprietary amounts in the trial balances submitted by the accounting offices because DFAS Indianapolis removes all budgetary data from the trial balance submissions because not all accounting offices submit budgetary data. We focused primarily on the trial balances submitted by the accounting offices because prior recommendations focused on abnormal balances in the trial balances submissions. We will look at all elements of the compilation and consolidation process in our subsequent audit of the DFAS process for consolidating and compiling the ODO financial statements.

During the audit we contacted accounting offices where prior recommendations were made to disclose abnormal balances in the footnotes to the trial balance submissions provided to DFAS Indianapolis. Specifically, we contacted the accounting offices in order to identify any internal standard operating procedures or guidance received from DFAS Indianapolis regarding the identification, disclosure, and correction of abnormal balances on the trial balances. We performed this audit from August 2005 through March 2006 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We used trial balance submissions from the accounting offices, DD Forms 1176 generated by the Budget Execution Reports Division, PBA reports and trial balances generated from CLRS, and financial data provided from the Defense Departmental Reporting System to determine the existence of abnormal balances in the financial data supporting the ODO financial statements. However, we did not verify the processes used to prepare these documents or validate or refute the validity of the amounts reported. We reviewed procedures directly related to the abnormal balances included in the trial balance submissions. In addition, we reviewed the processes used by the accounting offices and DFAS Indianapolis to identify and disclose those abnormal balances in the trial balance submissions and in the notes to the ODO financial statements, respectively.

Use of Technical Assistance. The audit team consulted with Quantitative Methods Division personnel regarding the application of materiality used by DFAS Indianapolis when identifying and disclosing abnormal balances.

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

Appendix B. Prior Coverage

During the last 7 years, the DoD IG has issued several reports discussing abnormal balances in the financial statements for the ODO. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports.

DoD IG

DoD IG Report No. D-2004-0118, "Army General Fund Controls Over Abnormal Balances for Field Accounting Activities," September 28, 2004

DoD IG Report No. D-2002-0096, "Major Deficiencies in Financial Reporting for Other Defense Organizations-General Funds," May 31, 2002

DoD IG Report No. D-2002-0038, "Financial Reporting for the Other Defense Organizations-General Funds at the Defense Finance and Accounting Service San Antonio," January 14, 2002

DoD IG Report No. D-2001-0116, "Compilation of the FY 2000 Financial Statements for Other Defense Organizations-General Funds," May 8, 2001

DoD IG Report No. D-2001-0049, "Abnormal General Ledger Account Balances for Other Defense Organizations Reported by DFAS Cleveland," February 13, 2001

DoD IG Report No. D-2001-0048, "Financial Reporting for Other Defense Organization at the Defense Agency Financial Services Accounting Office," February 9, 2001

DoD IG Report No. D-2000-0153, "Compilation of the FY 1999 Financial Statements for Other Defense Organizations-General Funds," June 23, 2000

DoD IG Report No. D-1999-0191, "Compilation of the FY 1998 Financial Statements for Other Defense Organizations," June 21, 1999

DoD IG Report No. D-1999-0039, "Internal Controls and Compliance with Laws and Regulations for the FY 1998 Financial Statements of Other Defense Organizations," April 2, 1999

Appendix C. Other Defense Organizations

Data from Other Defense Organizations* compiled and consolidated at DFAS Indianapolis

1. American Forces Information Service
2. Building Maintenance Fund, Defense
3. Chemical Biological Defense Program
4. Civilian Military Program
5. Counter Intelligence Field Activity
6. Court of Appeals of the Armed Forces
7. Defense Acquisition University
8. Defense Advanced Research Projects Agency
9. Service Medical Activity
10. Defense Information Systems Agency - General Funds
11. Defense Intelligence Agency
12. Defense Legal Services Agency
13. Defense Prisoner of War/ Missing Persons Office
14. Defense Security Cooperation Agency
15. Defense Technology Security Agency
16. Defense Threat Reduction Agency
17. DoD Component Level Accounts
18. DoD Education Activity
19. Emergency Response Fund, Defense
20. Homeowners Assistance Fund, Defense
21. Iraqi Freedom Fund
22. Joint Chiefs of Staff
23. Military Housing Privatization Initiative
24. Missile Defense Agency
25. National Defense University
26. National Geospatial - Intelligence Agency
27. National Security Agency
28. Office of Economic Adjustment
29. Office of the Inspector General, DoD
30. Office of the Secretary of Defense (OSD)
31. Other "TI-97" funds provided to the Air Force by OSD
32. Other "TI-97" funds provided to the Army by OSD
33. Other "TI-97" funds provided to the Navy by OSD
34. Payments to the Military Retirement Fund
35. Payments to the Medicare-eligible Retiree Health Care Fund
36. Pentagon Force Protection Agency
37. Pentagon Reservation Maintenance Revolving Fund
38. Technical Research Institute
39. TRICARE Management Activity
40. U.S. Special Operations Command
41. Washington Headquarters Services

* Other Defense Organizations include agencies, offices, activities, programs, commands, and funds.

Data from Other Defense Organizations compiled and consolidated at other DFAS centers

1. Defense Cooperation Account
2. DoD Education Benefits Fund
3. Defense Technical Information Center
4. National Defense Stockpile Transaction Fund
5. National Security Education Trust Fund
6. Voluntary Separation Incentive Trust Fund
7. Defense Commissary Agency
8. Defense Contract Management Agency
9. Defense Finance and Accounting Service - General Funds
10. DoD Human Resources Activity
11. Defense Security Service
12. Defense Contract Audit Agency
13. Defense Logistics Agency General Funds
14 Ready Reserve Mobilization Income Insurance Fund
15. Host Support for U.S. Relocation Activities

Appendix D. Report Distribution

Office of the Secretary of Defense

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

Director, Program Analysis and Evaluation

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
- Director, Defense Finance and Accounting Service Indianapolis Center
- Director, Defense Finance and Accounting Service Cleveland Center
- Director, Defense Finance and Accounting Service Columbus Center
- Director, Defense Finance and Accounting Service Denver

Director, Defense Information Systems Agency
Director, Defense Threat Reduction Agency
Director, DoD Education Activity
Director, Tricare Management Activity-Aurora
Director, Washington Headquarters Services
Director, White House Communications Agency
President, Uniformed Services University of Health Sciences

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE
8899 EAST 56TH STREET
INDIANAPOLIS, INDIANA 46249

MAY 20 2006

DFAS-ADL/IN

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Controls over Abnormal Balances in Financial Data Supporting Financial Statements for Other Defense Organizations, Dated April 21, 2006 (Project No. D2005-D000FA-0262.000)

Indianapolis Operations is providing management comments to the following recommendations:

Recommendation A. We recommend that the Director, Defense Finance and Accounting Service Indianapolis revise the existing year-end guidance or establish separate quarterly guidance to specifically require accounting offices to provide Defense Finance and Accounting Service Indianapolis explanatory footnotes for all abnormal balances in the quarterly trial balance submissions.

Current Management Comment: Stakeholder: Dorothy Ferguson, 317-510-5594. Concur. The Director, Defense Finance and Accounting Service – Indianapolis (DFAS-IN) will revise the existing year-end guidance and establish separate quarterly guidance to specifically require accounting offices to provide DFAS-IN explanatory footnotes for all abnormal balances in the quarterly trial balance submissions.

Current Estimated Completion Date: June 30, 2006

Recommendation B. We recommend that the Director, Defense Finance and Accounting Service Indianapolis establish and implement a process to identify abnormal balances in the financial data supporting the Other Defense Organizations financial statements and disclose the financial statement disposition of those anomalies.

1. Develop an identification and disclosure metric for abnormal amounts in the entity code level supporting the financial statement account or line item.

2. Disclose in the notes to the financial statements the metric and the abnormal amounts when they exceed that metric, to include amounts that are eliminated as a result of reclassifications.

3. Disclose in the notes to the financial statements the nature of individual amounts in an entity code or at the entity code that individually exceed the metric to include the following:
    - the dollar amount of the abnormal balance,
    - the business event that caused the abnormal balance,
    - the reason the abnormality occurred,
    - the fiscal time period in which the abnormal balance occurred, and
    - when the abnormality will be corrected.

Current Management Comment: Stakeholder: Dorothy Ferguson, 317-510-5594. Non-concur. DFAS-IN has established and implemented a process to identify abnormal balances in the financial data supporting the Other Defense Organizations (ODO) financial statements and disclose the financial statement disposition of those anomalies.

1. DFAS-IN uses the materiality threshold as identified in the Department of Defense (DoD) Financial Management Regulation (FMR) Volume 6B, Chapter 10. DFAS-IN developed an identification and disclosure metric for abnormal amounts at the financial statement account or line item level. Specifically, the identification and disclosure metric for abnormal amounts is a materiality threshold of 2% total assets and/or 10% fluctuation from prior year's balance. This provides the Other Defense Organization (ODO) consolidated financial data a mechanism to identify material amounts disclosed as identified in the DoD FMR 7000 14-R Volume 6B guidance prior to the January 2006 update. Due to the sheer volume of the data received to support the ODO General Fund financial data, DFAS-IN has to analyze the data at a summarized level. DFAS-IN analyzes the general ledger account data at the entity code level in order to meet the accelerated 21-day reporting schedule. Therefore, DFAS-IN summarizes the data at the entity code level and applies a materiality threshold.

2. DFAS-IN discloses in Note 1, section 1.W, to the financial statements the metric for the identification and the disclosure of abnormal balances. The metric is based on the materiality threshold of 2% total assets and/or 10% fluctuation from prior year's balance as identified in DoD FMR Volume 6B, Chapter 10. This guidance is used to disclose in the notes to the financial statements the abnormal amounts when they exceed that metric. DFAS-IN does not include amounts that are eliminated as a result of reclassifications. The reclassification is a corrective action and/or adjustment to better represent the financial position of the ODO General Fund financial data, based on known system deficiencies. If these reclassifications are material to ODO General Fund financial data, we disclose the impacts of the reclassifications in the footnotes based on the applicable line they impact on the financial statements.

3. DFAS-IN discloses in the notes to the financial statements the nature of individual amounts when an entity materially contributes to the total change in the financial statement account or line item causing it to exceed the metric. Footnote disclosures for entities that exceed the metric and materially contribute to the total change include the following information:
    - the dollar amount of the abnormal balance,
    - the business event that caused the abnormal balance,
    - the reason the abnormality occurred,
    - the fiscal time period in which the abnormal balance occurred, and
    - when the abnormality will be corrected.

My point of contact is Ms. Dorothy Ferguson, 317-510-5594.

Audrey R. Eckhart

for Steve R. Bonta
Director, Indianapolis Operations

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