

September 22, 2006



Financial Management

Selected Controls Over the Military Personnel, Army Appropriation (D-2006-112)

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Acronyms

| | |
|---------|---|
| DFAS | Defense Finance and Accounting Service |
| DFAS-IN | Defense Finance and Accounting Service Indianapolis |
| FMR | Financial Management Regulation |
| MPA | Military Personnel, Army |



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

September 22, 2006

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE INDIANAPOLIS OPERATIONS

SUBJECT: Report on Selected Controls over the Military Personnel, Army
Appropriation (Report No. D-2006-112)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report. The Assistant Secretary of the Army (Financial Management and Comptroller) comments on Recommendations A.1.b. and A.1.d. were partially responsive.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Assistant Secretary of the Army (Financial Management and Comptroller) provide additional comments on Recommendation A.1.b. and reconsider her comments on Recommendation A.1.d. by October 23, 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 authorizing 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 Carmelo G. Ventimiglia at (317) 510-4801 (DSN 699-4801) ext. 275 or Mr. Robert J. Ringwald at (317) 510-4801 (DSN 699-4801) ext. 272. See Appendix C for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Paul J. Granetto", is positioned above the typed name.

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

Department of Defense Office of Inspector General

Report No. D-2006-112

September 22, 2006

(Project No. D2005-D000FI-0268.000)

Selected Controls over the Military Personnel, Army Appropriation

Executive Summary

Who Should Read This Report and Why? Department of the Army and Defense Finance and Accounting Service (DFAS) officials who manage and account for the Military Personnel, Army (MPA) appropriation should read this report. The report discusses control weaknesses that led to a potential Antideficiency Act violation in the FY 2005 MPA appropriation.

Background. This is the first of two audit reports evaluating the processes and controls over managing and accounting for the MPA appropriation. We will discuss other aspects of the audit objective in a separate report focusing on controls over permanent change of station travel advances and suspense accounts. The MPA appropriation is a centrally managed, single-year appropriation that funds soldiers' pay and allowances and other related personnel costs. For FY 2005, direct obligation authority totaled \$41.8 billion. Within the Office of the Assistant Secretary of the Army (Financial Management and Comptroller), the Army Budget Office, Military Pay Division is responsible for formulating and justifying the MPA appropriation budget. The Army Budget Office, in coordination with the fund holder, the Office of the Deputy Chief of Staff for Personnel, centrally manages the execution of the entire appropriation by developing obligation plans and monitoring and analyzing execution performance against the plans. The Military Pay Accounting Division at DFAS Indianapolis (DFAS-IN) is responsible for the accounting and financial reporting of the appropriation.

Results. The Army did not establish effective processes and controls for managing the MPA appropriation. As a result, as of January 31, 2006, the Army had obligated about \$617.1 million and disbursed about \$431.7 million in excess of the \$41.8 billion approved funding for the FY 2005 MPA appropriation. As such, the Army may have incurred an Antideficiency Act violation reportable under subsection 1517(b), title 31, United States Code. On December 19, 2005, the Assistant Secretary of the Army (Financial Management and Comptroller) approved a plan to strengthen management controls over the MPA appropriation. In addition to the planned actions, the Army Budget Office, in coordination with the Office of the Deputy Chief of Staff for Personnel, should use the Program Budget Accounting System - Funds Distribution to create and issue funding targets; include non-payroll costs in the costing model methodology; document the methodology for estimating obligations and the decisions made to align resources with available funds; prepare accounting adjustments transferring obligations and disbursements to the correct fiscal year; and report a potential Antideficiency Act violation in the FY 2005 MPA appropriation. DFAS-IN should coordinate and implement system changes to receive and record obligations based on the supply requisition date (finding A).

The Army Budget Office and DFAS-IN lacked effective internal controls to ensure the accuracy and reliability of accounting data. Specifically, the Army Budget Office and DFAS-IN did not establish a formal process to identify and track transactions and adequately document and support accounting adjustments, and did not conduct thorough joint reviews of recorded obligations and disbursements. The absence of effective internal controls resulted in managers questioning the reliability and accuracy of reported financial data and contributed to the potential Antideficiency Act violation. The Army Budget Office and DFAS-IN should develop and implement procedures for preparing and maintaining documentation for accounting adjustments, tracking and controlling accounting transactions, and conducting periodic joint reviews of MPA appropriation obligations and disbursements. In addition, DFAS-IN should dedicate adequate staff to ensure thorough periodic obligation reviews. The Managers' Internal Control Program self-evaluations should also be updated and, if the conditions continue to exist, report a material weakness to the next higher level of management (finding B). See the Findings section for the detailed recommendations.

Management Comments and Audit Response. The Assistant Secretary of the Army (Financial Management and Comptroller) responded for the Director, Army Budget. The Assistant Secretary concurred with recommendations to use the Program Budget Accounting System - Funds Distribution, include non-payroll costs in the model for estimating obligations, and document results of budget execution reviews. The Assistant Secretary also agreed to modify the Army Food Management Information System to create an obligation document and implement procedures for preparing and maintaining documentation supporting accounting adjustments. In addition, the Assistant Secretary agreed to coordinate with DFAS-IN to establish a formal process to identify and track accounting transactions, implement procedures for conducting periodic joint reviews of obligations, and update self-evaluations of internal controls. The Assistant Secretary did not respond to the recommendation to thoroughly document the costing model methodology and retain documentation to support estimated obligations.

The Assistant Secretary nonconcurred with recommendations to prepare accounting adjustments to transfer obligations and disbursements from FYs 2004 and 2006 to FY 2005, and report a potential Antideficiency Act violation. The Assistant Secretary stated that the Army would postpone a decision on making the accounting adjustments and reporting a potential Antideficiency Act violation pending completion of reviews by the U.S. Army Audit Agency. We believe the action taken by the Assistant Secretary meets the intent of the recommendations. However, we do not agree with the Assistant Secretary's position for not processing an accounting adjustment transferring \$113.9 million of subsistence interfund bills from FY 2004 to FY 2005. The business practice of obligating current year funds when DFAS-IN receives a disbursement for which a corresponding obligation has not been recorded in the accounting system is contrary to the DoD Financial Management Regulation, volume 3, chapter 8. We request that the Assistant Secretary reconsider her position and require the Director, Army Budget to prepare accounting adjustments to transfer MPA appropriation obligations and disbursements to the correct fiscal year. We request that the Assistant Secretary provide additional comments on the final report by October 23, 2006.

The Director, DFAS-IN Operations concurred with all recommendations. See the Findings section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

The Military Personnel, Army (MPA) appropriation is a centrally managed, single-year appropriation that funds soldiers' pay and allowances and other related personnel costs. For FY 2005, direct obligation authority totaled \$41.8 billion, including emergency supplemental authority of \$11.1 billion primarily for support of the Global War on Terrorism and \$915.7 million authorized by Title IX of the FY 2005 Department of Defense Appropriations Act.

Starting in FY 2004, the MPA appropriation changed from an open allotment to a specific allotment with accounting and financial reporting performed by the Military Pay Accounting Division located at the Defense Finance and Accounting Service (DFAS) Indianapolis (DFAS-IN). Only the uniform and clothing account and the subsistence budget activities continued to operate as a special open allotment. Under a specific allotment, DFAS-IN records obligations and disbursements as individual transactions and reports the transactions by specific fiscal stations. Under an open allotment, DFAS-IN records and reports obligations and disbursements meeting established criteria at the summary account level using a general fiscal station number.

Within the Office of the Assistant Secretary of the Army (Financial Management and Comptroller), Army Budget Office (Army Budget), the Military Pay Division is responsible for formulating and justifying the MPA appropriation budget. Army Budget, in coordination with the fund holder, the Army Office of the Deputy Chief of Staff for Personnel (Army G-1), centrally manages the execution of the entire MPA appropriation by developing obligation plans and monitoring and analyzing execution performance against the plans. DoD Regulation 7000.14R, the DoD Financial Management Regulation (FMR), volume 6A, chapter 2, "Financial Reports, Roles, and Responsibilities," assigns the DoD Components responsibility for establishing appropriate internal controls over financial data provided to DFAS-IN. As such, the DoD Components are responsible for ensuring the accuracy, completeness, and documentary support for the data recorded in the finance and accounting systems and used to prepare financial reports.

Objective

Our overall audit objective was to evaluate whether processes and controls were in place to ensure accurate and timely recording of the Army's military pay and benefits cost data. We also reviewed the Managers' Internal Control Program as it related to the overall objective. This is the first of two audit reports that discuss the processes and controls over managing and accounting for the Military Personnel, Army appropriation. We will address the other aspects of the audit objective in a subsequent report focusing on controls over permanent change of station travel advances and suspense accounts. See Appendix A for a discussion of the scope and methodology. See Appendix B for prior coverage related to the objective.

Review of Internal Controls

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996,¹ 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.

We evaluated Army Budget and DFAS-IN internal controls and management's self-evaluations of internal controls over the management of and accounting for the MPA appropriation. Specifically, we focused on the Military Pay Division within Army Budget and Military Pay Accounting Division within DFAS-IN.

We identified material internal control weaknesses as defined by DoD Instruction 5010.40 in both Army Budget and DFAS-IN. Internal controls did not ensure adherence to the DoD FMR policy for distributing funds, estimating and recording obligations, preparing and documenting adjustments, controlling and tracking transactions, and conducting joint reviews of obligations. Management's self-evaluations performed by the Military Pay Division within Army Budget and the Military Pay Accounting Division within DFAS-IN did not identify or report these weaknesses. Recommendations A.1.b., A.1.c., A.1.f., A.2., B.1., B.2.a., B.2.b., and B.3., when implemented, will correct the internal control weaknesses. Recommendation B.2.c. should provide for a more accurate assessment and reporting of internal controls. The Findings section of this report discusses the internal control weaknesses and the adequacy of management's self-evaluation process. A copy of the report will be provided to the senior official responsible for management controls in Army Budget and DFAS-IN.

¹ Our review of internal controls was done under the auspices of DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. DoD Directive 5010.38 was canceled on April 3, 2006. DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," was reissued on January 4, 2006.

A. Management of Military Personnel, Army Appropriation Funds

The Army did not effectively manage the MPA appropriation. Specifically, Army Budget, in coordination with the Army G-1, did not:

- establish and distribute formal funding targets to program managers responsible for obligating and expending MPA appropriation funds,
- accurately estimate and document support for obligations, and
- modify budget execution plans or request additional funding when forecasted funding requirements exceeded approved funding.

These conditions occurred because Army Budget did not develop formal processes and written procedures to manage the MPA appropriation. In addition, Army Budget and DFAS-IN did not comply with DoD FMR policy on recording obligations in the accounting period that they occurred. As a result, as of January 31, 2006, the Army had obligated about \$617.1 million and disbursed about \$431.7 million in excess of the \$41.8 billion approved funding for the FY 2005 MPA appropriation. The Army may have violated subsection 1517, title 31, United States Code (31 U.S.C. 1517).

Criteria

Roles and Responsibilities. Preparing and issuing Component financial reports is a joint responsibility of DFAS and the DoD Component. The DoD FMR, volume 6A, chapter 2, “Financial Reports, Roles, and Responsibilities,” assigns the DoD Component responsibility for ensuring the accuracy, completeness, timeliness, and documentary support for all data generated by the DoD Component and input into the finance and accounting systems. DFAS is responsible for accurate and timely recording and processing of data provided by the DoD Component. Both DFAS and the DoD Component are responsible for reviewing financial reports to assess the accuracy of the reported financial information and for taking corrective actions, as needed, to improve the timeliness and quality of the financial reports. Ultimately, however, the DoD Component is responsible for the accuracy and completeness of information in financial reports.

Recording Obligations. The DoD FMR, volume 3, chapter 15, “Receipt and Use of Budgetary Resources - Execution Level,” states that obligations incurred are amounts of orders placed, contracts awarded, services received, and similar transactions during an accounting period that will require payment. Chapter 8, “Standards for Recording and Reviewing Commitments and Obligations,” requires that the military Services record obligations for amounts payable to military personnel in the month they earned it. Chapter 8 also prescribes the basis

for determining the amount to record and the accounting period in which obligations will be recorded. DoD Components are to obligate funds at the time they requisition items. The office that incurs an obligation is responsible for providing the accounting station with documentary evidence of the transaction. If personnel do not know the amount of an obligation at the time they record it, they should provide their best estimate based on a thorough analysis of the transaction that actually occurred.

Antideficiency Act Requirements. Under 31 U.S.C. 1517(a), Government officials are prohibited from making obligations or expenditures in excess of an apportionment² or reapportionment, or in excess of the amount permitted by agency regulation. Section 1517(b) requires the agency head to immediately report violations to the President and Congress and to include all relevant facts and actions taken. DoD Directive 7200.1, “Administrative Control of Appropriations,” requires DoD Components to investigate and report on actual or potential violations of section 1517(a). Specific procedures for investigating and reporting potential violations are contained in the DoD FMR, volume 14, “Administrative Control of Funds and Antideficiency Act Violations.”

Funding Target Distribution

Army G-1 did not establish and distribute formal funding targets to the Army program managers who were directly responsible for obligating and expending MPA appropriation funds. Army Budget, in coordination with Army G-1, developed obligation plans and monitored and analyzed execution performance against the plans. However, other Army organizations were directly responsible for executing programs funded by the MPA appropriation. For example, the U.S. Army Human Resources Command is the program manager for permanent change of station moves. The approved FY 2005 budget for permanent change of station moves totaled \$1.2 billion. However, as of January 31, 2006, cumulative obligations exceeded the permanent change of station budget by \$112.2 million. The absence of a formal process for establishing and distributing funding targets prevented Army G-1 from holding program managers accountable for executing their programs within the approved budget.

Accuracy of Estimated Obligations

Army Budget did not adequately document the estimated obligations recorded in the monthly Accounting Report M-1002, “Appropriation Status by Fiscal Year, Program, and Sub-account.” The documentation was inadequate because Army Budget had not developed written procedures detailing the methodology and data used for estimating obligations. Prior to each month-end, DFAS-IN provided Army Budget with a summary of the current year-to-date obligations and

² An apportionment is a distribution by the Office of Management and Budget of dollar amounts available for obligation in an appropriation or fund account. The amounts apportioned limit the obligations and expenditures the fund holder may incur.

disbursements. Army Budget then prepared a plan of estimated obligations using the data provided by DFAS-IN, prior years' obligation and disbursement rates, and current year budget requirements. The estimated obligations represented the amount of unpaid accrued expenditures³ at month end. However, Army Budget did not retain the data nor document the process for estimating the obligations. As a result, there was no assurance that the obligation data reported in the monthly Accounting Report M-1002 were reliable and accurate.

Army Budget understated year-end FY 2005 MPA appropriation obligations. Rather than determining and recording total year-end obligations based on best estimates, Army Budget personnel obligated the \$248.2 million that remained unobligated in the MPA appropriation as of September 30, 2005. An Army Budget official informed us that, at the end of FY 2005, they estimated obligations totaled about \$510.0 million, \$261.8 million more than the amount recorded in the September 30, 2005, Accounting Report M-1002. However, Army Budget personnel could not provide documentation to support the estimated year-end obligations. Specific costs not obligated at year-end included \$102.6 million for Service Group Life Insurance and \$80.0 million for Unemployment Compensation. Without documentation to substantiate estimated obligations, Army Budget did not have a valid basis for approving the September 30, 2005, Accounting Report M-1002.

Budget Execution

Army Budget and Army G-1 neither modified the budget execution plan nor requested additional funds based on changes in requirements. The FY 2005 mid-year budget execution review reported that cumulative actual obligations equaled planned obligations. However, changes in requirements, primarily in projected officer and enlisted grade structures and incentives associated with the ongoing Global War on Terrorism, caused cumulative actual obligations to exceed planned obligations starting in April 2005. Table 1 displays planned and actual MPA appropriation obligations from April through September 2005.

| Table 1. Comparison of Planned to Actual FY 2005 MPA Appropriation Obligations (Dollar amounts in billions) | | | | | | |
|--|--------------|------------|-------------|-------------|---------------|------------------|
| | <u>April</u> | <u>May</u> | <u>June</u> | <u>July</u> | <u>August</u> | <u>September</u> |
| Planned | \$24.4 | \$28.1 | \$31.7 | \$34.6 | \$38.6 | \$41.8 |
| Actual | 24.6 | 28.3 | 31.3 | 35.1 | 39.0 | 41.8 |
| Variance | (0.2) | (0.2) | 0.4 | (0.5) | (0.4) | 0.0 |

³ Unpaid accrued expenditures represent the dollar value of goods and services received but not paid. On the Accounting Report M-1002, unpaid accrued expenditures will equal the unpaid obligation amount.

Although Army Budget and Army G-1 officials closely monitored execution of the MPA appropriation budget, they did not document any specific recommendations or actions taken to align requirements with available funds or to request additional funding. Army Budget officials explained that they questioned the reliability of the MPA appropriation obligation and disbursement data reported in the monthly Accounting Report M-1002 and anticipated making accounting adjustments to avoid exceeding the approved funding. As of September 30, 2005, Army Budget reported in the year-end Accounting Report M-1002 that it had obligated all its funding (\$41.8 billion) and made disbursements totaling about \$41.6 billion.

Accounting Adjustments

Army Budget inappropriately made accounting adjustments that had the effect of increasing the obligation authority in the FY 2005 MPA appropriation. The recording of transactions in the wrong fiscal year occurred because Army Budget and DFAS-IN officials did not comply with DoD FMR policy, which requires obligations be recorded in the accounting period they occur.

Interfund Bills Charged to FY 2004 Appropriation. Army Budget inappropriately reversed an accounting adjustment for subsistence items processed through the interfund billing system.⁴ In April 2005, DFAS-IN accountants determined that \$312.8 million of interfund bills from the Defense Logistics Agency processed between November 2004 and April 2005 erroneously cited FY 2004 MPA appropriation funds rather than FY 2005 MPA appropriation funds. The detailed list of requisition transactions supporting the interfund bills showed requisition dates after September 30, 2004. DFAS-IN personnel concluded that inaccurate correlations of Fiscal Station Numbers and DoD Activity Address Codes associated with the establishment of the Army's Installation Management Agency caused transactions to cite the wrong fiscal year. Based on the information provided by DFAS-IN, Army Budget personnel prepared a Standard Form 1081, Voucher and Schedule of Withdrawals and Credits, dated May 12, 2005, transferring the obligations and disbursements from FY 2004 to FY 2005.

On September 20, 2005, Army Budget prepared a Standard Form 1081 reversing the May 12, 2005, adjustment. The Standard Form 1081 cited apparent discrepancies in requisitioning dates on transactions supporting the interfund bills from the Defense Logistics Agency as the reason for the adjustment. However, Army Budget officials did not document the data analysis they performed to conclude that requisitions occurred in FY 2004 rather than FY 2005. In addition, the Standard Form 1081 indicated a need for additional research to ensure that disbursements posted correctly. However, Army Budget officials could not

⁴ The interfund billing system is an automated billing and fund transfer process designed to replenish the seller's cash reserves immediately when consumable items are delivered to the buyer. The seller's accounting station submits bills to the buyer through the Defense Automated Addressing System Center. The seller submits both a summary bill, by appropriations charged, and a detailed list of requisition transactions.

provide documentation or a description of the additional research performed to validate the accounting adjustment. In the absence of support for the adjustment made on September 20, 2005, Army Budget should reverse it by processing a Standard Form 1081 charging FY 2005 MPA appropriation funds rather than FY 2004 funds.

Review of FY 2005 Appropriation Accounting Transactions. On November 10, 2005, DFAS-IN informed Army Budget of a potential negative cash balance⁵ in the FY 2005 MPA appropriation. Army Budget officials, in coordination with DFAS-IN personnel, reviewed FY 2005 MPA appropriation accounting transactions valued individually at more than \$1 million to determine whether recorded obligations and disbursements were proper and cited the correct fiscal year. As a result of their review, Army Budget and DFAS-IN personnel processed eight accounting adjustments decreasing FY 2005 obligations and disbursements by about \$587.5 million. Processing the eight adjustments increased the FY 2005 MPA appropriation cash balance to \$411.8 million as of November 30, 2005. We reviewed the eight adjustments and concluded that one adjustment for \$108.3 million incorrectly cited FY 2006 funds rather than FY 2005 MPA appropriation funds. The joint review by Army Budget and DFAS-IN also identified, but did not correct, a \$190.3 million payment to the Medicare Eligible Retiree Health Care Fund that incorrectly cited FY 2004 rather than FY 2005 MPA appropriation funds.

Interfund Bills Charged to FY 2006 Appropriation. DFAS-IN improperly charged the FY 2006 MPA appropriation for subsistence items requisitioned during FY 2005. Army food service activities requisitioned subsistence items managed by the Defense Logistics Agency using the Army Food Management Information System. However, the system did not create an obligation transaction at the time food service activities prepared the requisition. As a result, DFAS-IN followed its established business practice and created the obligation transaction based on the date it disbursed funds to pay the bill. DFAS-IN used the Operational Data Store to interface information for entitlement, disbursing, and accounting systems. If the Operational Data Store did not locate a matching obligation when processing the detail list of interfund transactions, the system assigned a transaction code that simultaneously created an obligation and disbursement transaction for the accounting system citing the current fiscal year appropriation. This practice was contrary to DoD FMR policy that requires DoD Components to obligate funds at the time they requisition items.

The October 2005 summary interfund bill received from the Defense Logistics Agency, totaling \$108.3 million, charged the FY 2005 MPA appropriation. However, when the detail list of interfund transactions processed through the Operational Data Store, the system assigned a transaction code that simultaneously obligated and disbursed transactions within the accounting system citing the FY 2006 MPA appropriation. Following normal business practices, DFAS-IN reversed the summary bill that cited the FY 2005 appropriation and

⁵ Cash balance is the difference between approved funding and total disbursements. Because the FY 2005 MPA appropriation was fully obligated, the cash balance equaled unpaid obligations. A negative cash balance occurs when total disbursements exceed approved funding.

charged the FY 2006 appropriation. However, the detail list of transactions showed that all requisition documents originated in FY 2005. In addition, using the same business practice, DFAS-IN processed another \$5.6 million of interfund bills in October and December 2005 that charged FY 2006 funds rather than FY 2005 funds. Army Budget should prepare a Standard Form 1081, transferring the \$113.9 million of interfund bill charges to the FY 2005 MPA appropriation.

Medicare Eligible Retiree Health Care Fund Costs. Army Budget erroneously charged \$190.3 million for contributions to the Medicare Eligible Retiree Health Care Fund (the Fund) to the FY 2004 MPA appropriation rather than the FY 2005 MPA appropriation. DoD Components are to recognize costs for pensions and medical benefits for retirees during the years in which the employees are working in lieu of when the benefits are actually paid. Monthly, Army Budget computed payments to the Fund based on personnel end strength and annual contribution rates established by the Fund's Board of Actuaries. In processing the October 2004 contribution, Army Budget prepared the Standard Form 1081 citing FY 2004 funds rather than FY 2005 funds and DFAS-IN processed the payment accordingly. Because of changes in their monthly payment process, Army Budget personnel assumed the payment was for September 2004 rather than for October 2004, thus directing DFAS-IN to use FY 2004 funds. DFAS-IN identified the error while researching prior adjustments involving Army contributions to the Fund and informed Army Budget of the error in November 2005.⁶ As of May 25, 2006, Army Budget had not taken action to adjust accounting records.

Summary. Army Budget and DFAS-IN improperly cited FYs 2004 and 2006 funds rather than FY 2005 MPA appropriation funds. Processing the three correcting adjustments totaling \$617.1 million would result in obligations and disbursements exceeding approved funds and a potential Antideficiency Act violation as of January 31, 2006, reportable under 31 U.S.C. 1517(b). The Army had obligated about \$617.1 million in excess of the \$41.8 billion in approved funding for the FY 2005 MPA appropriation. As of January 31, 2006, the projected cash deficit (disbursements in excess of approved funding) would total \$431.7 million, after processing the \$617.1 million in correcting accounting adjustments. See Table 2 for a description of the projected cash deficit.

⁶ Adjustments recommended by DoD IG Report No. D-2006-034, "Accuracy of the Contributions to the Medicare-Eligible Retiree Health Care Fund," December 7, 2005.

| Table 2. FY 2005 MPA Appropriation Status, as of January 31, 2006 (Dollar amounts in millions) | |
|---|-----------------|
| Approved Funding/Total Obligations | \$41,839.7 |
| Less: Total Disbursements | <u>41,654.3</u> |
| Net Cash Balance | 185.4 |
| Less: Correcting Accounting Adjustments | <u>617.1</u> |
| Projected Cash Deficit | (431.7) |

Improvements in MPA Appropriation Management

Fund Distribution. To improve accountability and control for managing the execution of programs funded by the MPA appropriation, Army G-1 issued letters providing FY 2006 funding targets to several Army program managers. Army G-1 issued letters to the Chief of Staff for Logistics for subsistence requirements, the U.S. Army Human Resource Command for permanent change of station moves and enlisted incentive requirements, and the U.S. Military Academy for cadet pay and allowances. The funding letters directed the recipients to monitor actual execution against the targets to ensure that obligations and expenditures did not exceed funding targets. Army Budget and Army G-1 plan to issue more funding targets in FY 2007. The funding target letters are a positive step to place accountability on Army managers for executing programs within funding limits. However, Army Budget and Army G-1 should formalize the process by using the Program Budget Accounting System - Funds Distribution to create the funding document and distribute it to the recipient. The system should be used to prevent distribution of more funds than authorized to fund holders and program managers and to provide a documented audit trail for assigning and holding recipients responsible for executing programs within established funding targets.

Estimated Obligations. Army and DFAS-IN officials developed a Plan of Milestone Actions to improve MPA appropriation processes and controls. The Plan of Milestone Actions includes interim and long-range milestones to improve the process for estimating monthly payroll obligations. Specifically:

- In December 2005, Army Budget and Army G-1 began to coordinate with the Deputy Assistant Secretary of the Army for Cost and Economics to develop a costing model for estimating obligations.
- In January 2006, Army Budget began to provide DFAS-IN with a manually generated obligation plan, estimating the current month's payroll liability by the fifth workday of the month.

-
- During the third quarter FY 2007, DFAS-IN plans to implement system changes for an automated process to develop payroll obligation estimates.

However, the Plan of Milestone Actions did not address estimating obligations for non-payroll costs such as permanent change of station travel. To ensure that the estimates are complete, reasonable, and adequately supported, Army Budget and Army G-1 need to include non-payroll costs in the costing model for estimating obligations, thoroughly document the costing model methodology, and retain documentation to support recorded obligations.

Budget Execution. In a memorandum signed on December 19, 2005, the Assistant Secretary of the Army (Financial Management and Comptroller) assigned the Director of Operations and Support, Army Budget, responsibility for ensuring effective implementation of the business process changes in the Plan of Milestone Actions within prescribed timeframes. The memorandum stated that the Army G-1 would continue to execute assigned responsibilities for managing the Army's personnel force structure within available resources. Army Budget and Army G-1 are to use the monthly MPA execution reviews as a forum to advise the Army leadership on the status of resources and to identify requirements that are not affordable within current available funds. To ensure accountability and clear communication of program results and management decisions, Army Budget and Army G-1 should document data analysis and recommendations they make to align requirements with available resources and Army leadership decisions.

Interfund Transactions. Army Budget and DFAS-IN recognized that obligating subsistence interfund transactions based on the date the bills process rather than the date of requisition did not comply with DoD FMR policy. The Army Food Management Information System did not create an obligation document to pass to the Standard Finance System, the Army's installation accounting system, at the time of requisition. The Plan of Milestone Actions identified the U.S. Army Materiel Command's Funds Control Module as a potential tool for passing obligations between the Army Food Management Information System and the Standard Finance System. However, in February 2006, Army Materiel Command personnel told us that they had no plans to modify the Fund Control Module to interface with the Army Food Management Information System. As an alternative measure, Army Budget and Army G-1 should work with the Office of the Deputy Chief of Staff, G-4 (Logistics) to modify the Army Food Management Information System to create an obligation document at the time the supply requisition is prepared. DFAS-IN should then implement the required system changes for Operational Data Store to receive obligation transactions from the Army Food Management Information System and to pass the transactions to the Standard Finance System for recording in the fiscal year the requisition is made.

Summary

The Army had not established effective controls and procedures to manage the MPA appropriation. As of January 31, 2006, the cash balance in the FY 2005

MPA appropriation totaled about \$185.4 million. Army Budget and DFAS-IN improperly recorded \$617.1 million of obligations and disbursements in the FYs 2004 and 2006 MPA appropriations rather than the FY 2005 MPA appropriation. Correction of accounting transactions may result in a potential Antideficiency Act violation reportable under DoD Directive 7200.1 and the DoD FMR, volume 14. Although the Assistant Secretary of the Army (Financial Management and Comptroller) has approved a plan that addresses many recognized weaknesses and strengthens management controls over the MPA appropriation, Army Budget, Army G-1, and DFAS-IN need to take additional corrective actions to improve processes and controls to manage the MPA appropriation.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Director, Army Budget, in coordination with the Deputy Chief of Staff for Personnel:

a. Develop a formal process to use the Program Budget Accounting System - Funds Distribution for creating and issuing funding authorization targets to program managers responsible for obligating and expending Military Personnel, Army appropriation funds.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that Army Budget was working with Army G-1 to evaluate the issuance of formal funding targets through the Program Budget Accounting System. They anticipate that any changes will occur during FY 2007 or the start of FY 2008.

b. Include non-payroll costs in the costing model for estimating obligations, thoroughly document the costing model methodology, and retain documentation to support the monthly and year-end estimated obligations recorded in the Accounting Report M-1002.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that the cost model under development will be used to estimate most non-payroll costs in FY 2007.

Audit Response. Management comments are partially responsive. The Assistant Secretary did not indicate whether the Army will thoroughly document the costing model methodology and retain documentation to support the monthly and year-end estimated obligations. We request that the Assistant Secretary provide comments on the final report.

c. Implement, as a part of the monthly budget execution reviews of the Military Personnel, Army appropriation, procedures to thoroughly document the data analysis performed, recommendations made to align requirements with available resources, and decisions made by Army leadership.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that the budget execution reviews will be documented.

d. Prepare Standard Form 1081 accounting adjustments to transfer Military Personnel, Army appropriation obligations and disbursements to the correct fiscal year. Specifically, prepare accounting adjustments to move:

(1) \$312.8 million of subsistence interfund bills from FY 2004 to FY 2005.

(2) \$113.9 million of subsistence interfund bills from FY 2006 to FY 2005.

(3) \$190.3 million of Medicare Eligible Retiree Health Care Fund costs from FY 2004 to FY 2005.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) nonconcurred and stated that further review of the interfund bills and Medicare Eligible Retiree Health Care Fund costs was necessary before making the accounting adjustments. Regarding the \$312.8 million of subsistence interfund bills, the Assistant Secretary stated that prior reconciliations of the FY 2005 Military Personnel, Army appropriation were limited in scope and focused primarily on high-dollar transactions. The U.S. Army Audit Agency is performing a complete reconciliation of interfund bills processed during the six fiscal quarters covering the fourth quarter FY 2004 through the first quarter FY 2006. The preliminary report is due in November 2006, and the final report is due in January 2007. The Assistant Secretary nonconcurred with the recommendation to move \$113.9 million of subsistence interfund bills from FY 2006 to FY 2005 and stated that it is standard DoD business practice to obligate current year funds when a disbursement is received with no corresponding obligation. The Assistant Secretary stated that the recommendation to transfer \$190.3 million of Medicare Eligible Retiree Health Care costs from FY 2004 to FY 2005 does not consider the impact of over and under payments. U.S. Army Audit Agency is also reviewing payments made to the Medicare Eligible Retiree Health Care Fund. Army Budget officials will process the necessary accounting adjustments upon completion of the U.S. Army Audit Agency reviews.

Audit Response. Management comments are partially responsive. The DoD FMR, volume 14, chapter 3, requires that within 10 business days of receipt of a DoD Inspector General draft report alleging a potential Antideficiency Act violation, the Assistant Secretary of the Army (Financial Management and Comptroller) will request a preliminary review of the potential violation. If the review determines that a potential violation occurred, the Assistant Secretary will initiate a formal investigation within 15 business days and report the potential violation to the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. We believe that the reviews of the \$312.8 million of subsistence interfund bills and the \$190.3 million of Medicare Eligible Retiree Health Care Fund costs by the U.S. Army Audit Agency meet the DoD FMR

requirement to conduct a preliminary review of an audit-identified potential Antideficiency Act violation.

We do not agree with the Assistant Secretary's rationale for recording the \$113.9 million of subsistence interfund bills in FY 2006 rather than FY 2005. Although the standard business practice was to obligate current year funds when DFAS-IN received a disbursement for which a corresponding obligation had not been recorded in the accounting system, the practice was contrary to the DoD FMR, volume 3, chapter 8, which requires the buyer placing an order for a stock-funded item to record the obligation when placing the order. In addition, DFAS-IN Regulation 37-1, "Finance and Accounting Policy and Implementation," requires that when an obligation is incurred in a prior fiscal year, but not recorded in the prior year, the fund holder will use prior year funds to record the obligation. On December 19, 2005, the Assistant Secretary approved a plan to strengthen controls over the MPA appropriation. The plan included changing processes to obligate supply requisitions upon acceptance by the source of supply. In addition, the Assistant Secretary and the Director, DFAS-IN Operations concurred with Recommendations A.1.f. and A.2. to modify systems to record obligations at the time of requisition. DFAS-IN improperly recorded the \$113.9 million of interfund bills in FY 2006 rather than FY 2005 by following practices that comply with DoD policy. As a result, Army Budget should process an accounting adjustment to transfer obligations and disbursements to the correct fiscal year. The impact of this adjustment on the potential Antideficiency Act violation should be evaluated as a part of the U.S. Army Audit Agency reconciliation of interfund bills processed during the six fiscal quarters covering the fourth quarter FY 2004 through the first quarter FY 2006. We request that the Assistant Secretary reconsider her position and provide comments in response to the final report.

e. Report a potential Antideficiency Act violation in the FY 2005 Military Personnel, Army appropriation as prescribed in DoD Financial Management Regulation, volume 14.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) nonconcurred pending completion of U.S. Army Audit Agency's reconciliation of subsistence interfund bills processed during the six fiscal quarters covering the fourth quarter FY 2004 through the first quarter FY 2006. The Assistant Secretary stated that the Army will report an Antideficiency Act violation, if required, upon completion of the reconciliation and processing of the necessary accounting adjustments.

Audit Response. Management comments are responsive. The reviews of subsistence interfund bills and Medicare Care Health Care Fund costs by U.S. Army Audit Agency meet the DoD FMR requirement to conduct a preliminary review of an audit-identified potential Antideficiency Act violation. Based on the results of U.S. Army Audit Agency's review, the Army should report an Antideficiency Act violation, if required.

f. Coordinate with the Office of the Deputy Chief of Staff, G-4 (Logistics) to modify the Army Food Management Information System to create an obligation document at the time the supply requisition is prepared.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that the Army was working with the Army G-4, DFAS, and other interested parties to modify existing systems to enable the obligation of funds at the time subsistence requisitions are accepted by the source of supply. The Army anticipates that the system change to the Army Food Management Information System will be in place and working by October 2006 and worldwide fielding will occur throughout FY 2007.

A.2. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Operations implement system changes to the Operational Data Store to receive and post obligation transactions from the Army Food Management Information System to the accounting records.

Management Comments. The Director, DFAS-IN Operations concurred and stated that DFAS was working with Army G-4 and the Army Food Management Information System contractors on system changes that will create obligations at the point of requisition. The Director stated that he does not expect complete implementation before September 30, 2007.

B. Accounting and Financial Reporting for the Military Personnel, Army Appropriation

Army Budget and DFAS-IN lacked effective internal controls to ensure proper accountability over and reporting for the MPA appropriation. Specifically, the Military Pay Division within Army Budget and the Military Pay Accounting Division at DFAS-IN did not:

- adequately document, support, and review accounting adjustments;
- establish a formal process to identify and track the number, type, and dollar amounts of the obligation transactions and adjustments Army Budget submitted to DFAS-IN for recording;
- conduct thorough tri-annual reviews of recorded obligations; and
- implement an effective internal control program over the MPA appropriation.

These deficiencies occurred because Army Budget and DFAS-IN did not adhere to DoD FMR requirements and have in place local procedures to document and support accounting adjustments, control obligation transactions, and conduct thorough periodic reviews of recorded obligations. As a result, Army Budget officials could not rely on the accuracy and completeness of the accounting data they used to manage the MPA appropriation.

Criteria

Accounting Adjustments. The DoD FMR, volume 6A, chapter 2, “Financial Reports, Roles, and Responsibilities,” discusses the requirements for accounting adjustments. DFAS and DFAS customers are required to support accounting adjustments by written documentation sufficiently detailed to provide an audit trail to source transactions that require the adjustments. This documentation is to contain the rationale and justification for the adjustment, detailed numbers and dollar amounts of errors or conditions that relate to the transactions or records that are proposed for adjustment, date of the adjustment, and name and position of the individual approving the adjustment.

DFAS-IN Regulation 37-1, “Finance and Accounting Policy Implementation,” requires the fund holder or accounting office detecting an error in a reported disbursement to prepare an accounting adjustment. The regulation requires that the fund holder or accounting office use a Standard Form 1081 to correct errors

related to the reported department, fiscal year, basic symbol, fund limit, fiscal station, or dollar amount. The accounting office is responsible for reviewing, certifying, and processing all Standard Forms 1081 submitted by the fund holder. In addition, the DoD FMR and DFAS-IN Regulation 37-1 require DFAS customers to maintain controls that include tools to identify and track the numbers, types, and dollar amounts of accounting transactions and adjustments submitted to DFAS.

Joint Reviews. The DoD FMR volume 3, chapter 8, “Standards for Recording and Reviewing Commitments and Obligations,” requires that fund holders, with assistance from supporting accounting offices, review commitment and obligation transactions for timeliness, completeness, and accuracy during each of the 4-month periods ending January 31, May 31, and September 30. The accounting offices are responsible for providing the fund holders with lists identifying the outstanding obligations. The lists provide a means of documenting the review, to include corrective actions taken and additional research required. The fund holder and accounting office are responsible for processing required adjustments and corrections within 10 workdays. The fund holder is responsible for signing a confirmation statement attesting to the accomplishment of the review and the accuracy and completeness of the recorded amounts. In addition, DFAS-IN Regulation 37-1 requires that the responsible accountants provide the fund holder with a report documenting the results of the review.

Documentation Supporting Accounting Adjustments

Army Budget and DFAS-IN did not adequately document and support accounting adjustments as required by the DoD FMR and DFAS-IN Regulation 37-1. Three of the nine adjustments to the MPA appropriation, totaling about \$900.3 million, that Army Budget and DFAS-IN processed from September through November 2005, did not use a Standard Form 1081. Of the six adjustments that used Standard Forms 1081, two did not have any additional supporting documentation explaining the adjustment.

Military Pay Accounting Division personnel made an adjustment that moved \$37.7 million of costs for bonus payments to soldiers from the FY 2005 MPA appropriation to the FY 2006 MPA appropriation. Accounting personnel stated that they made the adjustment to correct errors in the processing of transactions at year’s end. At our request, accounting personnel queried the Operational Data Store and identified the adjustment transaction and date processed. However, DFAS-IN neither prepared a Standard Form 1081 nor retained supporting documentation describing the justification for the adjustment, the transaction requiring correction, or the individual approving the adjustment.

On September 20, 2005, Army Budget prepared a Standard Form 1081 reversing a prior adjustment and transferring charges of \$312.8 million from the FY 2005 MPA appropriation to the FY 2004 MPA appropriation. Army Budget officials did not provide DFAS-IN with documentation to support the adjustment. In addition, comments on the Standard Form 1081 indicated that additional research was required to ensure that the disbursements posted correctly. However,

accounting personnel processed the adjustment without supporting documentation or evidence that they reviewed and certified the adjustment. Army Budget officials could not provide us evidence to support the adjustment.

Both Army Budget and DFAS-IN lacked local procedures for implementing DoD FMR and DFAS-IN Regulation 37-1 requirements for preparing, documenting, and processing voucher adjustments.

Controlling Transactions

Army Budget and DFAS-IN did not have a formal process in place to identify, track, and control the number, types, and dollar amounts of transactions and adjustments submitted by Army Budget to DFAS-IN for entry into the accounting system. Army Budget used several methods to create and transmit obligation transactions and accounting adjustments to DFAS-IN, to include:

- Standard Form 1080 (Voucher for Transfer Between Appropriations and/or Funds),
- Standard Form 1081,
- monthly spreadsheets of forecasted obligations,
- facsimiles and e-mails, and
- telephone conversations and messages.

DFAS-IN maintained a computer file to store an electronic copy of the standard forms, spreadsheets, and e-mails received from Army Budget. However, Army Budget did not maintain a documented record of all obligation transactions and adjustments sent to DFAS-IN for recording in the accounting system. In addition, DFAS-IN did not have a point of contact established to receive and control transactions sent by Army Budget or written procedures for tracking and maintaining documentation of transactions received.

The lack of a formal process to control obligation transactions limited Army Budget's ability to validate the accuracy and completeness of obligations reflected in financial reports. To illustrate, the monthly spreadsheet of forecasted obligations did not reconcile to the amounts recorded in the accounting records. DFAS-IN personnel stated that they frequently adjusted forecasted obligations based on e-mails and telephone messages from Army Budget. The absence of a formal process for tracking and controlling obligation transactions compromised the reliability of the financial data and contributed to an environment where Army Budget managers questioned the reported status of the MPA appropriation. In addition, the lack of a formal control process hindered management's ability to assign responsibility and accountability for the recorded financial data. Army Budget and DFAS need to establish a formal process for identifying, tracking, and controlling the number, types, and dollar amounts of transactions for entry into the accounting system.

Obligation Reviews

Army Budget and DFAS-IN did not perform thorough reviews of recorded obligations and disbursements in accordance with the DoD FMR. During FY 2005, Army Budget and DFAS-IN performed two of the three required reviews, one in January and the other in July 2005. The review performed in July 2005 included only FY 2005 recorded transactions and did not include any prior year transactions. In addition, since Army Budget and DFAS-IN completed the review more than 2 months prior to fiscal year's end, the review did not include validation of the estimated obligations made for FY 2005 year's end. Personnel responsible for the review annotated control spreadsheets indicating transactions requiring correction, adjustment, or additional research. However, managers did not continue to monitor the process to ensure completion of the required actions. We compared transactions annotated on the July 2005 spreadsheets as requiring corrective action or further research to the documentation supporting the January 2006 review. The majority of the transactions appeared again on spreadsheets for the January 2006 review. Military Pay Accounting Division officials explained that they lacked adequate staffing to review and research all transactions and complete required corrections.

The Plan of Milestone Actions developed by Army and DFAS-IN officials recognized the need to improve the process for conducting tri-annual reviews. During January 2006, Army Budget personnel visited DFAS-IN to conduct a joint review of MPA appropriation obligations. The review covered FY 2006 and prior fiscal years. In early March 2006, DFAS-IN personnel certified that they had completed the review and validation of obligations, and the designated Army Budget official signed a confirmation statement attesting to performance of the review in accordance with the DoD FMR guidance. Although Army Budget and DFAS-IN personnel conducted a more detailed review than the one in July 2005, they did not complete the review of travel and advance pay obligations and disbursements. Military Pay Accounting Division personnel attributed this to continued insufficient staffing. In addition, personnel did not annotate the spreadsheets to show the corrective actions taken and the dates they completed the actions.

A thorough and better documented review of obligations and disbursements would improve the reliability and accuracy of data certified in financial reports and used to manage the MPA appropriation. Army Budget and DFAS-IN should perform the year-end review in conjunction with development of the final year-end obligation plan. Individuals performing the review should annotate the control spreadsheets to show actions taken and dates completed. Responsible supervisors should monitor the process to ensure that research and corrective actions are completed in a timely manner. Army Budget and DFAS-IN officials should also qualify their certification and confirmation statements as to any limitations on the completeness, accuracy, and timeliness of the review. In addition, DFAS-IN should dedicate adequate staff to thoroughly review recorded obligations and disbursements.

Adequacy of Management's Self-Evaluation

Army Budget and DFAS-IN managers did not perform comprehensive self-evaluations of internal controls related to managing and accounting for the MPA appropriation. As a result, neither Army Budget nor DFAS-IN reported the internal control weaknesses we identified.

The Military Pay Division of Army Budget conducted a self-evaluation of internal controls in support of the FY 2005 Annual Statement of Assurance for the Assistant Secretary of the Army (Financial Management and Comptroller). The self-evaluation relied primarily on a review of internal processing checklists. The self-evaluation did not identify the material internal control weaknesses discussed in this report related to fund distribution, estimating and recording obligations, accounting adjustments, control of transactions, and joint reviews of obligations.

Military Pay Accounting Division assessable unit managers conducted self-evaluations using locally developed matrices to assess internal controls over the major functions performed by the division. However, managers did not identify voucher preparation and control of accounting transactions as a major function of their assessable units. Managers did identify tri-annual reviews of obligations as a major function and concluded that adequate internal controls were in place.

In FY 2005, Army Budget and DFAS-IN should have recognized their failure to adhere to DoD policy for distributing funds, estimating and recording obligations, preparing and documenting accounting adjustments, controlling and tracking transactions, and conducting joint reviews of obligations. Army Budget and DFAS-IN should update their self-evaluations and coordinate to determine whether existing conditions meet the criteria for a material weakness. Army Budget and DFAS-IN should also consider progress in completing the Plan of Milestone Actions established to address recognized weaknesses and strengthen management controls over the MPA appropriation. If conditions meet the criteria, then Army Budget should report the material weaknesses to the next higher management level.

Summary

Army Budget and DFAS-IN did not have effective processes in place to control obligation transactions, document and support accounting adjustments, and conduct periodic reviews of recorded obligations. The lack of effective internal controls contributed to an environment where Army managers questioned the reliability of the reported status of the MPA appropriation. Army Budget and DFAS-IN need to establish and strengthen controls regarding the preparation and documentation for adjustment vouchers, tracking documentation, reviewing obligations and disbursements, and performing self-evaluations of internal controls. DFAS-IN also needs to dedicate adequate staff to reviews of obligations and disbursements.

Recommendations and Management Comments

B.1. We recommend that the Director, Army Budget develop and implement procedures for preparing and maintaining documentation supporting accounting adjustments that detail the number and dollar amounts of errors or conditions requiring adjustment and describe the rationale and justification for the adjustment.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that in FY 2007 the Army will institute a process to prepare and maintain documentation supporting accounting adjustments that detail the number and dollar amounts of errors or conditions requiring adjustment and describe the rationale and justification for the adjustment.

B.2. We recommend that the Director, Army Budget, in coordination with the Director, Defense Finance and Accounting Service Indianapolis Operations:

a. Implement a formal process to identify, track, and control the number, types, and dollar amounts of transactions submitted for entry into the accounting system.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that in FY 2007 the Army will institute a formal process to identify, track, and control the number, types, and dollar amounts of transactions submitted for entry into the accounting system. The Director, DFAS-IN Operations also concurred and stated that they are working with the Army to use sequential transmittal numbers to submit Military Pay accounting transactions.

b. Implement procedures for conducting tri-annual reviews of Military Personnel, Army appropriation obligations to ensure that:

(1) All reviews are scheduled and completed within the required timeframes.

(2) The year-end review is performed in conjunction with development of the year-end obligation plan.

(3) Individuals responsible for performing the review annotate the control spreadsheets to show actions taken and dates completed.

(4) Supervisors monitor control spreadsheets to ensure that research and corrections are made timely.

(5) Officials qualify their certification and confirmation statements as to any limitations on the completeness, accuracy, and timeliness of the review.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that the Army will conduct joint reviews in accordance with the DoD FMR, volume 3, chapter 8. The Director, DFAS-IN Operations also concurred and stated that DFAS will coordinate with Army Budget to schedule and complete joint reviews within required timeframes and ensure that the year-end review is performed in conjunction with the year-end obligation plan. The Director further stated that supervisors would monitor annotated control spreadsheets to ensure that accounting personnel research and make corrections timely, and officials would qualify their certification statements as to any limitations on the completeness and accuracy of the review.

c. Update the self-evaluations of the Army Budget Office's Military Pay Division and Defense Finance and Accounting Service's Military Pay Accounting Division to reflect the conditions discussed in this report and to describe the progress in completing the Plan of Action Milestones. Determine whether the conditions meet the criteria for a material weakness as stated in DoD Instruction 5010.40, "Managers, Internal Control (MIC) Program Procedures," January 4, 2006. Army Budget should coordinate with the Defense Finance and Accounting Service Indianapolis to report the material weakness to the next higher level of management.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) concurred and stated that the Chief, Military Pay Division elevated these issues to the next higher level of management as input to the FY 2006 Annual Statement of Assurance. The Assistant Secretary further stated that the Army is aware of these internal control issues and is working to improve financial operations. The Director, DFAS-IN Operations also concurred and stated that DFAS will work with the Army to continue efforts to improve financial management. The Director further stated that DFAS has identified the MPA account maintenance as a reportable condition on the Annual Statement of Assurance.

B.3. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Operations:

a. Develop and implement procedures for preparing and maintaining documentation in support of Military Personnel, Army appropriation accounting adjustments.

Management Comments. The Director, DFAS-IN Operations concurred and stated that DFAS will maintain a transmittal log along with supporting documentation by accounting month.

b. Dedicate adequate staffing to ensure that the Military Pay Accounting Division completes thorough reviews of recorded obligations and disbursements.

Management Comments. The Director, DFAS Operations concurred and stated that DFAS has identified work-year shortfalls and is working on filling positions.

Appendix A. Scope and Methodology

We reviewed processes and controls for managing and accounting for the MPA appropriation. We interviewed Army Budget and Army G-1 personnel to determine procedures for managing budget execution and distributing MPA funds to program managers. We examined the Army Budget monthly budget execution plans and compared forecasted requirements to actual obligations and disbursements. We obtained copies of month-end and fiscal year-end obligation plans and compared them to actual amounts recorded in the Accounting Report M-1002.

We reviewed the nine accounting adjustments made by Army Budget and DFAS-IN during the fourth quarter FY 2005 and first quarter FY 2006. We analyzed supporting documentation and rationale for the adjustments and evaluated this information for compliance with DoD FMR policy for recording obligations. We requested and analyzed data queries from DFAS-IN from the Operational Data Store and the Standard Finance System to verify transactions supporting the adjustments. We also reviewed DFAS-IN's research of the Medicare Eligible Retiree Health Care Fund payments. We requested that the Office of Inspector General Legal Counsel review several of the accounting adjustments made by Army Budget and DFAS-IN for compliance with United States Code and DoD Directive 7200.1. We reviewed and evaluated the Plan of Milestone Actions the Army and DFAS-IN developed to improve MPA appropriation processes and controls.

We interviewed Army Budget and DFAS-IN personnel to determine the procedures used to identify, track, and control transactions submitted by Army Budget to DFAS-IN for entry into the accounting system. We evaluated procedures for preparing, documenting, and approving journal voucher adjustments. We also examined the joint reviews of obligations made by Army Budget and DFAS-IN in July 2005 and January 2006 to determine the completeness of the reviews and corrective actions taken.

We performed this audit from August 2005 through May 2006 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We used accounting data and reports generated by payroll and accounting systems within DFAS-IN and DFAS field accounting sites to perform this audit. Systems used to process and account for MPA appropriation financial data include the Defense Joint Military Pay System, Standard Finance System, Operational Data Store, and Headquarters Accounting and Reporting System. The Department of Defense Inspector General (DoD IG) has reported, and DoD has acknowledged, deficiencies in the adequacy of general and application controls in at least two of these systems. DoD IG Report No. D-2005-059, "Report on Standard Finance System Control Placed in Operation and Tests of Operating Effectiveness for the Period October 1, 2004 through March 31, 2005," April 30, 2005, identified numerous system and application control deficiencies. DoD IG Report No. D-2001-052, "Controls Over the Defense Joint Military Pay System," February 15, 2001, reported that there

were also significant system and application control deficiencies with the pay system. Because of the acknowledged unreliability of DoD financial management systems, we did not perform additional tests regarding data reliability.

The lack of adequate Army Budget and DFAS-IN controls over the MPA appropriation data used to prepare the Accounting Report M-1002 also casts doubts over the reliability of computer-processed data. For the large-dollar accounting adjustments reviewed, we reconciled adjustment totals to source documentation. Testing of the adjustments, when reviewed in context of other available evidence, provided reasonable assurance that the data were sufficiently reliable to support audit opinions, conclusions, and recommendations. However, because it was not feasible to examine all reported obligations and adjustments and significant data reliability problems existed, we were not able to determine the extent that total obligations and disbursements exceeded FY 2005 MPA appropriated funds.

Government Accountability Office (GAO) High-Risk Area. GAO has identified several high-risk areas in DoD. This report provides coverage of the financial management high-risk area.

Appendix B. Prior Coverage

During the last 5 years, GAO, DoD IG, and the U.S. Army Audit Agency (USAAA) have issued nine reports discussing military personnel costs. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>. USAAA reports are restricted to military domains and GAO. They can be accessed at <https://www.aaa.army.mil/reports.htm>.

GAO

GAO Report No. 05-882, “Global War on Terrorism: DoD Needs to Improve the Reliability of Cost Data and Provide Additional Guidance to Control Costs,” September 21, 2005

GAO Report No. 05-87R, “Military Personnel: DoD Needs to Strengthen the Annual Review and Certification of Military Personnel Obligations,” November 29, 2004

GAO Report No. 04-915, “Military Operations: Fiscal Year 2004 Costs for the Global War on Terrorism Will Exceed Supplemental, Requiring DoD to Shift Funds from Other Uses,” July 21, 2004

GAO Report No. 04-668, “Military Operations: DoD’s Fiscal Year 2003 Funding and Reported Obligations in Support of the Global War on Terrorism,” May 13, 2004

DoD IG

DoD IG Report No. D-2005-059, “Report on Standard Finance System Controls Placed in Operation and Tests of Operating Effectiveness for the Period October 1, 2004 through March 31, 2005,” April 30, 2005

USAAA

USAAA Report No. A-2005-0167-FFF, “Followup Audit of Mobilization and Pay Record Discrepancies in the Reserve Component,” May 6, 2005

USAAA Report No. A-2003-0324-FFF, "Mobilization and Pay Record Discrepancies in the Reserve Component," June 30, 2003

USAAA Report No. A-2002-0452-FFG, "Military Pay and Benefits: The Army's Contribution to the Military Retirement Trust Fund," August 14, 2002

USAAA Report No. A-2002-0427-FFG, "Soldier Out-of-Service Debt Avoidance, Fort Leonard Wood Site," July 3, 2002

Appendix C. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency

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

Department of the Army Comments



INPLY TO
ATTENTION OF

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
100 ARMY PENTAGON
WASHINGTON DC 20310-0109

AUG 22 2006

MEMORANDUM FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Report on Selected Controls Over the Military Personnel, Army, Appropriation
(Project No. D2005-D000FI-0268.000)

Thank you for the opportunity to comment on the subject draft audit report. We share many of the same concerns and are taking corrective action to apply better business practices to the military personnel appropriation. These actions will address internal control and management improvement issues cited. I should point out that we non-concur with recommendations to apply several large transactions to FY 2005 pending the results of a more thorough audit of the entire subsistence account and of payments made to the Medicare Eligible Retiree Health Care Fund.

Attached is the Army's formal response to the audit report findings and recommendations. Should you have any questions, my point of contact for this action is Mr. Arthur Hagler, who may be reached at (703) 692-8531 or john.a.hagler@hqda.army.mil.

A handwritten signature in cursive script, reading "V. Baldwin".

Valerie L. Baldwin
Assistant Secretary of the Army
(Financial Management and Comptroller)

Encl

Army Comments

A.1. "We recommend that the Director, Army Budget, in coordination with the Deputy Chief of Staff for Personnel:

- a. Develop a formal process to use the Program Budget Accounting System - Funds Distribution for creating and issuing funding authorization targets to program managers responsible for obligating and expending Military Personnel, Army appropriation funds."

Concur. We are working with the Army G1 to evaluate issuance of formal funding targets through the Program Budget Accounting System (PBAS). We anticipate that this change will occur during FY 2007 or the start of FY 2008 where feasible.

- b. "Include non-payroll costs in the costing model for estimating obligations, thoroughly document the costing methodology, and retain documentation to support the monthly and year-end estimated obligation recorded in the Accounting report M-1002."

Concur. The cost model under development will estimate most non-payroll costs and will be used effective FY 2007.

- c. "Implement as part of the monthly budget execution reviews of the Military Personnel, Army appropriation, procedures to thoroughly document the data analysis performed, recommendations made to align requirements with available resources, and decisions made by Army leadership."

Concur. The result of budget execution reviews will be documented.

- d. "Prepare Standard Form 1081 accounting adjustments transferring Military Personnel, Army appropriation obligations and disbursements to the correct fiscal year. Specifically, prepare accounting adjustments to move:

- (1) \$312 million of subsistence interfund bills from FY 2004 to FY 2005.
- (2) \$113.9 million of subsistence interfund bills from FY 2006 to FY 2005.
- (3) \$190.3 million of Medicare Eligible Retiree Health Care Cost from FY 2004 to FY 2005."

Nonconcur with recommendation to move \$312 million of subsistence interfund bills from FY 2004 to FY 2005. Reconciliations and audits of the FY 2005 Military Personnel, Army appropriation have been limited in scope, focusing primarily on high dollar transactions processed during a limited time period. The U.S. Army Audit Agency (AAA) has been tasked to perform a complete reconciliation of interfund bills processed during the fourth quarter of fiscal year 2004, all of fiscal year 2005, and the first quarter

Enclosure

of fiscal year 2006. AAA expects to issue a preliminary report in November 2006 and the final report in January 2007. Proper accounting adjustments will be processed upon completion of the reconciliation. We encourage the DoDIG to observe the audit process.

Nonconcur with recommendation to move \$113.9 million of subsistence interfund bills from FY 2006 to FY 2005. Standard DoD business practice is to obligate current funds when a disbursement is received with no corresponding obligation. The interfund bills in question posted during fiscal year 2006 (October-December 2005) with no previously recorded obligation.

Nonconcur with recommendation to move \$190.3 million of Medicare Eligible Retiree Health Care cost from FY 2004 to FY 2005. This recommendation is inconsistent with previous audit coverage and does not consider the impact of over and underpayments. The Army Audit Agency is currently reviewing payments made to the Medicare Eligible Retiree Health Care Fund. Necessary adjustments will be made upon completion of this review.

- e. "Report a potential Antideficiency Act violation in the FY 2005 Military Personnel, Army appropriation as prescribed in DoD Financial Management Regulation, volume 14."

Nonconcur pending completion of the reconciliation of all interfund bills processed during the six fiscal quarters covering the fourth quarter of fiscal year 2004 and the first quarter of fiscal year 2006. An Antideficiency Act violation will be reported upon completion of the reconciliation, and processing of necessary adjustments if required.

- f. "Coordinate with the Office of the Deputy Chief of Staff, G-4, (Logistics) to modify the Army Food Management Information System to create an obligation document at time the supply requisition is prepared."

Concur. We are working with Army G-4, the Defense Finance and Accounting Service, and other interested parties to modify existing systems to enable the obligation of funds at the time subsistence requisitions are accepted by the source of supply. We anticipate the system change to the Army Food Management Information System will be in place and working by October 2006, and worldwide fielding will occur throughout FY 2007.

B.1. "We recommend that the Director, Army Budget develop and implement procedures for preparing and maintaining documentation supporting accounting adjustments that detail the numbers and dollar amounts of errors or conditions requiring adjustment, and describe the rationale and justification for the adjustment."

Concur. Effective FY 2007 we will institute a process to prepare and maintain documentation supporting accounting adjustments that detail the numbers and dollar amounts of errors or conditions requiring adjustment, and describe the rationale and justification for the adjustment.

B.2. "We recommend the Director, Army Budget, in coordination with the Director, Defense Finance and Accounting Service Indianapolis Operations:

- a. Implement a formal process to identify, track, and control the number, types, and dollar amounts of transactions submitted for entry into the accounting system."

Concur. Effective FY 2007 we will institute a formal process to identify, track, and control the number, types, and dollar amounts of transactions submitted for entry into the accounting system.

- b. "Implement procedures for conducting triannual reviews of Military Personnel, Army appropriation obligations to ensure that:

- (1) All reviews are scheduled and completed within the required timeframes.

- (2) The year-end review is performed in conjunction with development of the year-end obligation plan.

- (3) Individuals responsible for performing the review annotate the control spreadsheets to show actions taken and dates completed.

- (4) Supervisors monitor control spreadsheets to ensure that research and corrections are made timely.

- (5) Officials qualify their certification and confirmation statements as to any limitations on the completeness, accuracy, and timeliness of the review."

Concur. Joint reviews will be conducted in accordance with DoD FMR Vol. 3 Chapter 8, paragraph 0804.

- c. "Update the self-evaluations of the Army Budget Office's Military Pay Division and Defense Finance and Accounting Service's Military Pay Accounting Division to reflect the conditions discussed in this report and to describe the progress in completing the Plan of Action Milestones. Determine whether conditions meet the criteria for a material weakness as stated in DoD Instruction 5010.40, 'Material Control (MC) Program Procedures,' January 4, 2006. Army Budget should coordinate with the Defense Finance and Accounting Service Indianapolis to report the material weakness to the next higher level of management."

Concur. The Chief of the Army Budget Office's Military Pay Division raised these issues to the next higher level of management as input to the FY 2006 Annual Statement of Assurance. The Army is aware of these internal control issues and is working to improve financial operations.

Defense Finance and Accounting Service Indianapolis Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
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AUG 18 2006

DFAS-ADL/IN

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Selected Controls Over the Military Personnel, Army Appropriation Project No. D2005-D000FI-0268.000 June 22, 2006

Indianapolis Operations is providing management comments to the following recommendations:

Recommendation A.2: Implement system changes to Operational Data Store to receive and post obligations transactions from the Army Food Management Information System (AFMIS) to the accounting records.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. We are working with Army G4 and AFMIS contractors on system changes that will create obligations at the point of requisition.

Estimated Completion Date: Full implementation is not expected before September 30, 2007.

Recommendation B.2: We recommend that the Director, Army Budget, in coordination with the Director, Defense Finance and Accounting Service Indianapolis Operations:

a. Implement a formal process to identify, track, and control the number, types, and dollar amounts of transactions submitted for entry into the accounting system.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. We are working with the Army to utilize sequential transmittal numbers for Military Pay Accounting submissions.

Estimated Completion Date: December 31, 2006

b. Implement procedures for conducting tri-annual reviews of Military Personnel, Army appropriation obligations to ensure that:

(1) All reviews are scheduled and completed within the required timeframes.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. We will coordinate with ABO to schedule and complete within required timeframes. Schedule will be pre-arranged for each review.

Estimated Completion Date: December 31, 2006

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(2) The year-end review is performed in conjunction with development of the year-end obligation plan.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. Year-end review will be in conjunction with the development of year-end obligation plan. This requires coordination with the Army Budget Office.

Estimated Completion Date: September 30, 2007

(3) Individuals responsible for performing the review annotate the control spreadsheets to show actions taken and dates completed.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. Control spreadsheets showing actions taken and dates completed will be reviewed by persons responsible.

Estimated Completion Date: 60 Days post each joint review.

(4) Supervisors monitor control spreadsheets to ensure that research and corrections are made timely.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. Supervisor will monitor spreadsheets to ensure that research and corrections are made timely.

Estimated Completion Date: 60 Days post each joint review.

(5) Officials qualify their certification and confirmation statements as to any limitations on the completeness, accuracy, and timeliness of the review.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. Any limitations on the completeness, accuracy and timeliness of the review will be specified on the certification statements prior to signing.

Estimated Completion Date: 90 Days post each joint review.

c. Update the self-evaluations of the Army budget Office's Military Pay Division and Defense Finance and Accounting Service's Military Pay Accounting Division to reflect the conditions discussed in this report and to describe the progress in completing the Plan of Action Milestones, Determine whether the conditions meet the criteria for a material weakness as stated in DoD Instruction 5010.40, "Material Control (MC) Program Procedures," January 4, 2006. Army budget should coordinate with the Defense Finance and Accounting Service Indianapolis to report the material weakness to the next higher level of management.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. We continue our efforts to improve financial management with the Army. Additionally, Military Personnel, Army account has been identified as a "Reportable Condition" on the Annual Statement of Assurance.

Estimated Completion Date: Will be finalized with Assessable Unit Assurance Statements, 3rd Quarter, FY 2007.

Recommendation B.3: We recommend that the Director, Defense Finance and Accounting Service Indianapolis Operations:

a. Develop and implement procedures for preparing and maintaining documentation in support of Military Personnel, Army appropriation accounting adjustments.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. We will maintain a transmittal log along with supporting documentation to include 1081s on the shared drive by accounting month.

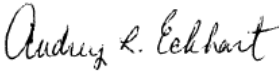

Estimated Completion Date: December 31, 2006

b. Dedicate adequate staffing to ensure that the Military Pay Accounting Division completes thorough reviews of recorded obligations and disbursements.

Comment: Stakeholder: Michael Green, 317-510-7410. Concur. We have identified our work-year shortfall and are in the process of filling these positions from the mobility list.

Estimated Completion Date: September 30, 2007

My point of contact is Michael Green, 317-510-7410.


 Steve R. Bonta
Director, Indianapolis Operations

Team Members

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