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Acronyms

DFAS	Defense Finance and Accounting Service
FFMIA	Federal Financial Management Improvement Act (1996)
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAFS-BL	General Accounting and Finance System–Base Level
GAFS-R	General Accounting and Finance System–Rehost
GAO	Government Accountability Office
IAPS	Integrated Accounts Payable System
MOCAS	Mechanization of Contract Administration Services
OMB	Office of Management and Budget
PCIE	President’s Council on Integrity and Efficiency
SBR	Statement of Budgetary Resources
SFFAS	Statement of Federal Financial Accounting Standards
USSGL	United States Standard General Ledger



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

February 9, 2007

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Report on Vendor Pay Disbursement Cycle, Air Force General Fund:
Financial Accounting (Report No. D-2007-059)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report. We considered comments from the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Central Site Director, Defense Finance and Accounting Service, Denver.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request the Assistant Secretary of the Air Force (Financial Management and Comptroller) reconsider his position on the Recommendation subparts 1.-6. and the Central Site Director, Defense Finance and Accounting Service, Denver reconsider his position on the Recommendation subparts 1.-5. by April 9, 2007.

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 Ms. Amy J. Frontz at (303) 676-7392 (DSN 926-7392) or Mr. John W. Barklage at (303) 676-3298 (DSN 926-3298). The team members are listed inside the back cover. See Appendix E for the report distribution.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, appearing to read "Paul J. Granetto".

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

Department of Defense Office of Inspector General

Report No. D-2007-059
(Project No. D2004-D000FD-0040.003)

February 9, 2007

Vendor Pay Disbursement Cycle, Air Force General Fund: Financial Accounting

Executive Summary

Who Should Read This Report and Why? Air Force and Defense Finance and Accounting Service personnel who are responsible for financial accounting should read this report. This report discusses the need for improving internal control for recognizing, posting, and programming edit checks to ensure compliance with laws and regulations, and tracing supporting documents to the transactions recorded in the Air Force accounting records. The improvements are needed for the Air Force to provide reasonable assurance that periodic reports, such as the SF-133, "Report on Budget Execution and Budgetary Resources," and Air Force financial statements are reliable and reflect compliance with laws and regulations.

Background. Management is responsible for establishing and maintaining internal control to assure effective and efficient operations, reliable financial reporting, and compliance with laws and regulations. The Inspector General Act of 1978, as amended, provides for the independent review of agency programs and operations in accordance with generally accepted government auditing standards, which require audit to report on internal controls and compliance with laws and regulations. Such a review of the vendor pay disbursement cycle spans the acquisition; funding; delivery, receipt, and acceptance; payment; and recording of the financial transactions in the official accounting records. This is the fourth in a series of five reports on internal control of the Air Force General Fund vendor pay disbursement cycle. This report identifies internal control weaknesses in the recording of transactions in the Air Force accounting records that are used to prepare financial reports and statements.

Results. Internal control was not effective to ensure that transactions processed in the acquisition of goods and services were properly accounted for in Air Force accounting records. Specifically, all transactions were not recognized,¹ posted, subjected to edit checks to ensure compliance with laws and regulations, and traceable to supporting documentation. As a result, the risk is high that periodic reports and annual financial statements were unreliable and materially misstated in FYs 2003 and 2004. Left uncorrected, the internal control weaknesses could affect future reports, adversely affecting those who use the reports in their decision-making. The Assistant Secretary of the Air Force (Financial Management and Comptroller) and Defense Finance and Accounting Service should initiate changes that will integrate financial systems so that data can be entered and processed to accurately record financial information.

¹ Recognition is defined as the formal recording of an item in the records and financial statements as an asset, liability, expense, revenue, or similar element.

Management Comments and Audit Response. The Director, Air Force Accounting Policy and Compliance (Financial Management) responded for the Assistant Secretary of the Air Force (Financial Management and Comptroller). He provided general comments to the report and agreed to work with the DFAS Denver office on our recommendation to ensure policy is implemented on systemic changes stated in the first five recommendations.

The Central Site Director, Defense Finance and Accounting Service, Denver, partially concurred with one recommendation, nonconcurred with four recommendations and deferred to the Air Force on one recommendation. The Director stated that DFAS would like to evaluate the potential for daily interfaces of receipt transactions to ensure more timely posting to the general ledger for most of the accounts payable records in the Mechanization of Contract Administration Services system. However, the Director did not agree that the findings constitute a high risk as presented in the audit, stating that the sample of 45 items was not a true representation of the total contracts. He stated that they believe that the internal controls are adequate and the related risk is low. The Director further stated that the systems reviewed during the audit (Integrated Accounts Payable System and the Mechanization of Contract Administration Services system) should be considered subsidiary ledgers of the Air Force's accounting system, and that reference numbers (invoice number, receipt reference) are not typically posted in the accounting system. He further stated all financial transactions are posted to the general ledger within the appropriate month, and that any transactions not posted as part of the daily interface are included in the end of month accrual process. We disagree that these conditions do not constitute a high risk because our assessment was based on the Government Accountability Office and President's Council on Integrity and Efficiency Financial Audit Manual criteria for conducting a control sample test of internal control and compliance with laws and regulations. The criteria states that in a sample of 45 items, one defect does constitute a high risk that controls are not effective. We also do not agree that the internal controls are adequate. We attempted to trace the recording of the budgetary and proprietary transactions from the supporting documents to the transactions posted in the Air Force standard general ledger. We could not trace numerous transactions because adequate source document references were not in the supporting General Accounting and Finance System–Base Level transactions. In addition, generally accepted accounting principles do not state that transactions should be posted in the appropriate accounting month. They require transactions to be recognized on the date the financial event occurred and matched to the accounting period in which the event occurred. We identified numerous budgetary and proprietary transactions where the date of the financial event was not recognized as the date of the transaction.

We request the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Central Site Director, Defense Finance and Accounting Service, Denver, reconsider their positions. We request all comments to the final report by April 9, 2007. See the Finding section of the report for a discussion of management comments to the finding and recommendations, and the Management Comments section of the report for the complete text of the comments.

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Background

This is the fourth in a series of five audit reports on the effectiveness of internal control related to the Air Force General Fund vendor pay disbursement cycle. The first report in this series, “Report on Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding” (D-2006-056), March 6, 2006, covered the internal control related to contract formation and followup, with the focus on the contracting officer’s role and responsibility. The second report in this series, “Vendor Pay Disbursement Cycle, Air Force General Fund: Funds Control” (D-2006-085), May 15, 2006, addressed the fund holder’s responsibilities in the review of the execution of their budget and the status of funds. The third report in this series, “Vendor Pay Disbursement Cycle, Air Force General Fund: Payments to Vendors,” (Project No. D2004-D000FD-0040.002), June 20, 2006, addressed the certifying officers’ and accountable officials’ responsibility in paying vendors on time and maintaining effective cash management practices. This report identifies internal control weaknesses in the processing and recording of financial transactions in the Air Force general ledger.

Management is responsible for establishing and maintaining internal control to assure effective and efficient operations, reliable financial reporting, and compliance with laws and regulations. The Inspector General Act of 1978, as amended, provides for the independent review of agency programs and operations in accordance with generally accepted government auditing standards which require audit to report on internal controls and compliance with laws and regulations. Such a review of the vendor pay disbursement cycle spans the acquisition; funding; delivery, receipt, and acceptance; payment, and recording of the financial transactions in the official accounting records.

Three types of internal controls exist: compliance, operations, and financial reporting. In this audit, we conducted a series of control sample tests related to the three types of internal controls as presented in the Government Accountability Office (GAO) and President’s Council on Integrity and Efficiency (PCIE) Financial Audit Manual. In accordance with these guidelines,¹ we randomly selected 45 contracting actions for a comprehensive examination of:

- the nature and funding of the contracts;
- delivery, receipt, and acceptance;
- payment; and
- financial recording of the related budgetary and proprietary transactions in the official accounting records.

In a sample of 45 items, one defect indicates that the risk is high that the relevant internal control is not effective. Depending on the type and nature of the internal

¹ GAO/PCIE Financial Audit Manual, section 400, figure 450.1, “Sample Sizes and Acceptable Numbers of Deviations,” July 2004.

control deviation, the internal control defect might be significant as a separate finding or treated as one of a group of like errors and related causes.

Objective

Our overall audit objective was to assess internal controls and compliance with laws and regulations pertaining to the vendor pay disbursement cycle in the Air Force General Fund and supported activities. See Appendix A for a discussion on the scope and methodology, Appendix B for critical guidance used in this audit, Appendix C for an explanation of the financial reports and statements discussed in the report, and Appendix D for a complete list of the 45 contracting actions randomly selected for examination.

Recording Transactions in Accounting Records

Internal control was not effective to ensure that transactions processed in the acquisition of goods and services were properly recorded in Air Force accounting records. All transactions were not recognized, posted, or subjected to edit checks to ensure compliance with laws and regulations, and were not traceable to supporting documentation. Specifically:

- Transactions were not recognized the date that financial events transpired.
- Contract holdbacks² and unfunded liabilities were not posted.
- Internal edits³ did not exist to ensure that all liabilities were posted to the accounting records in compliance with laws and regulations.
- Transactions could not be traced to the source documents to support the accounting entries in the United States Standard General Ledger (USSGL) for the delivery of goods and services, and payments to vendors.

Internal control was not effective because the Air Force and Defense Finance Accounting Service (DFAS) systems⁴ were not designed and integrated, and procedures were not in place, to ensure the recording of all necessary information to properly report accounting data. As a result, the risk is high that periodic reports and annual financial statements were unreliable and materially misstated in FYs 2003 through 2004. Left uncorrected, the internal control weaknesses could impact future reports, adversely affecting those who use the reports for making decisions.

Critical Guidance and Financial Reports

See Appendix B for the guidance that is critical to this report and finding. See Appendix C for a list of the financial reports and statements, and their uses, as they pertain to this finding.

² Holdbacks are the amounts withheld from grantees or contractors pending completion of related contracts.

³ Automated internal edits are a form of programmed control technique that forms the basis for application controls directly related to individualized computerized applications. Application controls help ensure that transactions are valid, properly authorized, and completely and accurately processed and reported.

⁴ The systems include the: General Accounting and Finance System–Rehost; General Accounting and Finance System–Base Level; Integrated Accounts Payable System; and Mechanization of Contract Administration System.

Internal Control

Internal control was not effective to ensure that transactions processed in the acquisition of goods and services were properly accounted for in the Air Force accounting records. All transactions were not recognized, posted, or subjected to edit checks to ensure compliance with laws and regulations, and were not traceable to supporting documentation. Those conditions existed because of internal control weaknesses in the design and integration of the General Accounting and Finance System–Rehost (GAFS-R), General Accounting and Finance System–Base Level (GAFS-BL), Integrated Accounts Payable System (IAPS), and Mechanization of Contract Administration Services (MOCAS) systems.

Recognizing the Financial Event. Budgetary and proprietary transactions were not recognized as of the date, and in the financial reporting period, that financial events transpired. Non-recognition of the date that financial events transpired also affected Air Force compliance with generally accepted accounting principles (GAAP) in accounting for foreign currency transactions. Specifically:

- Budgetary undelivered orders–obligations, unpaid were not recognized on the date that contracting actions were executed (financial event) (9 contracting actions).
- Budgetary delivered orders–obligations, unpaid; and the proprietary accounts payable were not recognized as of the date that goods or services were received (financial event) (24 contracting actions).
- Budgetary delivered orders–obligation, paid; and the proprietary Fund Balance with Treasury transactions were not recognized as of the date that vendors were paid (financial event) (26 contracting actions).

GAFS-R can accommodate recognition of prior period transactions so long as the transactions are processed before the closeout of the accounting records in the subsequent period. However, DFAS used the date and reported the budgetary and proprietary transactions in the period that the transactions were loaded and recognized in GAFS-R. The identified deficiencies affected both the budgetary and proprietary general ledger accounts used in the preparation of the Report on Budgetary Execution (SF-133), the Statement of Budgetary Resources, the Statement of Net Cost, the Statement of Changes in Net Position, and the Balance Sheet. For example, in two contracting actions⁵ the dates liabilities were recorded in the GAFS-R general ledger were 127 and 167 days later than the dates that performance occurred. In both cases, the liabilities were not recognized in the fiscal year performance was made, thus understating the assets, liabilities, and expenses of the period affecting management’s completeness assertion. Those deficiencies, created by the non-recognition of the transactions as of the date that financial events transpired, adversely affected management’s ability to

⁵ On sample number 5 the invoice had a ship date of 09/10/2003 and an effective date in the general ledger of 01/15/2004 (127 days); on sample number 25, the invoice had a performance period end date of 09/05/2003 and an effective date in the general ledger of 02/19/2004 (167 days).

assert on the existence, completeness, and rights and obligations of the transactions.⁶ As a result, periodic reports and annual financial statements may have been materially misstated.

Foreign Currency. In addition, DFAS personnel did not account for and recognize foreign currency transactions in accordance with GAAP. Specifically, DFAS did not initially measure the foreign currency fluctuation gain or loss as of the date goods or services were received. In three of the contracting actions examined, DFAS processed and paid invoices submitted for payment in Japanese yen.⁷ In each case, DFAS computed the losses based on the exchange rate as of the settlement date. The settlement date is the date a vendor is paid. However, the initial measurement of the gain or loss was not computed and recognized as of the date of the payable. For two contracting actions, the assets, if booked, would have been understated as of the initial measurement date. In a third contracting action, the asset would have been overstated.⁸

Contract Holdbacks. For one contracting action reviewed, DFAS personnel did not post contract holdbacks.⁹ The Federal Acquisition Regulation (FAR) and Defense Federal Acquisition Regulation Supplement provide for contract holdbacks under various conditions. The holdbacks in this report relate to FAR 52.216-8, “Fixed Fee,” which limits the fixed fee a vendor can be paid without contracting officer approval to 85 percent of the amount the vendor can earn. However, amounts that are held back remain the liability of the Government and should be recognized in the accounting records as an “other liability.” The vendor reported an amount held back for fixed fees earned to comply with the contract terms. DFAS personnel paid the vendor the net amount owed, but did not report the holdbacks to GAFS-BL for posting in the accounting records.

Unfunded Liabilities. In two other contracting actions, DFAS personnel did not post the accounts payable required to recognize unfunded liabilities in the proprietary general ledger. The Statement of Federal Financial Accounting Standards No. 1, “Accounting for Selected Assets and Liabilities,” requires disclosure of a liability in the accounting records even when budgetary resources do not exist. Unfunded liabilities can lawfully exist where Congress has authorized the Government to enter into contracts in advance of appropriations, such as certain civil works contracts let by the U.S. Army Corps of Engineers. However, in this audit, we identified the existence of unfunded liabilities related to contracts that were potentially improperly executed or inadequately funded. Accounts payable should have been posted for amounts the vendors earned but were not funded:

⁶ See appendix B for an explanation of the existence, completeness, and rights and obligations assertions.

⁷ Sample numbers 11, 27, and 33. All actions were for capital improvement to property, plant, and equipment.

⁸ In GAFS-R, accounts payable are all expensed at the transaction level. In our opinion the contracting actions that we examined related to improvements to property, plant and equipment, and the cost of those improvements should have been capitalized. However, our audit scope did not extend to determining whether the expense and property, plant, and equipment asset accounts were subsequently adjusted by journal entry.

⁹ Sample number 36.

-
- prior to the execution date of the delivery orders,¹⁰ and
 - to adequately cover the cost incurred on contract to pay for delivery or performance against a specific line item.

Because the contract holdbacks and unfunded liabilities were not posted, Air Force liabilities were understated. Moreover, if the accounts payable was posted to recognize the unfunded liability, DFAS system edit checks could have been created to ensure compliance with laws and regulations

Edit Checks. System edits did not exist to check compliance with laws and regulations, and to ensure that unrecorded accounts payable were recognized in the period and on the date that goods and services were received. System edit checks were needed to ensure all liabilities were posted and recognized in the GAFS-BL and GAFS-R systems. Specifically, system edit checking is needed because:

- unfunded liabilities were not posted in the accounting records to recognize the existence, completeness, rights and obligations, and compliance with laws and regulations; and
- accounts payable transactions were not posted in accounting records to recognize the existence, completeness, and rights and obligations of account balances.

In two contracting actions, unfunded liabilities were not recognized in the accounting records. We addressed the internal control recognition and posting weaknesses in the preceding sections. If management takes corrective action on both weaknesses, and unfunded liabilities are reported in the future, system edit checks can be executed to notify Air Force financial managers when an unfunded liability is reported. These system edit checks are possible because the corrective actions would:

- recognize, based on the date that financial events transpired, when goods were delivered or services were rendered prior to the recognition of the date that the contract was executed and obligation was incurred; and
- post the accounts payable to the proprietary accounts without a corresponding entry against the budgetary accounts, indicating a liability was potentially incurred in advance of the appropriation or obligation.

A system edit check based on these rules could effectively notify management when an unfunded liability is reported, thus requiring management followup to determine why performance occurred prior to, or in excess of, the recorded obligation.

In three contracting actions, accounts payable transactions were not posted in the accounting records. DFAS posted disbursement transactions in FY 2004 under

¹⁰ Sample numbers 4 and 26. See also our Report on Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding (D-2006-056), finding B.

what DFAS refers to as “straight pay” transactions. The posting of straight pay transactions allows posting and recognition of the disbursement while the accounts payable is bypassed. As a result, Air Force receipt of services in FY 2003 was not recognized in the FY 2003 end-of-year financial statements.¹¹ During the 1st and 2nd quarters FY 2004, two deficiencies existed in each period where the payables were not posted, and thus understated the liabilities in the interim reports. A system edit check is necessary to notify personnel when an accounts payable transaction is bypassed and is required to recognize the payable before the disbursement is processed.

Locating Source Documents. Budgetary and proprietary transactions did not provide a reference to trace the transactions to source documents. Source document references to receiving documents for tangible goods, invoices for services, or vouchers for payments, were not reflected in the GAFS-BL and GAFS-R transactions. In our examination of the 45 contracting actions, we could not trace numerous transactions to the budgetary and proprietary accounts shown below. While we could not conclusively determine whether the transactions existed,¹² neither could we prove they did not exist because of the lack of a source document reference to help us find the transaction. As a result of the missing transactions, abnormal balances that consisted of both over and understatements at the transaction level were included in the financial reports.¹³ Source documents references were needed to readily trace the posting of:

- the budgetary delivered order–obligations, unpaid;
- the budgetary delivered order–obligations, paid;
- the proprietary accounts payable; and
- the proprietary Fund Balance with Treasury transactions.

While we believe the risk is low that a material misstatement was reported in the SF-133 and financial statements because of the abnormal balances,¹⁴ fund holders and program managers could not rely on the accounting data at the program or activity level to monitor the status of their funds to base their programming and budgetary decisions.

¹¹ Sample numbers 5, 7, and 21.

¹² The transactions we attempted to trace could have been erroneously entered or embedded in a transaction that rolled up a number of individual entries.

¹³ DFAS personnel did not adjust abnormal balances at the transaction level. According to DFAS personnel, they adjusted abnormal balances at the appropriation level.

¹⁴ The over and understatements would have offset each other, minimizing the risk of material misstatement.

System Integration

We attributed the general processing and internal control weaknesses to a lack of integration between the GAFS-R, GAFS-BL, IAPS, and MOCAS systems and personnel actions affecting both manual and systematic processes and operations.

Recognizing the Financial Event. Air Force and DFAS accounting and finance systems were not designed to integrate, either by system interface or personnel input, transactions as of the date that financial events transpired. Specifically, an interrelationship between the GAFS-R, GAFS-BL, IAPS, and MOCAS software, hardware, personnel, procedures, controls, and data did not exist to ensure transactions are recognized as of the date financial events transpire. However, we believe an interrelationship is achievable with changes to the current system software, hardware, controls, and data. Personnel training and procedures are needed to ensure that personnel properly enter the date that financial events transpired. We believe the systems' changes are achievable because:

- GAFS-R can presently recognize the date that financial events transpired for inclusion in the financial reports and statements;
- GAFS-BL can presently recognize the date that financial events transpired for interface with GAFS-R;
- IAPS can recognize the date goods or services are received and payment is made for integration with GAFS-BL;¹⁵ and
- MOCAS can recognize the date goods or services are received and payment is made for integration with GAFS-BL.¹⁶

Foreign Currency Transactions. DFAS, in accounting for foreign currency transactions, calculates and recognizes gains and losses at the time payment is made in accordance with DoD Financial Management Regulation. However, the Financial Management Regulation is not consistent with GAAP, which requires the recognition of gains and losses on the date of the payable. While the Federal Accounting Standards Advisory Board (FASAB) has not issued guidance addressing this issue, the Department of the Treasury has proposed a scenario for recording these transactions in the USSGL in accordance with GAAP. Consequently, DoD must change its policy to recognize GAAP in accounting for foreign currency transactions. We believe IAPS could accommodate the correct processing of foreign currency transactions.

¹⁵ DFAS personnel recognize a change is needed in IAPS to process the date goods or services are received. IAPS currently reflects the date that goods or services are accepted by the Government.

¹⁶ The recognition of receipt in GAFS-BL could be interfaced with the MOCAS Material Acceptance and Accounts Payable Report.

Posting of Contract Holdbacks and Unfunded Liabilities. Contract holdbacks were not posted as liabilities in the accounting records because:

- DFAS personnel, who were responsible for certifying payment in IAPS, did not report the holdbacks even though the amounts were shown as deductions on the hardcopy invoices and detail information; or
- vendors, who submitted invoices electronically, could not report the holdbacks through electronic submission. The electronic format did not have a field for entering and reporting the holdback.

Unfunded liabilities were not posted in the accounting records because DFAS personnel had not developed adequate internal control procedures to report the unfunded liabilities. Effective internal control measures should prompt personnel to report all unfunded liabilities when:

- vendors report a cost incurred for a period of performance or delivery before the execution date of the contract (potential unauthorized commitment), whether or not the invoice passed pre-validation;¹⁷
- DFAS personnel reject an invoice because they cannot pre-validate the existence of the obligation to make payment (potential unauthorized commitment or untimely recorded obligation); and
- vendors report an amount withheld for cost incurred in excess of the unliquidated balance of the obligation for a contract line item (inadequate line item funding).

Edit Checks. The edit checks discussed in this report did not exist because Air Force and DFAS systems were not integrated to recognize transactions as of the date financial transactions transpired in accordance with FASAB and GAAP. Effective internal edit checks exist when systems are integrated and critical data can be correlated to perform edit checks, such as those mentioned, to ensure compliance with laws and regulations.

Locating Source Documents. GAFS-BL and GAFS-R transactions did not provide source document references because the GAFS-BL, IAPS, and MOCAS systems were not integrated and procedures were not established to ensure a source document reference was processed to record the receipt of goods and services, and the payments made to vendors.

¹⁷ Under the existing rules for pre-validation, DFAS personnel are required to reject paying an invoice if funds are not adequate or not obligated on contract. However, the DFAS rejection of the invoice would not preclude personnel from processing the transaction necessary to recognize the unfunded liability.

Conclusion

A high risk exists that periodic and annual financial statements were unreliable and materially misstated in FYs 2003 through 2004. Left uncorrected, the internal control weaknesses could affect future reports, adversely affecting those who use the reports in their decision-making.

It is management's responsibility to establish and maintain efficient and effective internal control over financial reporting.¹⁸ Consequently, Air Force and DFAS personnel must work together to integrate existing systems when it is possible and cost effective. In our opinion, the internal control weaknesses related to recognizing transactions as of the date financial events transpired, and providing source document references, are correctible within existing systems. We consider both conditions material weaknesses because the deficient conditions affect all transactions in the universe, presenting a high risk that the reports and financial statements were materially misstated.

We consider the remaining internal control weaknesses reportable, but not necessarily material weaknesses. However, these weaknesses could, at the aggregate level, materially misstate the reports and financial statement lines. The reportable weaknesses relate to foreign currency gains and losses, unrecorded contract holdbacks, unfunded liabilities, and accounts payables that were bypassed as a result of processed straight pay transactions. The non-recognition of unfunded liabilities in the accounting records are potentially material to any management assertions made related to compliance with laws and regulations.

The absence of edit checks within existing Air Force and DFAS systems is a potentially material weakness. Effective edit checks ensure compliance with laws and regulations, such as appropriation laws¹⁹ and the FAR. Because we have identified at least one instance where vendors started work prior to the execution of the contract²⁰ and vendors performed work under cost contracts in excess of the amount obligated for delivery of the line item,²¹ we believe the risk is high that these conditions exist in numerous other Air Force contracts.

Management Comments on the Finding and Audit Response

Management Comments. The Central Site Director, Defense Finance and Accounting Service, Denver, did not concur with the finding, stating that the

¹⁸ Office of Management and Budget (OMB) Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004.

¹⁹ Throughout this series of reports we have identified violations of section 1502, title 31, United States Code and section 2410a, title 10, United States Code. If effective edit checks existed, we believe that Air Force management would have been notified of the potential violation for immediate followup.

²⁰ DoD IG Report of Audit D-2006-056, Report on Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding, finding B.

²¹ Sample number 26.

limited sample of 45 items used does not provide a sufficient basis for projecting results to the total contracts loaded in the IAPS and MOCAS systems. The Director further stated that internal control was adequate and the related risk is low.

Audit Response. We disagree that the limited sample does not provide sufficient basis for our conclusions or that internal controls are adequate. Our use of a 45-item sample to assess internal control is a generally accepted governmental auditing standard established in the Government Accountability Office and President's Council on Integrity and Efficiency Financial Audit Manual. It requires auditors to examine risk to determine the nature, timing, and extent that substantive testing is necessary to determine if a material internal control weakness or misstatement of the financial statements exists. The criteria states that in a sample of 45 items, one defect indicates that the risk is high that a potential material internal control weakness, or misstatement in the financial transactions, may exist.

In addition, these deficiencies are more meaningful because the results relate to the processing of automated transactions. Thus, groups of identical transactions are processed consistently and any deficiencies will occur consistently in all similar transactions. For example, we reported a contract holdback that was not recognized in the Air Force accounting records in accordance with Federal Acquisition and Defense Federal Acquisition Regulation Supplement policy. The risk is not limited to this one unrecognized contract holdback, but what the defect represents in relation to all similarly processed transactions.

Recommendations, Management Comments, and Audit Response

We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Director, Defense Finance and Accounting Service, coordinate and direct the:

1. System changes and integration of the General Accounting and Finance System–Base Level, Integrated Accounts Payable System, and Mechanization of Contract Administration Services systems so that the General Accounting and Finance System–Rehost recognizes transactions as of the date the financial events transpired, and all source document references are provided and transactions can be readily traced to the supporting documents.

Management Comments. The Central Site Director, Defense Finance and Accounting Service, Denver partially concurred with the recommendation, agreeing to evaluate the potential for daily interfaces of receipt transactions from the MOCAS system to ensure timelier posting of the accounts payable to the general ledger. The estimated completion date for that evaluation is June 1, 2007.

However, the Central Site Director, Defense Finance and Accounting Service, Denver, did not concur that the references for the receiving documents, invoices, and vouchers are not available. He stated that the references are posted in either the entitlement or Air Force accounting system, General Accounting and Finance System, depending on the category of the document. Disbursement voucher information is available in the GAFS-BL or the MOCAS entitlement system. Invoice and receipt information is available in the IAPS and MOCAS system. He added that the systems reviewed during the audit, the IAPS and MOCAS system, should be considered extensions or subsidiary ledgers to the core accounting systems and thereby, through referential integrity, provide the documentation references identified in this recommendation.

The Director further stated that all financial transactions are posted in the GAFS-R general ledger in the appropriate accounting month. The posting of the receipt and disbursement records in the IAPS and MOCAS system, as subsidiary ledgers, are the official accounting records. Therefore, the transactions are posted and recorded on the date of the financial event. Transactions not posted as part of the daily interface are included in the end-of-month accrual process. The accrual process, for both IAPS and MOCAS system, includes the financial events that are not posted in the daily accounting records, and are included in the financial records before the end of the reporting period.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) did not respond to the recommendation.

Audit Response. The Central Site Director, Defense Finance and Accounting Service, Denver, comments are not responsive. The General Accounting and Finance System–Rehost was developed to serve as the Air Force standard general ledger and implement the United States Standard General Ledger requirements to interface with the Defense Departmental Reporting System which is used to prepare the financial statements. We attempted to trace the recording of the budgetary and proprietary transactions in the GAFS-R from the supporting documents to the transactions posted in the general ledger. DoD Financial Management Regulation, volume 1, chapter 2, December 1998, states that a general ledger and its subsidiary ledgers serve as a source database, data must be edited, validated, and in some instances, computed before it is integrated into an accounting system. Data needed to record a transaction should be entered only once and transferred to appropriate accounts in the accounting system. For those individual transactions that we examined in the general ledger, we could not trace numerous transactions in the budgetary and proprietary accounts because all of the necessary data was not transferred to the general ledger. A match by source document reference and financial event date is needed to trace the entries made in the general ledger and have reasonable assurance that transactions are accurately recognized in the general ledger and disclosed in the financial statements in accordance with generally accepted accounting principles. The Director stated that the IAPS and MOCAS system are subsidiary ledgers and should be accepted as extensions of the core financial systems. This is possible only if all of the data needed to ensure referential integrity existed between the general ledger as the control account and the subsidiary ledgers. We could not trace transaction amounts by source document reference and date from the control account to the

subsidiary ledgers, thus we do not have reasonable assurance that all transactions are accurately posted to the general ledger.

Generally accepted accounting principles do not state that transactions should be posted in the appropriate accounting month. Rather, they require transactions to be recognized on the date the financial event occurred and matched to the accounting period in which the event occurred. We identified numerous budgetary and proprietary transactions where the dates of the commitment; undelivered order, unpaid; delivered order, unpaid; accounts payable; delivered order, paid; and disbursement were not recognized on the date of the financial events. As for the delivered order, unpaid; and accounts payable; we determined the IAPS accounts payable date was not based on the date that goods or services were received, but was based on the date the Government accepted the goods or services. Even if the IAPS had the correct date, that date was not recorded in the GAFS-BL system for proper recognition in the GAFS-R system general ledger. Additionally, the accounts payable date was not passed from the MOCAS system to the GAFS-BL and GAFS-R systems. Neither the IAPS nor MOCAS system passed the payment date to the GAFS-BL and GAFS-R systems. As a result, the GAFS-BL and GAFS-R systems did not reflect the actual dates of the accounts payable and cash disbursement. For the Director's statement that the IAPS and MOCAS system are subsidiary ledgers that eliminate the need to recognize the date of the financial events in the general ledger to be accurate, the subsidiary ledgers would have to post to the control accounts as of the effective date of the financial event. To the extent the GAFS-R, as the general ledger, allows an accounts payable or cash disbursement to process on a transaction basis, the general ledger must reflect the date of the financial event for proper recognition on the date and in the period that the event (goods or services were received, or cash payment was made) occurred.

The Federal Accounting Standards Advisory Board upholds the use of estimates for recording accruals in financial statement reporting. However, an estimate should not be used if the actual payable amount is known prior to the preparation of the financial statements. In addition, a means must exist to reconcile the transaction estimate to the actual amount reported in the control account and subsidiary ledgers. Although we did not examine the estimates that DFAS reportedly used in lieu of processing the actual transactions, we did identify accounts payable and cash disbursement transactions reported with effective dates in a subsequent accounting period where the financial events occurred in the prior period. Unless DFAS is able to match each accrual to its actual transaction through its subsidiary ledgers and adjust the balance, the accounts payable will be overstated in the subsequent accounting period and a valuation error could exist in the prior period.

2. System changes and integration of the Integrated Accounts Payable System, General Accounting and Finance System–Base Level, and General Accounting and Finance System–Rehost to process foreign currency fluctuation gains and losses in accordance with generally accepted accounting principles.

Management Comments. The Central Site Director, Defense Finance and Accounting Service, Denver, nonconcurrent and stated that foreign currency gains

and losses were processed in accordance with the DoD Financial Management Regulation. He further stated that if the regulation is not in compliance with generally accepted accounting principles, the DoD Inspector General should direct the recommendation to the Office of the Secretary of Defense, Comptroller.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) did not respond to the recommendation.

Audit Response. The Central Site Director, Defense Finance and Accounting Service, Denver, comments are not responsive. While we agree that coordination with the Office of the Secretary of Defense, Comptroller is necessary, DFAS maintains the accounting systems and prepares the annual financial statements. The DoD Inspector General opines on the financial statements based on compliance with generally accepted accounting principles; therefore, if DFAS does not follow those principles it is appropriate for the DoD IG to recommend action to bring the accounting systems and financial statements into compliance. We confirmed that DoD did not have a waiver from implementing the generally accepted accounting principles for foreign currency fluctuations.

3. System change to create an edit in the General Accounting and Finance System–Base Level to account for a delivered order, unpaid and account payable prior to or concurrent with a disbursement. The goods or services receipt date (financial event) must be shown as the effective date of the delivered order, unpaid and account payable entry so the transaction can be properly recognized as a prior period event requiring a prior period adjustment to the financial statements or a current period event.

Management Comments. The Central Site Director, Defense Finance and Accounting Service, Denver, nonconcurred and stated that the recommendation will not achieve the intended benefit of “ensuring liabilities are recognized in the period that goods or services are received.” The Director comments addressed the daily and monthly processing interfaces between the IAPS and MOCAS system with the GAFS-BL. The Director also stated that because the MOCAS system is a subsidiary ledger, not posting the financial event date in the general ledger is a non-issue. The GAFS-BL does not determine when a disbursement is due; it only records the disbursement transaction after an entitlement system has determined that all requirements are met for payment by the correct date. An edit to prevent recording a proper disbursement because the receipt was not posted in the accounting system would only delay payment. If the disbursement is already made, then the edit would delay recording the accounting transactions.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) did not respond to the recommendation.

Audit Response. The Central Site Director, Defense Finance and Accounting Service, Denver, comments are not responsive. In our response to comments on recommendation 1, we discussed the IAPS and MOCAS system as subsidiary ledgers. Unless DFAS can reconcile the subsidiary ledgers to the control account by source document reference and date, either through the monthly accounts payable and cash disbursement journal entries or on a transaction basis, it cannot provide reasonable assurance that all transactions are recognized on the date and

in the accounting period the financial events occurred. The purpose of the recommended edits is to ensure that all accounting transactions, both budgetary and proprietary, are posted in the accounting period that the financial event occurred for disclosure in the financial statements, or as subsequent events or a prior period adjustment requiring potential correction in the prior and current accounting periods. Because a proper payment should not be made without evidence of receipt and acceptance, it is expected the payable existed and could have been recognized prior to the making and posting of the disbursement. For straight pay transactions, the payables should be processed with the dates that goods or services were received prior to, but concurrent with, the disbursement transactions to ensure the payables are properly recognized. For interim payments related to contract financing or cost reimbursement contracts for services, we realize that receipt and acceptance is not required within the MOCAS system. However, a payable for constructive acceptance as of the last date of the vendor's billing cycle should be recorded for proper recognition in the accounting period. Based on the number of deficiencies related to the completeness assertion and the related risk, we expect DFAS to evaluate their edit capabilities to minimize this risk.

4. System changes, personnel training, and processing procedures in the Mechanization of Contract Administration Services system to ensure processing of contract holdbacks and unfunded liabilities for integration with the General Accounting and Finance System–Base Level and Rehost systems. This includes recording an account payable when DFAS personnel reject an invoice because an obligation does not exist or the unliquidated balance is not sufficient to pay the vendor.

Management Comments. The Central Site Director, Defense Finance and Accounting Service, Denver, nonconcurrent with the recommendation and stated that true contract holdback amounts for MOCAS payments are classified as accounts payable and the system issues monthly reports for contract holdbacks that are processed by accounting activities in accordance with established procedures. He also stated that the examples in the draft report were not true contract holdbacks and would not have been recorded as accounts payable. One example was a deduction for a fixed fee over the ceiling so no liability existed at that time. The Director further stated that unfunded liabilities arise when Congress authorizes the Government to enter into contracts in advance of appropriations. These contracts are not entered into the MOCAS system without appropriations, and accounts payable are established only when a corresponding obligation and associated appropriation are in the system. When an invoice is received and a corresponding contract cannot be found, DFAS personnel contact the administrative contracting officer and use research tools to determine if a valid obligation exists. If an obligation cannot be determined, the invoice is returned to the contractor in accordance with the Prompt Payment Act. Finally, the Director stated that DFAS Columbus does not reject invoices because of insufficient unliquidated obligations. Research is done to determine how to correct the insufficiency and process the payment. The payable would have already been recorded at the time the insufficient unliquidated obligation was discovered.

The Assistant Secretary of the Air Force (Financial Management and

Comptroller) did not respond to the recommendation.

Audit Response. The Central Site Director, Defense Finance and Accounting Service, Denver, comments are partially responsive. According to the U.S. Treasury United States Standard General Ledger chart of accounts and Department of Defense Financial Management Regulation, contract holdbacks are not accounts payable, and should be recorded in general ledger account 2130 and reported in the financial statements as other liabilities. Management comments addressed one (sample number 4) of the two samples in the contract holdbacks section of the draft report, but not the other (sample number 36). Upon further review, we agree that sample number 4 is not a contract holdback. However, sample number 36 is a contract holdback, and management needs to address the circumstances surrounding that contracting action. Those circumstances represent a risk that all like transactions are not correctly recognized in the accounting records.

As we stated in the report, unfunded liabilities can legally exist when Congress has authorized the Government to enter into contracts in advance of an appropriation. We provided a reference to contracts let by the United States Corp of Engineers as an example. However, in sample numbers 4 and 26, the vendors performed services prior to the execution of the delivery orders. Thus, obligations were not recorded in the official accounting records until after the orders were executed and processed in the financial system. According to the United States Standard General Ledger, future funded expenses (account 6800) are recognized without the posting of a budgetary entry. Therefore, management's assertion that a liability cannot be posted without a corresponding obligation in the system is not in compliance with the U.S. Treasury requirements. During the audit, we identified two instances (sample numbers 4 and 26) where liabilities were incurred prior to the execution and funding of the order. The Air Force, in commenting on our first report on this subject (Report on Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding, D2006-056, March 6, 2006), agreed to conduct a preliminary investigation into the propriety of the contracting action (sample number 4), and agreed that the memorandum sent by the contracting officer that resulted in the vendor starting work prior to the execution of the order was not appropriate (sample number 26). However, we believe the financial systems should have the capability to recognize the liabilities, either as an account payable or a contingent liability, depending on the circumstances, without the existence of any budgetary entries. When vendors perform work in good faith and incur liabilities, those liabilities should be recognized in the accounting records. In each of the examples provided, the critical issue is the system's capability to process a transaction that discloses a financial event, whether the event is legal or not. In the case of sample number 4, the work performed improperly as an unauthorized constructive change should likely be disclosed as a contingent liability. On the other hand, the contracting officer's direction to a vendor to commence work prior to the execution of the order (sample number 26) was not illegal, but was inappropriate. In both cases, we believe the accounting systems should have procedures and processes in place to recognize the costs in the proprietary general ledger of the official accounting records without an entry made in the budgetary accounts. While DFAS personnel could not legally pay the vendors until an obligation is

recorded in the budgetary general ledger accounts, the absence of the obligation does not mean a liability did not exist and should not have been recognized.

5. System changes to create an edit to notify Air Force personnel when vendors are incurring costs, based on the recording of the payable or vendors indicating performance, without a proper, sufficient, and timely obligation recorded to pay for the goods or services.

Management Comments. The Central Site Director, Defense Finance and Accounting Service, Denver, nonconcurrent with the recommendation and stated that DFAS Columbus personnel do not have the information to discern if vendors are incurring costs without proper, sufficient, and timely obligations. He stated that DFAS relies on the reviews performed by the Defense Contract Audit Agency, and evaluations performed by the administrative contracting and purchasing contract officer, to ensure vendors are not incurring costs without a valid obligation, and that costs are valid. The Director further stated that the proposed system changes to record a payable without an obligation cannot be accomplished in the MOCAS system. For any contract payment system to generate an accounts payable, the appropriations must be in the contract record and line items must be established in the schedule record. In the MOCAS system, an account payable can only be recorded with a proper and sufficient obligation.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) did not respond to the recommendation.

Audit Response. The Central Site Director, Defense Finance and Accounting Service, Denver, comments are not responsive. The Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards, requires payables to be disclosed even when budgetary resources do not exist. As previously stated, the U.S. Treasury United States Standard General Ledger also provides for recognition of a liability in the proprietary accounting records, even though no budgetary entries are made. The Director stated that a payable cannot be recognized in the MOCAS system without existence of the obligation in the accounting system; therefore, no liabilities can exist for posting to the subsidiary ledger and general ledger. The administrative delay in recording the obligation does not negate the existence of the liability in the period that it was incurred. Hence, the recording of the liability, consistent with the Statement of Federal Financial Accounting Standards and the United States Standard General Ledger, is necessary for full disclosure in the period that the financial event occurred. DFAS personnel's inability to pay an invoice if an adequate unliquidated obligation is not on contract should not prevent the recording of the liability. In addition, the recording of the proprietary accounts payable without an offsetting obligation is an appropriate control to notify Air Force personnel of a potential administrative error or oversight in the processing of the obligation.

6. Development of the accounting guidance and procedures to ensure Air Force personnel enter the correct dates that financial events transpired and the source document references once the system changes are made, as recommended in 1 - 5.

Management Comments. The Director, Air Force Accounting Policy and

Compliance (Financial Management) responded for the Assistant Secretary of the Air Force (Financial Management and Comptroller). He provided general comments, agreeing to work with DFAS Denver to ensure policy is implemented depending on systemic changes recommended in the report. However, the Director stated that he is concerned that there was no mention of compensating controls in the report, and wants to ensure there is continuity in audit's approach with other independent audit efforts.

The Central Site Director, Defense Finance and Accounting Service, Denver, did not comment on the recommendation, deferring to the Air Force for comment.

Audit Response. The Director, Air Force Accounting Policy and Compliance (Financial Management) comments are partially responsive because DFAS only partially concurred with recommendation 1 and nonconcurred with recommendations 2 through 5. We did not mention compensating controls in the report because we did not identify any during the audit. Because the Secretary of the Air Force is responsible for the Air Force financial statements, we believe that the Assistant Secretary of the Air Force (Financial Management and Comptroller), and the Director, Defense Finance and Accounting Service must work together to examine the accounting policies, processes, and procedures that require correction or strengthening to mitigate the risk that a material internal control weaknesses exists, or that a material misstatement in the financial statements could be made.

We request the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Central Site Director, Defense Finance and Accounting Service, Denver, to reconsider their positions on recommendations 1 through 6, and provide final comments to the report by April 9, 2007.

Appendix A. Scope and Methodology

This is the fourth in a series of reports examining internal control and compliance with laws and regulations of the Air Force General Fund vendor pay disbursement cycle. In this report, we discuss the outcome of tests of the processing of commitments, obligations, and expenditures in the accounting records for 45 contracting actions. We examined the transactions that were posted to both the budgetary and proprietary chart of accounts. We performed internal control tests to determine whether the financial events were posted to the accounting records in accordance with the Federal financial accounting standards and GAAP. The financial events were related to: (1) the certification of fund availability, (2) execution of the contracting actions, (3) delivery of the goods or services, and (4) payment of the invoices.

In our examination of the 45 contracting actions (which included funding modifications), we examined the contract file documentation for each sample to determine the timing, nature, character, and terms and conditions related to the action as a financial event. We also obtained copies of the funding documents for the contracting action. Based upon the contract data gathered, we traced the delivery of the goods or services through receipt and acceptance by the Government, invoice certification, payment, and recognition of the related transactions in the budgetary and proprietary general ledger accounts in the official accounting records.

We performed this audit from January 2004 through May 2006 in accordance with generally accepted government auditing standards. Our review of the transactions and the financial events related to the deliveries and payments made against the contracting actions during the period October 2003 through June 2004, except for those actions that were funding modifications. We reconstructed the funding and payment histories for all funding modifications back to the inception of the basic order or contract. Because of the length of time that transpired in the completion of this audit and the report series, we followed up with personnel in May 2006 to determine whether management had taken corrective action to the deficiencies identified in this report.

Use of Computer-Processed Data. We relied on data from the General Accounting and Finance System–Rehost, General Accounting and Finance System–Base Level, Integrated Accounts Payable System, Mechanization of Contract Administration Services, and Electronic Document Access systems. However, we did not perform a formal reliability assessment of those systems. Instead, we compared the system data by tracing the hardcopy contract, funding, invoices, receiving documents, and payment vouchers to the transactions recorded in the accounting system.

Use of Technical Assistance. The Office of General Counsel, Office of the Inspector General, assisted in the review of the legality of the contracting actions and funds used to pay vendors identified in this report. In addition, personnel from the Quantitative Methods Division, Office of the Inspector General, assisted in the development of the statistical analysis presented in this report.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report addresses issues related to the Defense Financial Management high-risk area.

Prior Coverage

During the last 5 years, DoD IG has issued three reports related to the Air Force General Fund vendor pay disbursement cycle. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

DoD IG

DoD IG Report No. D-2007-027, “Vendor Pay Disbursement Cycle, Air Force General Fund: Payments to Vendors,” November 24, 2006

DoD IG Report No. D-2006-085, “Vendor Pay Disbursement Cycle, Air Force General Fund: Funds Control,” May 15, 2006

DoD IG Report No. D-2006-056, “Vendor Pay Disbursement Cycle, Air Force General Fund: Contract Formation and Funding,” March 6, 2006

Appendix B. Critical Guidance

The following laws and regulations apply to this audit report. As stated, management is responsible for internal control over the reliability of financial reporting. The Federal financial accounting regulations that follow OMB Circular A-123, which covers management's responsibility for internal control, establish the financial management system requirements and accounting principles germane to this report. The budgetary reports and financial statements affected by this guidance are presented in Appendix C.

Office of Management and Budget (OMB)

OMB Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004, states that "Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting." If financial information is reliable, the Air Force can reasonably assert that:

- all reported transactions actually occurred during the reporting period and all assets and liabilities exist as of the reporting date (existence and occurrence);
- all assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included (completeness);
- all assets are legally owned by the agency and all liabilities are legal obligations of the agency (rights and obligations);
- all assets and liabilities have been properly valued, and where applicable, all costs have been properly allocated (valuation);
- the financial report is presented in the proper form and any required disclosures are present (presentation and disclosure);
- the transactions are in compliance with applicable laws and regulations (compliance); and
- documentation for internal control, all transactions, and other significant events is readily available for examination.

OMB Circular A-127, "Financial Management Systems," July 23, 1993, states the following.

- In the use of the United States Standard General Ledger (USSGL) at the transaction level, the recording of transactions is based on the financial event that transpired. A financial event is any occurrence having financial consequences, and includes the acquisition of goods or services and payments made to vendors.
- Integration of financial management systems, by design, provides for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. The integration of

systems provides for common transaction processing and consistent internal control to assure the validity of information and protection of Federal Government resources.

Federal Financial Management Improvement Act (FFMIA)

The FFMIA of 1996 states that a Federal agency's ability to trace source documents to the USSGL indicates transactions are processed at the transaction level.

Federal Accounting Standards Advisory Board (FASAB)

FASAB Statement of Federal Financial Accounting Standards (SFFAS), No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993, stated the following:

- Recognition is defined as the formal recording of an item in the records and financial statements as an asset, liability, expense, revenue, or similar element.
- For financial statement purposes, personnel recognize liabilities when goods or services are received or are recognized based on an estimate of work completed under a contract or agreement.
- In budgetary accounting, a Federal agency records an obligation when the entity places a purchase order or signs a contract.
- Federal agencies disclose liabilities when budgetary resources do not exist.

FASAB, "Statements of Federal Financial Accounting Standards," volume II, Current Text, June 2004, provides the following definition of accrual accounting.

Records the effects on a reporting entity of transactions and other events and circumstances in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the entity. Accrual accounting is concerned with an entity's acquiring of goods and services and using them to produce and distribute other goods and services. It recognizes that the buying, producing, selling, distributing, and other operations of an entity during a period, as well as other events that affect entity performance, often do not coincide with the cash receipts and payments of the period.

FASAB, SFFAS No. 7, "Accounting for Revenue and Other Financing Sources," April 1996, provided the following statement on budgetary accounting.

The budget provides the principal basis for planning and controlling obligations and expenditures by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to the apportionment, allotment, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than accrual accounting, are the bases for budgeting and reporting on budget execution.

Generally Accepted Accounting Principles (GAAP)

Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation," December 1981, provides guidance related to foreign currency transactions.

Foreign currency transactions are transactions denominated in a currency other than the entity's functional currency. Foreign currency transactions may produce receivables or payables that are fixed in terms of the amount of foreign currency that will be received or paid.

Further, the document states: at the date the transaction is recognized, each asset, liability, revenue, expense, gain, or loss arising from the transaction shall be measured and recorded in the functional currency of the recording entity by use of the exchange rate in effect at that date. At each balance sheet date, recorded balances that are denominated in a currency other than the functional currency of the recording entity shall be adjusted to reflect the current exchange rate.

Lastly, transaction gains or losses result from a change in exchange rates between the functional currency and the currency in which a foreign currency transaction is denominated. They represent an increase or decrease in (a) the actual functional currency cash flows realized upon settlement of foreign currency transactions and (b) the expected functional currency cash flows on unsettled foreign currency transactions.²²

²² The foreign currency transaction gain or loss results from exchange rate fluctuations occurring between the goods or services receipt date and the disbursement date and is not the result of any speculative or hedging transaction.

Appendix C. Financial Reports and Statements

The following budgetary and financial reports apply to this audit report. Management's responsibility for the internal control necessary to ensure the reliability of these reports is presented in Appendix B.

SF-133, Report on Budget Execution and Budgetary Resources

OMB Circular A-11, "Preparation, Submission, and Execution of the Budget," November 5, 2005, states that the SF-133:

- Fulfills the requirement in 31 U.S.C. 1511–1514 [sections 1511-1514, title 31, United States Code] that the President review Federal expenditures at least four times a year.
- Allows the monitoring of the status of funds that were apportioned on the SF 132 Apportionment and Reapportionment Schedule and funds that were not apportioned.
- Provides a consistent presentation of information across programs within each agency, and across agencies, which helps program, budget, and accounting staffs to communicate.
- Provides historical reference that can be used to help prepare the President's Budget, program operating plans, and spend-out rate estimates.
- Provides a basis to determine obligation patterns when programs are required to operate under a continuing resolution.
- Ties an agency's financial statements to their budget execution. The compilation of an agency's SF 133s should generally agree with an agency's Statement of Budgetary Resources.

Financial Statements

OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements," September 25, 2001,²³ defines the use of the financial statements that Federal Agencies are required to prepare and are affected by the deficiencies identified in this report.

- **Balance Sheet.**

The balance sheet presents, as of a specific time, amounts of future economic benefits owned or managed by the reporting entity exclusive of items subject to stewardship reporting (assets), amounts owed by the

²³ OMB Bulletin No. 01-09 was superseded by OMB Bulletin No. 136, "Financial Reporting Requirements" on August 23, 2005.

entity (liabilities), and amounts which comprise the difference (net position).

The Balance Sheet relates to the reporting of:

Fund Balance with Treasury. The aggregate amount of the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. This account includes clearing account balances and the dollar equivalent of foreign currency account balances.

Accounts payable. The amounts owed by the reporting entity for goods and services received from other entities, progress in contract performance made by other entities, and rents due to other entities.

- **Statement of Budgetary Resources.**

The Statement of Budgetary Resources (SBR) and related disclosures provide information about how budgetary resources were made available as well as their status at the end of the period. It is the only financial statement predominantly derived from an entity's budgetary general ledger in accordance with budgetary accounting rules, which are incorporated into GAAP for the Federal Government. Information on the SBR should be consistent with and reconciled to the budget execution information reported on the Report on Budget Execution and Budgetary Resources (SF 133) and with information reported in the Budget of the United States Government to ensure the integrity of the numbers presented.

- **Statement of Net Cost.**

The Statement of Net Cost is designed to show separately the components of the net cost of the reporting entity's operations for the period.

- **Statement of Changes in Net Position.**

The Statement of Changes in Net Position reports the change in net position during the reporting period.

Further, the appropriations used, as reported in this statement, "are considered used as a financing source when goods and services are received or benefits are provided. This is true whether goods, services, and benefits are payable or paid as of the reporting date, and whether the appropriations are used for items that are expensed or capitalized. Appropriations Used does not include undelivered orders or unobligated appropriations.

Appendix D. Contracting Actions Selected for Review*

CONTRACTING ACTION NUMBER	SAMPLE NUMBER	CONTRACTING OFFICE	CONTRACTING ACTION	CONTRACT VALUE	DESCRIPTION GOODS/SERVICES
1	1	WR-ALC / LRK 750 3rd Street Robins AFB, GA 31098-2122	F34601-00-G-0006 RU32	319,431	Miscellaneous Engine Accessories, Aircraft
2	2	Air Force Material Command Aeronautical System Center 2640 Loop Road West, Building 557 Wright-Patterson AFB, OH 45433-7106	F33657-00-G-4029	645,500	Airframe structural components
3	3	OO-ALC / LGJ 6050 Gum Lane, Building 1215 Hill AFB, UT 84056-5825	GS-07F-7465C F42630-03-F-0059	677,385	Converters, Electrical, Nonrotating
4	4	Air Force Material Command Human System Center / PKR 7909 Lindbergh Drive Brooks AFB, TX 78235-5352	F41624-97-D-6004	112,000	RDT&E Other Research and Development-Eng. / Manuf. Development
5	5	Air Force Material Command Air Force Research Laboratory 2310 8th Street, Building 167 Wright-Patterson AFB, OH 45433-7801	F33615-03-M-2385	99,661	RDT&E / Aircraft-Applied Research
6	6	55 Contracting Squadron 101 Washington Square, Building 40 Offutt AFB, NE 68113-2107	F25600-02-D-0008	319,972	Automated Information System Design and Integration Services
7	7	OC-ALC/PSK B-52 3001 Staff Drive Building 3001, Suite 2AG87A Tinker AFB, OK 73145-3020	F34601-99-C-0006 P00130	75,000	Systems Engineering Services
8	10	ASC/PKW Area C Building 1 1940 Allbrook Drive, Suite 3 Wright-Patterson AFB, OH 45433-5309	NIH--26303D0541 F33600-03-F-3217	68,570	ADP Support Equip
9	11	18 CONS / Infrastructure Acquisition Unit 5199, Building 95 Kadena AB--Japan APO, AP 96368	F62321-00-D-0007	142,185	Maintenance / Other Miscellaneous Buildings
10	12	Department 8, AF Research Laboratory Directorate of Contracting / PK 2251 Maxwell Avenue SE Kirtland AFB, NM 87117-5773	F29601-97-C-0115 P00065	106,600	RDT&E / Weapons-Adv Tech Devopment
11	14	39 CONS / LGC FA5685 39 Uncu Kontrat Subayligi Bina Number 488, 10 Uncu Tanker US Incirlik/Adana, Turkey	F61358-03-P-0104	128,750	Aircraft Ground Servicing Equipment
12	17	R325 CONS / LGCB / STOP 28 501 Illinois Avenue, Suite 5 Tyndall AFB, FL 32403-5526	F08637-02-D-6999	680,028	Facilities Operations Support Services
13	18	OC-ALC / PKOAA 7858 5th Street, Suite 1 Tinker AFB, OK 73145	NAS501142 F34650-03-F-A384	148,127	ADPE System Configuration
14	19	Directorate of Contracting Building 1206, OO-ALC / LHKC 6039 Wardleigh Road Hill AFB, UT 84056-5838	F42600-01-D-0027	3,688,503	Systems Engineering Services
15	20	AAC / YUB Building 11, 102 W. D Avenue, Ste 300 Eglin AFB, FL 32542-6808	F08635-03-D-0007	195,626	Bombs

Note: Sample numbers are not in consecutive order. Twelve contracting actions resulting in deliveries and payment prior to October 1, 2003 were replaced.

* The FAR does not define a funding modification as a contracting action.

CONTRACTING ACTION NUMBER	SAMPLE NUMBER	CONTRACTING OFFICE	CONTRACTING ACTION	CONTRACT VALUE	DESCRIPTION GOODS/SERVICES
16	21	Air Force Material Command 311th Human Systems Wing / PKV 3300 Sidney Brooks Brooks City Base, TX 78235-5112	F41624-01-D-8552	99,461	Other Industrial Buildings
17	22	OO-ALC / YWK Directorate of Contracting Building 1215, 6050 Gum Lane Hill AFB, UT 84056-5825	F42630-99-C-0170 P00085	56,862	Maintenance and Repair of Equipment / Training Aids and Devices
18	23	Contracting Squadron IT 14040 Building 17000 Andersen AFB, GU 96543-4040	F64133-03-P-0242	89,708	Miscellaneous Items
19	24	CONS / Infrastructure Acquisition Unit 15199, Building 95 Kadena AB--Japan APO, AP 96368	F62321-03-D-0010	83,345	Maintenance / Other Miscellaneous Buildings
20	25	OC-ALC Directorate of Contracting / Aircraft 3001 Staff Dr, Suite 1AE1 107B Tinker AFB, OK 73145-3020	F34601-97-C-0032 P00126	587,000	Aircraft Fixed Wing
21	26	ESC / SRK Electronic Systems Center Air Force Material Command Hanscom AFB, MA 01731-3010	GS-35F-4668G F19628-02-F-8197 P00010	1,508,316	Other Professional Services
22	27	374 Contracting Squadron Unit 5228, Building 620 Yokota AB--Japan Fussa-Shi, Tokyo 197-0001	F62562-03-C-0049	620,200	Maintenance / Religious Facilities
23	28	AAC / PKO-FA2823 205 West D Avenue Building 350, Suite 541 Eglin AFB, FL 32542-6862	GS-07F-0397K F08651-03-F-A294	68,995	Recreational and Gymnastic Equipment
24	30	Air Force Material Command HQ Aeronautical Systems Center 2300 D Street Wright-Patterson AFB, OH 45433-7249	F33657-98-D-0021	876,488	Data Analyses (Other Than Scientific)
25	31	OO-ALC / PKOS 6038 Aspen Ave, B1289 NE Hill AFB, UT 84056-5805	F42650-02-C-0024 P00013	250,000	Custodial-Janitorial Services
26	32	82 CONS / LGC 136 Avenue, Ste 1, Building 1664 Sheppard AFB, TX 76311-2746	F41612-01-D-0006	573,366	Maintenance / Maintenance Building
27	33	374 Contracting Squadron Unit 5228, Building 620 Yokota AB--Japan Fussaa-Shi, Tokyo 197-0001	F62562-03-P-0648	42,085	Maintenance / Family Housing Facilities
28	34	88 ABW / PKS 1940 Allbrook Drive, Suite 3 Wright-Patterson AFB, OH 45433-5309	GS-28F-8021H F33601-03-F-0228	67,770	Office Furniture
29	35	USAFE Contracting Squadron Unit 3115 APO, AE 09094	GS-06F-0007J F61521-03-F-A494	206,530	Miscellaneous Items
30	36	OC-ALC / PKOE 7858 5th Street, Suite 1 Tinker AFB, OK 73145	F34650-98-D-0033	124,359	Architect - Engineering Services

Note: Sample numbers are not in consecutive order. Twelve contracting actions resulting in deliveries and payment prior to October 1, 2003 were replaced.

CONTRACTING ACTION NUMBER	SAMPLE NUMBER	CONTRACTING OFFICE	CONTRACTING ACTION	CONTRACT VALUE	DESCRIPTION GOODS/SERVICES
31	37	99 CONS / LGCB 5865 SWAAB Boulevard, Building 588 Nellis AFB, NV 89191-7063	GS-35F-4076D F26600-03-F-8613	486,000	ADP Input / Output and Storage Devices
32	38	35 CONS / LGC Unit 5201, Building 302 (Japan) APO, AP 96319-5201	GS-07F-8756D F62509-03-F-0067	77,173	Tractor, Wheeled
33	40	38 Contracting Squadron Unit 14040, Building 17000 Andersen AFB, GU 96543-4040	F64133-98-D-0009	128,590	Maintenance / Other Miscellaneous Bulding
34	41	Air Force Material Command Aeronautical Systems Center 2640-Loop Road West, Room 213 Wright-Patterson AFB, OH 45433-7106	F33657-03-C-3003 P00016	3,232,511	Drones
35	42	15th Contracting Squadron 90G Street, Building 1201 Hickam AFB, HI 96853-5230	F64605-03-C-0020	1,499,980	Maintenance / All Other Non- Building Facilities
36	44	Special Operations Forces Contracting Division WR-ALC / IUK 228 Cochran Street Robins AFB, GA 31098-2200	F09603-02-C-0286 P0007	442,297	Modification of Equipment / Aircraft Components & Accessories
37	46	Air Force Material Command Aeronautical Systems Center 2640 Loop Rd West, Rm 203 Wright-Patterson AFB, OH 45433-7106	F33657-00-G-4042	85,371	Systems Engineering Services
38	47	ASC / PKW Area C, Building 1 1940 Allbrook Drive, Suite 3 Wright-Patterson AFB, OH 45433-5309	F42620-00-D-0039 RZ16	71,092	Engineering Technical Services
39	48	OC/ALC / LGKIB (CFT) 3001 Staff Drive, Suite 1AC197E Tinker AFB, OK 73145-3028	F34601-97-D-0423	1,130,678	Maintenance and Repair of Equipment / Aircraft Structural Comps
40	50	12 CONS / LGCB-FA1691 395 B Street West, Suite 2 Randolph AFB, TX 78150-4525	GS-35F-4415G F41691-02-F-0653 P00001	74,630	Other ADP & Telecommunication Services
41	51	OO-ALC / LHKS Directorate of Contracting Building 1239, 6012 Fir Avenue Hill AFB, UT 84056-5820	F04606-97-D-0059 QPSB	317,027	Telephone & Telegraph Equipment
42	53	42nd Contracting Squadron 50 Lemay Plaza South Maxwell AFB, AL 36112-6334	F01600-03-F-A306	149,160	Office Furniture
43	54	22nd Contracting Squadron, FA4621 53147 Kansas Street, Suite 102 McConnell AFB, KS 67221-3606	DAHA14-02-D-5222 X406	168,272	Maintenance Religious Facilities
44	56	Air Force Material Command Air Armament Center Building 349 207 West D Avenue, Suite 622 Eglin AFB, FL 32542-6844	F08635-03-C-0098	2,500,000	Guided Missiles
45	57	50th Contracting Squadron, GWE 21D Falcon Parkway Schriever AFB, CO 80912-2118	GS-07F-6337A FA2550-03-F-A122	199,943	Miscellaneous Furniture and Fixtures

Note: Sample numbers are not in consecutive order. Twelve contracting actions resulting in deliveries and payment prior to October 1, 2003 were replaced.

Appendix E. 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 Army

Auditor General, Department of the Army

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Naval Inspector General
Auditor General, Department of the Navy

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Assistant Secretary of the Air Force (Financial Management and Comptroller)
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Combatant Command

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Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Contract Audit Agency
Director, Defense Contract Management 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
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House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement,
Committee on Oversight and Government Reform
House Subcommittee on National Security and Foreign Affairs, Committee on Oversight
and Government Reform
House Subcommittee on Information Policy, Census, and National Archives, Committee
on Oversight and Government Reform

Department of the Air Force Comments



DEPARTMENT OF THE AIR FORCE
WASHINGTON, DC

OFFICE OF THE ASSISTANT SECRETARY

04 December 2006

MEMORANDUM FOR MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR
AUDITING OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: 1130 Air Force Pentagon
Washington, DC 20330-1130

SUBJECT: DoDIG Draft Audit Report, Vendor Pay Disbursement Cycle, Air Force General
Fund: Financial Accounting, (Project No. D2004FD-0040.003)

This is in reply to your memorandum requesting the Assistant Secretary of the Air Force (Financial Management and Comptroller) to provide Air Force comments on subject report.

The following comments are general in nature from the Air Force Accounting Policy and Compliance Office. Our comments are in addition to those provided by DFAS-DE and the Air Force Accounting and Finance Office (AFAFO). The Policy office will work with the DFAS-DE office on the item 6 recommendation to ensure policy is implemented dependent on systemic changes recommended in items 1 thru 5. However we have an overriding concern that there is no mention of compensating controls in this draft report. As you know, the Air Force is working to get an independent audit effort accomplished within the current assets section of the financial statements. We want to ensure that there is continuity in audits approach (external and internal) in this area.

The SAF/FMPF point of contact is Mr. Roscoe Higginbotham, 697-6053, room 4D-212, Fax 614-5809 and E-mail fmpf.auditliaison@pentagon.af.mil.

Fredrick E. Carr
FREDRICK E CARR

Director, AF Accounting Policy & Compliance
(Financial Management)

cc:
SAF/FMP
SAF/FMPS
AFAFO

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

6760 E. IRVINGTON PLACE
DENVER COLORADO 80279-8000

NOV 30 2006

DFAS-AD/DE


MEMORANDUM FOR PROGRAM DIRECTOR, DEFENSE FINANCIAL AUDITING
SERVICE, DEPARTMENT OF DEFENSE INSPECTOR
GENERAL

SUBJECT: Management Comments to the DoDIG Draft Audit Report "Vendor Pay
Disbursement Cycle, Air Force General Fund: Financial Accounting",
Project No. D2004-D000FD-0040.003, dated October 20, 2006

In accordance with subject audit, DFAS management comments are provided for
Recommendations 1, 2, 3, 4, and 5. Recommendation 1 is a partial concur and
Recommendations 2, 3, 4, and 5 are non-concur. Air Force will provide comments for
Recommendation 6.

We do not agree that these findings constitute a high risk as presented in the audit.
The limited sample of 45 items used does not provide a sufficient basis for projecting
results to the total contracts loaded in IAPS and MOCAS. As indicated in the attached
comments, we believe internal controls are adequate and the related risk is low.

Questions your staff may have concerning the audit may be directed to Mr. Paul
Mahoney, DFAS-JBN/DE, commercial (303) 676-7253 or DSN 926-7253.


Richard J. Anderfurn
Central Site Director
DFAS Denver

Attachment:
As stated

www.dfas.mil
Your Financial Partner @ Work

**Management Comments to DoDIG Draft Audit Report, "Vendor Pay
Disbursement Cycle, Air Force General Fund: Financial Accounting",
Project No. D2004-DOOOFD-0040.003**

We recommend that the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Director, Defense Finance and Accounting Service, coordinate and direct the:

Recommendation 1: System changes and integration of the General Accounting and Finance System-Base Level, Integrated Accounts Payable System, and Mechanization of Contract Administration Services systems so that the General Accounting and Finance System-Rehost recognizes transactions as of the date the financial events transpired, and all source document references are provided and transactions can be readily traced to the supporting documents.

Management Comments: Partially Concur. "References" for receiving documents, invoices, and vouchers are available and posted in either the entitlement and/or the accounting system, depending on the category of document. This audit specifically addresses IAPS and MOCAS, both of which are entitlement systems that are considered subsidiary ledgers to our AF accounting system, GAFS. The disbursement voucher number for payments made out of IAPS are recorded in GAFS-BL, and are interfaced and stored in GAFS-R. The disbursement voucher information for MOCAS payments can be found in the MOCAS system and, using the obligation number, can be readily found in the MOCAS subsidiary records. Additionally, invoice and receipt documentation is available within the entitlement system (IAPS or MOCAS), and these reference numbers (invoice number, receipt reference) are not typically posted in the accounting system. Neither GAFS-BL nor GAFS-R were designed to store invoice level detail, and since there is an audit trail available through the entitlement systems, this additional data would be redundant. Both IAPS and MOCAS should be considered as extensions to the core accounting systems, and thereby, through referential integrity, provide the documentation references identified in this recommendation.

All financial transactions are posted into the GAFS-R General Ledger within the appropriate accounting month. The posting of the receipt and disbursement records in the IAPS and MOCAS systems is our official record, through the concept of subsidiary ledgers, that the transactions were posted and recorded on the date of the financial event. Through both the IAPS and MOCAS processes, the majority of these transactions are posted to the accounting system, and appropriate general ledger, through daily interface (IAPS receipt records to GAFS; MOCAS prevalidation requests to UPVM/GAFS). Transactions that are not posted as part of the daily interface are included in the end of month accrual process. This accrual process, for both IAPS and MOCAS, includes the financial events that hadn't been posted to the detail accounting records before the close of the reporting period.

We partially concur on this finding because we would like to evaluate the potential for daily interfaces of receipt transactions from MOCAS to ensure more timely posting to the General Ledger for the majority of the MOCAS generated Accounts Payable records. Functional requirements will be identified and system changes documented for those transactions deemed necessary for GAFS-R to be able to reduce the amount of accruals posted for MOCAS accounts payable records. Estimated completion date for effort is June 1, 2007. Implementation dates will be established once the scope and magnitude of the changes have been determined.

Estimated Completion Date: June 1, 2007.

Point of Contact: Deborah Los/Chief, Accounting Requirements Division/DFAS-ADWZ/DE/303-676-8192

Recommendation 2: System changes and integration of the Integrated Accounts Payable System, General Accounting and Finance System-Base Level, and General Accounting and Finance System-Rehost to process foreign currency fluctuation gains and losses in accordance with generally accepted accounting principles.

Management Comments: Non-concur. Foreign currency fluctuation gains and losses are processed today in accordance with the DOD FMR. If the DoDIG believes the DOD FMR is not in compliance with generally accepted accounting principles, suggest the intent of this recommendation be re-directed to the OSD Comptroller. The DoD FMR would need to be changed (and systems as well) in order to recognize gains and losses when Accounts Payable (A/P) are recorded rather than at the time of disbursement. It should be noted there is no gain or loss to recognize prior to the payment (settlement) to the vendor. The gain or loss to the Government is recognized on a cash basis when the funds are actually disbursed or collected, i.e., actual cash inflow or outflow. It is the difference between the obligation amount, which is calculated based on the budget rate for appropriations eligible to participate in the foreign currency fluctuation (FCF) program, and the daily currency exchange rate in effect on the date of payment or collection (see DoD FMR, Vol. 3, Chapter 8, and Vol. 6, Chapter 7 for additional guidance). OSD publishes budget execution rates at the beginning of each FY for the currencies covered under the FCF program. Foreign currency fluctuation procedures do not apply when the performing activity is funded by the Defense Working Capital Fund.

Point of Contact: Deborah Los/Chief, Accounting Requirements Division/DFAS-ADWZ/DE/303-676-8192

Recommendation 3: System changes to create an edit in the General Accounting and Finance System-Base Level to account for a delivered order, unpaid and account payable prior to or concurrent with a disbursement. The goods or services receipt date (financial event) must be shown as the effective date of the delivered order, unpaid and account

payable entry so the transaction can be properly recognized as a prior period event requiring a prior period adjustment to the financial statements or a current period event.

Management Comments: Non-Concur. The recommendation will not achieve the intended benefit of "ensuring liabilities are recognized in the period that goods or services are received". GAFS-BL is an accounting system that relies on the interface of receipt notification in order to record a delivered order unpaid and related accounts payable in GAFS-R. For IAPS, this interface occurs on a daily basis and the accounting system and related general ledger accounts are updated daily. Any receipt records that are received after the end of month, but which include an acceptance date prior to the end of month, are captured and posted as an adjusting entry to ensure all liabilities are recorded in the appropriate reporting period and financial reports. For MOCAS, the interfaces are accomplished daily, but include different types of information and also include a potential for delayed posting to the detail general ledger accounts. But, by virtue of the fact that MOCAS is considered a subsidiary ledger to the accounting systems, the lack of posting to the general ledger, on the date of the financial event should be a non-issue since the event is posted in MOCAS.

GAFS-BL does not determine when a disbursement is due, but only records the disbursement transaction after an entitlement system has determined that all requirements have been met for payment for the correct payment date. An edit to prevent recording a proper disbursement because the related "receipt" record had not been posted in the accounting system would only serve to delay payment to the payee and possibly incur interest penalties. If the disbursement had already been made (i.e., TBO or interfund transactions), this edit would increase intransit times between disbursement and recording of the accounting transaction. Because these transactions are posted in our subsidiary entitlement systems, this type of edit in the accounting system would not achieve the end result. As stated in management comments to recommendation 1, we will pursue direct interface of receipt transactions from MOCAS to improve the timeliness of posting MOCAS related accounts payable records to preclude the necessity of posting end of month accruals. Because this action is addressed in recommendation 1, we are non-concurring with this recommendation to also change GAFS-BL, since the timing of the transaction posting would be dependent upon the normal interface between the entitlement and accounting systems.

Point of Contact: Deborah Los/Chief, Accounting Requirements Division/DFAS-ADWZ/DE/303-676-8192

Recommendation 4: System changes, personnel training, and processing procedures in the Mechanization of Contract Administration Services system to ensure processing of contract holdbacks and unfunded liabilities, for integration with the General Accounting and Finance System-Base Level and Rehost systems. This includes recording an account payable when DFAS personnel reject an invoice because an obligation did not exist or the unliquidated balance was not sufficient to pay the vendor.

Management Comments: Non-Concur. True contract holdback amounts for MOCAS payments are classified as A/P. MOCAS issues monthly reports for contract holdbacks that are processed by accounting activities in accordance with established procedures.

For the examples mentioned in the report, a contract holdback did not exist. The contractor showed a deduction for fixed fee over the ceiling in computing the invoiced amount. Therefore, no liability existed. At the time of the deductions the liability did not exist, thus the contractors deductions were not a true contract holdback and would not have been recorded as an A/P.

Unfunded liabilities, as described in the audit report, is when Congress has authorized the Government to enter into contracts in advance of appropriations. Contracts are not input into MOCAS without appropriations.

A/P records are established prior to the pre-validation process. A/P records are established in MOCAS with the input of receipt documentation or input of cost vouchers, only when a corresponding obligation and associated appropriation are in the system. The A/P record is independent of the invoice and remains on the A/P record until paid. If an invoice is received and a corresponding contract can not be found, DFAS contacts the ACO and uses research tools to determine if a valid obligation exists. If an obligation can not be determined, the invoice is returned to the contractor in accordance with the Prompt Payment Act.

DFAS Columbus does not reject an invoice due to an insufficient unliquidated obligation (ULO). Research is done to determine how to correct the insufficient ULO and process the payment. The payable for this invoice would have already been recorded at the time the insufficient ULO was discovered.

Point of Contact: Lisa Levy, DFAS-CSQA/CO, at 614-693-7398 or DSN 869-7398

Recommendation 5: System changes to create an edit to notify Air Force personnel when vendors are incurring costs, based on the recording of the payable or vendors indicating performance, without a proper, sufficient, and timely obligation recorded to pay for the goods or services.

Management Comments: Non-concur. DFAS Columbus would not have the knowledge to know if vendors are incurring costs without a proper, sufficient and timely obligation. DFAS relies on the reviews performed by Defense Contract Audit Agency (DCAA) to ensure that vendors are not incurring costs without a proper obligation. As stated in the DCAA audit manual, it is the responsibility of DCAA to monitor costs incurred on a contract. The Administrative Contracting Officer, (ACO) uses risk evaluations performed by functional specialists, reports from the contract auditor, and information from the Purchasing Contract Officer (PCO) to assign a risk rating to the contractor's public voucher process. DCAA must take into consideration any input from the ACO in their

reviews. DCAA reviews the accounting and billing system for major contractors and will approve direct submittal authority for submission of vouchers if the contractor's systems are approved. DFAS procedure is to ensure that invoices contain the necessary information to process the payment, and insure that a corresponding obligation is established to disburse the money. The validity of costs being billed is the responsibility of DCAA.

Proposed system changes to record a payable without an obligation cannot be accomplished in MOCAS. An A/P record must be established at the appropriation level. Appropriations must be in the contract record and line items must be established in the schedule record in order for any contract payment system to generate A/P data. For MOCAS, an A/P record can only be recorded with a proper and sufficient obligation.

Point of Contact: Lisa Levy, DFAS-CSQA/CO, at 614-693-7398 or DSN 869-7398

Recommendation 6: Development of the accounting guidance and procedures to ensure Air Force personnel enter the correct dates that financial events transpired and the source document references once the system changes are made, as recommended in 1-5.

Management Comments: Air Force will respond to this recommendation.

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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