



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



REPORT
NO. 93-040

December 28, 1992

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Quick-Reaction Report on Financial Reporting
Procedures for the Defense Homeowners Assistance Fund
(Project No. 2FH-2002.01)

Introduction

We are issuing this quick-reaction report as part of our Audit of the Defense Homeowners Assistance Fund's (the Fund's) Financial Statements for FY 1992 (Project No. 2FH-2002). The objective of the audit is to determine whether the Fund's financial statements are presented fairly in accordance with generally accepted accounting principles. As part of the audit, we evaluated the internal control procedures used by the Defense Finance and Accounting Service (DFAS) to prepare the Fund's FY 1991 financial statements.

DFAS does not have adequate internal controls for preparing the Fund's financial statements. As a result, the FY 1992 financial statements may contain material misstatements or omissions.

Scope of Audit

As part of the financial statement audit, we evaluated the internal control policies and procedures that the DFAS-Washington Center (DFAS-Washington) and the DFAS-Indianapolis Center (DFAS-Indianapolis) used to prepare the FY 1991 financial statements. This portion of the audit was made during June and July 1992 in accordance with Office of Management and Budget Bulletin No. 91-14, "Audit Requirements for Federal Financial Statements" and auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD.

Financial reporting includes summarizing and reclassifying program cost elements and making adjusting entries to determine financial statement account balances. To evaluate this internal control category, we analyzed the processes that:

- o the U.S. Army Corps of Engineers (USACE) used for reporting costs to DFAS, and
- o the DFAS centers used for reporting costs to each other.

We also tested FY 1991 transactions to obtain reasonable assurance that procedures were properly designed and placed in

Prior Audit Coverage

The General Accounting Office (GAO) addressed the Army's internal control structure in its report, "Immediate Actions Needed to Improve Army Financial Operations and Controls" (GAO/AFMD-92-82), August 1992. DoD and the Army were aware of the problems reported by GAO, and improvements were under way. GAO said that the planned improvements were promising, but "more needs to be done to assure their success, particularly in the near term."

Discussion

This quick-reaction report is based on our observations of DFAS's preparation of the Fund's financial statements. It focuses on control procedures that DFAS can establish now to accurately report the Fund's financial position in FY 1992.

DFAS used sources other than the general ledger and the accounting records to prepare the Fund's FY 1991 financial statements. Because its internal control structure was inadequate, DFAS used alternative sources that were not properly documented. As a consequence, the FY 1992 financial statements could contain material misstatements and omissions.

The goal of accounting and financial reporting is to provide information that is useful to DoD management, the Office of Management and Budget, and Congress. Information is useful when it is accurate, timely, and reliable. The internal control structure should provide the basis to achieve this goal.

DFAS is responsible for establishing and maintaining the Fund's internal control structure for financial reporting. The internal control structure consists of the control environment, accounting system, and control procedures. Management determines the control environment and is the focal point for the organization's internal control structure. Through the accounting system, data on the organization's financial position and operations are recorded, classified, documented, and summarized. Control procedures should provide reasonable assurance that the control objectives are effective and working as designed.

Controls on Financial Reporting Between Centers. DFAS's internal control environment does not provide reasonable assurance that financial statements conform to generally accepted accounting principles. DFAS-Washington excluded cost categories from the Fund's FY 1991 statements and made adjusting entries without proper documentation.

DFAS-Washington prepared the Fund's official financial statements based solely on the DD Form 1176 and the Year-End Closing Statement (Treasury Fiscal Service [TFS] Form 2108). The DD Form 1176 was designed to monitor the status of budgetary

HAP purchases the homes by assuming or liquidating the outstanding mortgages, and the homes are subsequently sold. Although we question the methods used to calculate the account balances, we believe that "Inventory" and "Debt Issued Under Borrowing Authority" should be reported on the financial statements.

"Inventory." Available records show 126 homes, purchased for \$8.8 million, in "Inventory" on September 30, 1991. By excluding the HAP-acquired homes that had not been sold, DFAS-Washington understated HAP assets by 32 percent.

"Debt Issued Under Borrowing Authority." USACE recorded a liability, "Debt Issued Under Borrowing Authority," to cover outstanding mortgages on homes acquired by assumption. DFAS-Indianapolis showed a liability of \$2.6 million, but DFAS-Washington did not recognize this liability.

These cost categories were excluded in FY 1991 because of a lack of internal controls, which continues to exist today. At the time of our audit, control procedures had not been designed to require DFAS-Washington (or the DFAS center responsible for preparing the Fund's official financial statements) to:

- o use the feeder reports to prepare the official statements;
- o document adjusting entries and post them to the appropriate account; or
- o understand HAP's operations and disclosure requirements for financial statements.

This lack of controls could result in material misstatements and an adverse opinion on the Fund's financial statements for FY 1992.

Accounting Controls at DFAS-Indianapolis. While we did not audit the FY 1991 account balances, we evaluated the procedures that DFAS-Indianapolis used to prepare the financial statements. We identified significant weaknesses in the financial reporting procedures.

In its report issued in August 1992 (GAO/AFMD-92-82), GAO said that the Army's accounting system neither produces reliable information nor accumulates costs in the format needed to prepare accurate financial statements. Accounting policies and procedures do not accurately identify and report costs. DFAS-Indianapolis recognized the deficiencies in its accounting system. It also used alternative (sometimes inconsistent) sources to prepare the FY 1991 feeder reports for the Fund.

The general ledger was not used to accumulate the revenue and cost of day-to-day operations, as required by the DoD

as the inventory account balance and did not compare this amount to the accounting records. Furthermore, the statement included only HAP-acquired homes that were for sale, not homes that had been purchased by HAP but not yet placed on the market. In the "Report on Financial Position" for FY 1991, DFAS-Indianapolis mistakenly showed inventory as "Structures, Facilities, and Leasehold Improvements" (see Enclosure 1).

Homes on Hand. Neither DoD nor DFAS had clear guidance stating how real property (HAP-acquired homes) should be classified and valued. USACE's certified statement showed the total equity payments to the employee and the outstanding mortgage at the time of purchase as the cost for the "Homes-on-Hand Inventory." However, Financial Accounting Standards No. 67, "Accounting for Costs and Initial Operations of Real Estate Projects," recommends using net realizable value to record real estate held for sale. An allowance for the difference between actual costs and the net realizable value should also be established. Acquisition cost is not a clearly acceptable method of valuing these homes that were acquired at prices exceeding the market value; acquisition cost overstates asset value.

Estimating Account Balances. Accounting records and other documentation did not support the balances in "Appropriated Capital" and "Cumulative Results of Operations" as stated on the FY 1991 "Report on Financial Position". DFAS-Indianapolis officials told us that these Equity accounts were adjusted to balance the "Report on Financial Position." After DFAS-Indianapolis calculated the Equity balance (by subtracting Liabilities from Assets), they arbitrarily assigned balances to each account.

Estimation is generally not an acceptable method of deriving Equity account balances. The American Institute of Certified Public Accountants Statement on Auditing Standards No. 57, "Auditing Accounting Estimates," allows estimation if management:

- o identifies the situations requiring estimates;
- o identifies the relevant factors that may affect the accounting estimate; and
- o accumulates relevant, sufficient, and reliable data on which to base the estimate.

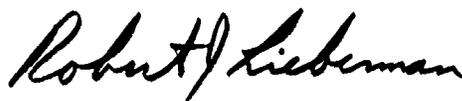
DFAS-Indianapolis did not have any supporting documentation to show how the two Equity account balances were derived.

will be provided to the senior official responsible for internal controls within the Defense Finance and Accounting Service.

Management Comments and Audit Response

We provided a draft of this report to the addressee on October 19, 1992, which requested the addressee comment by November 3, 1992. DFAS requested and received an extension to November 30, but no comments have been received. We request that DFAS provide comments to this final report by January 15, 1993. The comments should indicate concurrence or nonconcurrence with the finding and recommendations, as required by DoD Directive 7650.3.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Raymond D. Kidd at (703) 614-1682 (DSN 224-1682) or Ms. Sandra G. Elion at (703) 693-0469 (DSN 223-0469). Audit team members are listed in Enclosure 5. The distribution of this report is listed in Enclosure 6.



Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

cc:

Deputy Chief Financial Officer of the Department of Defense
Director for Military Construction, Office of the Deputy
Comptroller of the Department of Defense (Program/Budget)
The Inspector General, Department of the Army
Commander, U.S. Army Corps of Engineers
Director, Defense Finance and Accounting Service-Indianapolis
Center

COMPARISON OF ACCOUNT BALANCES FOR THE DEFENSE HOMEOWNERS ASSISTANCE FUND'S FY 1991 FINANCIAL STATEMENTS

<u>Report on Financial Position</u>	<u>DFAS - Indianapolis</u>	<u>DFAS - Washington</u>	<u>Over/Understatement by DFAS-Washington</u>	<u>Percentage of Over/Understatement by DFAS-Washington</u>	<u>Base Realignment and Closure Account</u>
Fund Balance with Treasury and Cash	\$ 16,650,088	\$ 8,395,108	\$ (8,254,980)	(49.58)	\$ 8,254,980
Accounts Receivable	1,458	1,458			
Structures, Facilities, and Leasehold Improvements	8,835,666		(8,835,666)	(100.00)	
Total Assets	<u>\$ 25,487,212</u>	<u>\$ 8,396,566</u>	<u>\$ (17,090,646)</u>	<u>(67.06)</u>	<u>\$ 8,254,980</u>
Accounts Payable	\$ 319,151	\$ 179,977	\$ (139,175)	(43.61)	\$ 139,175
Debt Issued Under Borrowing Authority	2,580,908		(2,580,908)	(100.00)	
Total Liabilities	<u>\$ 2,900,060</u>	<u>\$ 179,977</u>	<u>\$ (2,720,083)</u>	<u>(93.79)</u>	
Appropriated Capital	\$ 29,384,149		\$ (29,384,149)	(100.00)	
Cumulative Results of Operations	(6,796,997)	\$ 8,216,589	15,013,586	220.89	
Total Liabilities and Equity	<u>\$ 25,487,212</u>	<u>\$ 8,396,566</u>	<u>\$ (17,090,646)</u>	<u>(67.06)</u>	<u>\$ 139,175</u>
<hr/>					
<u>Report on Operations</u>					
Appropriated Capital Used	\$ 20,723,511	\$	\$ (20,723,511)	(100.00)	\$ 20,183,494
Revenue	2,512,150	2,512,150			
Other		8,533,918	8,533,918	100.00	
Total Financing Sources	<u>\$ 23,235,660</u>	<u>\$ 11,046,068</u>	<u>\$ (12,189,592)</u>	<u>(52.46)</u>	<u>\$ 20,183,494</u>
Cost of Goods Sold		\$ 3,570,254	\$ 3,570,254	100.00	
Operating/Program expenses	23,235,660		(23,235,660)	(100.00)	\$ 20,183,494
Total Operating Expenses	<u>\$ 23,235,660</u>	<u>\$ 3,570,254</u>	<u>\$ (19,665,406)</u>	<u>(84.63)</u>	<u>\$ 20,183,494</u>
NET RESULTS		\$ 7,475,814	\$ 7,475,814	100.00	

SOURCES OF FINANCIAL DATA FOR THE DEFENSE HOMEOWNERS ASSISTANCE FUND'S FY 1991 FINANCIAL STATEMENTS

<u>Report on Financial Position</u>	<u>Source</u>
Assets	
Fund Balance with Treasury and Cash	DD Form 1176 Line Items: 8 (Total Unobligated Balance Available) + 9 (Total Unobligated Balance Not Available) + 13 (Total Obligated Balance, Net, End of Period)
Accounts Receivable	DD Form 1176 Line Items: 13(b) (Total Uncollected Reimbursable Orders)
Structures, Facilities, and Leasehold Improvements	Certified Statement from USACE
Liabilities and Equity	
Accounts Payable	DD Form 1176 Line Items: 13(a)(2) (Accounts Payable and Accrued Liabilities)
Debt Issued Under Borrowing Authority	DD Form 1176 Supporting Schedules
Appropriated Capital	Estimates
Cumulative Results of Operations	Estimates
 <u>Report on Operations</u>	
Financing Sources	
Appropriated Capital Used	DD Form 1176 Line Items: 14 (Net Outlays, Cash Basis) + 15 (Total Change in Net Accounts Payable)
Revenue	DD Form 1176 Line Items: 3 (Total Reimbursement and Other Income)
Other	N/A
Expenses	
Cost of Goods Sold	N/A
Operating/Program Expenses	DD Form 1176 Line Items: 3 (Total Reimbursements and Other Income) + 14 (Net Outlays, Cash Basis) + 15 (Total Change in Net Accounts Payable)

SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

<u>Recommendation Reference</u>	<u>Description of Benefits</u>	<u>Type of Benefits</u>
1.	Internal Controls. Implementation of the recommendation should result in improved internal controls to accurately record financial data and report account balances on the financial statements of the Defense Homeowners Assistance Fund.	Nonmonetary.
2.	Program Results. Implementation of the recommendation should result in more accurate financial statements of the Defense Homeowners Assistance Fund.	Nonmonetary.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Deputy Comptroller of the Department of Defense
(Program/Budget), Washington, DC
Deputy Comptroller of the Department of Defense (Management
Systems), Washington, DC

Department of the Army

Assistant Secretary of the Army (Financial Management),
Washington, DC
Headquarters, U.S. Army Corps of Engineers, Washington, DC

Defense Agencies

Headquarters, Defense Finance and Accounting Service,
Washington, DC
Defense Finance and Accounting Service-Washington Center,
Washington, DC
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Commander, U.S. Army Corps of Engineers

Defense Agencies

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service-Indianapolis
Center

Non-DoD Activities

Office of Management and Budget
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Chairmen and Ranking Minority Members of the following
Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
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Committee on Government Operations