

**Audit**



**Report**

OFFICE OF THE INSPECTOR GENERAL

**FINANCIAL STATEMENTS OF THE DEFENSE LOGISTICS  
AGENCY SUPPLY MANAGEMENT DIVISION OF THE  
DEFENSE BUSINESS OPERATIONS FUND (DEFENSE  
FUEL SUPPLY CENTER FINANCIAL DATA) FOR FY 1992**

Report No. 93-164

September 2, 1993

**Department of Defense**

## Acronyms

AAS	Appropriation Accounting System
CFO	Chief Financial Officer
DFAMS	Defense Fuel Automated Management System
DFAS	Defense Finance and Accounting Service
DFSC	Defense Fuel Supply Center
DFSEO	Defense Logistics Agency Financial Systems Evaluation Office
DLA	Defense Logistics Agency
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
GBL	Government Bill of Lading
IG	Inspector General
IMC	Internal Management Control
IMCR	Internal Management Control Review
O&M	Operation and Maintenance
OMB	Office of Management and Budget
PC&S	Post, Camp, and Station
ULO	Unliquidated Obligation



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
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September 2, 1993

MEMORANDUM FOR SECRETARY OF DEFENSE  
COMPTROLLER AND CHIEF FINANCIAL OFFICER OF  
THE DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Financial Statements of the Defense Logistics Agency  
Supply Management Division of the Defense Business Operations Fund  
(Defense Fuel Supply Center Financial Data) for FY 1992  
(Report No. 93-164)

We are providing this audit report for your information and use, and for use by Congress. Financial statement audits are required by the Chief Financial Officers Act of 1990. Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General to render an opinion on the fairness of financial statements. Also, we are required to report on the adequacy of internal controls and compliance with laws and regulations.

This report discusses our audit of the Defense Fuel Supply Center (DFSC) financial data included in the FY 1992 financial statements for the Defense Logistics Agency Supply Management Division (the Division) of the Defense Business Operations Fund. We are also reporting on conditions that came to our attention that affected the form and content of the Division's financial statements taken as a whole. DFSC trial balance data used to formulate the Division's financial statements showed assets of \$2.0 billion, liabilities of \$169.4 million, revenues of \$5.3 billion, and expenses of \$5.7 billion.

A May 20, 1993, draft report was provided to the Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS) to give management an opportunity to correct conditions noted and mitigate the potential effect on the FY 1992 financial statements. Comments on the draft report were requested by June 10, 1993; however, the comments from DLA were received too late to be included in the report and neither comments nor revised financial statements were received from DFAS.

Although we were able to evaluate DFSC's internal control structure and its compliance with laws and regulations, we were unable to express an opinion on DFSC financial data included in the Division's financial statements. We are disclaiming an opinion on the DFSC financial data because of scope limitations for which we were unable to apply other auditing procedures. The Division did not have financial records to support Other Adjustments of \$2.74 billion in its Statement of Cash Flows and \$1.14 billion of Other Unfunded Expenses in its Statement of Budget and Actual Expenses. As a result, we were unable to determine what portion, if any, of the \$3.88 billion related to DFSC financial data. Further, significant deficiencies in the internal control structure related to DFSC unliquidated obligation financial data and the DFAS and DFSC reconciliation of general ledger accounting data with supporting records added to our inability to express an opinion. Also, management did not provide us a management representation letter that addressed all material issues related to the accuracy, completeness, and presentation of DFSC financial data.

We concluded that there were internal control weaknesses in ensuring that DFSC general ledger account balances were properly reconciled to subsidiary records; that DFSC subsidiary records were periodically verified to supporting documentation; and that DFSC reviewed unusual balances, such as negative unliquidated obligations. In addition, in analyzing the Division's statements taken as a whole, we found that \$2.7 billion related to accounts receivable, accounts payable, undistributed collections, and undistributed disbursements that either were not supported by subsidiary records or were not developed from official accounting records. Our tests of compliance with laws and regulations disclosed that DFAS and DFSC were not in compliance with requirements of DoD Manual 7220.9-M, "DoD Accounting Manual," the Federal Managers' Financial Integrity Act, and DoD guidance on the form and content of financial statements. Details on the weaknesses are discussed in Parts II and III of the report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Director, Defense Logistics Agency; Commander, DFSC; and the Director, Defense Finance and Accounting Service, must provide final comments on the recommendations identified in Part VI of this report by November 2, 1993. As required by DoD Directive 7650.3, the comments should indicate concurrence or nonconcurrence with each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, state your specific reasons for each nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Charles Hoeger or Mr. Terrance Wing at (215) 737-3881 (DSN 444-3881). The distribution of this report is listed in Part IV, Appendix C.



Robert J. Lieberman  
Assistant Inspector General  
for Auditing

## Office of the Inspector General

Audit Report No. 93-164  
(Project No. 2LD-5020)

September 2, 1993

### FINANCIAL STATEMENTS OF THE DEFENSE LOGISTICS AGENCY SUPPLY MANAGEMENT DIVISION OF THE DEFENSE BUSINESS OPERATIONS FUND (DEFENSE FUEL SUPPLY CENTER FINANCIAL DATA) FOR FY 1992

#### EXECUTIVE SUMMARY

**Introduction.** The Chief Financial Officers Act of 1990 requires an annual audit of funds, such as the Defense Logistics Agency Supply Management Division (the Division) of the Defense Business Operations Fund. The Division's revolving fund was established for procuring, storing, and selling consumable type supply items to DoD Components and other Government agencies. Due to the size and complexity of the Division's financial management system, we concluded that we could not provide an opinion on the Division's financial statements taken as a whole. This report discusses the audit of Defense Fuel Supply Center (DFSC) financial data included in the Division's financial statements. The report also discusses conditions that came to our attention that affected the form and content of the Division's financial statements taken as a whole. For FY 1992, the Division reported revenues of \$11.99 billion and a net loss of \$848.78 million. DFSC trial balance data used to formulate the Division's financial statements showed assets of \$2.0 billion, liabilities of \$169.4 million, revenues of \$5.3 billion, and expenses of \$5.7 billion.

On May 20, 1993, we issued draft audit report, "Financial Statements of the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund for FY 1992," Project No. 2LD-5020, to the Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS) to provide an opportunity to correct conditions noted and mitigate the potential effect on the FY 1992 financial statements. However, the comments from DLA were received too late to be included in the report and neither comments nor revised financial statements were received from DFAS. See Part VI for the draft report findings and recommendations.

**Objectives.** The primary objective of the audit was to determine whether DFSC financial data included in the Division's financial statements for FY 1992 were presented fairly in accordance with generally accepted accounting principles for Federal entities. We evaluated the internal control structure for DFSC financial data and assessed compliance with laws and regulations that could have a material effect on the DFSC financial data. We also analyzed the form and content of the Division's financial statements taken as a whole.

**Independent Auditor's Opinion.** We are issuing a Disclaimer of Opinion on the DFSC financial data included in the Division's financial statements. The Division did not have financial records to support Other Adjustments of \$2.74 billion in its Statement of Cash Flows and \$1.14 billion of Other Unfunded Expenses in its Statement of Budget and Actual Expenses. As a result, we were unable to determine what portion of the \$3.88 billion, if any, related to DFSC financial data. In addition, significant deficiencies in the internal control structure related to DFSC unliquidated obligation financial data and the DFAS and DFSC reconciliation of general ledger accounting data with supporting records contributed to our inability to express an

opinion. Also, management did not provide us a management representation letter that addressed all material issues related to the accuracy, completeness, and presentation of DFSC financial data. Since we determined that it was not practical for us to perform, nor did we perform, sufficient alternative audit procedures to enable us to express an opinion, we do not express an opinion on the DFSC financial data included in the Division's financial statements.

**Internal Controls.** Based on our tests of physical inventories and reconciliations, we concluded that internal controls were in place to ensure that DFSC inventory, stock on hand, valued at \$2.1 billion had been fairly valued. However, internal control weaknesses existed in other areas that we considered to be material and reportable conditions under standards established by Office of Management and Budget Bulletin 93-06. Controls were not adequate to provide for the periodic verification of DFSC subsidiary records to supporting documentation and for the review of unusual DFSC records, such as negative unliquidated obligations. Similar problems were reported in our audit of FY 1991 DFSC financial data. Additionally, DFSC and DFAS implementation of the Federal Managers' Financial Integrity Act (FMFIA) was inadequate. In analyzing the Division's statements taken as a whole, we found that \$2.7 billion related to accounts receivable, accounts payable, undistributed collections, and undistributed disbursements that either was not supported by subsidiary records or was not developed from official accounting records. Further, controls and procedures were not in place to ensure that DLA had sufficient time and information to review the accuracy and reliability of the financial statements produced by DFAS. Part II contains our report on material internal control weaknesses.

**Compliance with Laws and Regulations.** Part III contains our report on compliance with laws and regulations. Material instances of noncompliance with laws and regulations were disclosed. We noted in Part II, "Report on Internal Controls," that requirements of the FMFIA, DoD Manual 7220.9-M, "DoD Accounting Manual," and DoD guidance on the form and content of financial statements were not effectively implemented. Because noncompliance with laws and regulations generally represents internal control weaknesses, those issues are discussed in Part II. Appendix A of Part IV lists all laws and regulations tested.

**Usefulness of Financial Statements.** Although we could not ascertain the overall accuracy of DFSC financial data included in the Division's financial statements, we did note control problems that affected the reported numbers of the Division's financial statements taken as a whole and placed in doubt the ability of the Division to fairly present an accurate financial position. DLA acknowledged problems with accuracy of the statements. In a memorandum to the Comptroller, Department of Defense, DLA stated that in analyzing the financial statements, it was apparent that DFAS viewed the need to meet a due date as paramount to the need to have accurate financial reports. Also, DLA personnel informed us that based on their analysis of the financial statements received from DFAS, their initial view was that the statements were so unreliable that the statements should not have been submitted and that DLA was unable to certify the statements. In our opinion, the separation of the responsibility for the reports (DLA) from the capability of preparing the reports (DFAS) has significantly complicated the accuracy and resolution of problem areas associated with the financial statements. For this reason, most of the recommendations in Part VI are addressed jointly to DLA and DFAS. Implementation of the audit recommendations should significantly improve the accuracy of future financial information and financial statements. Also, managers will have accurate data to use in their decisionmaking process.

**Summary of Recommendations.** Recommendations were made to improve DFSC's financial management system. We recommended that DFAS and DFSC develop procedures to ensure that DFSC financial data are reconciled, supported, and accurate; that financial statements be revised or footnoted to correct financial data for unliquidated obligations, accounts payable, undistributed disbursements, undistributed collections, and claims receivable; and that DFAS and DFSC improve their implementation of the FMFIA. Regarding the Division's statements taken as a whole, we recommended that the financial statements be revised to include all required footnotes and supplemental information, that either support be provided for \$2.7 billion of financial data or the statements be revised to disclose the problems with the data, and that procedures be developed between DLA and DFAS to ensure that the financial statements are reliable and accurate.

**Management Comments.** Comments on the draft report from DLA were received too late to be included in the report. Neither comments nor revised financial statements were received from DFAS. We request comments on the findings and recommendations in Part VI of this report by November 2, 1993.



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This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate at (703) 614-6303 (DSN 224-6303).



**Part I - Independent Auditor's Opinion  
on the Financial Statements**

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## Introduction

The revolving fund for the Defense Logistics Agency Supply Management Division (the Division) of the Defense Business Operations Fund was established for procuring, storing, and selling consumable type supply items to DoD Components and other Government agencies. Due to the size and complexity of the Division's financial management system, we concluded that we could not provide an opinion on the Division's financial statements taken as a whole. This report addresses our audit of Defense Fuel Supply Center (DFSC) financial data included in the Division's financial statements. We are also reporting on conditions that came to our attention that affected the form and content of the Division's financial statements taken as a whole. For FY 1992, the Division reported revenues of \$11.99 billion and a net loss of \$848.78 million. DFSC trial balance data used to formulate the Division's financial statements showed assets of \$2.0 billion, liabilities of \$169.4 million, revenues of \$5.3 billion, and expenses of \$5.7 billion.

Financial statement audits such as this one are required by the Chief Financial Officers Act of 1990 (the CFO Act). The Principal Statements of the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund are the responsibility of the Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS). Our responsibility is to express an opinion on the financial statements based on our audit.

## Scope

We have audited the Defense Fuel Supply Center (DFSC) financial data included in the Division's financial statements and related notes to the financial statements as of and for the year ended September 30, 1992.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures related to the DFSC financial data, including the Notes thereto. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the DFSC financial data. We reviewed supply, procurement, and financial records; journal vouchers; and summaries for transactions supporting DFSC FY 1992 financial data. We observed the physical inventory and reconciliation processes at 13 locations representing \$434 million of DFSC's reported \$2.1 billion inventory. Also, at our request, the Air Force Audit Agency observed the physical inventory and reconciliation processes for fuel valued at \$71 million and stored at 22 Air Force bases. We believe that our audit provides a reasonable basis for our opinion. This financial statement audit was made from March 1992 through April 1993. See Part IV, Appendix B, for a list of organizations visited or contacted.

## **Auditing Standards**

We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, Department of Defense, and Office of Management and Budget (OMB) Bulletin 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance on whether the DFSC financial data and related Notes to the Financial Statements are free of material misstatement.

## **Accounting Principles**

Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal entities are to be promulgated by the Comptroller General of the United States; the Director, OMB; and the Department of Treasury of the United States, based on advice from the Board. In the interim, Federal agencies are to follow the applicable accounting standards contained in agency accounting policies, procedure manuals, and related guidance. The summary of significant accounting policies included in the Notes to the Principal Statements describes the principles and methods of applying those principles that management has concluded are the most appropriate for presenting the Division's significant assets, liabilities, net position, results of operations, cash flows, and reconciliation to budget.

## **Disclaimer of Opinion**

We were unable to express an opinion on the financial statements for several reasons. The Division did not have financial records to support Other Adjustments of \$2.74 billion in its Statement of Cash Flows and \$1.14 billion of Other Unfunded Expenses in its Statement of Budget and Actual Expenses. As a result, we were unable to determine what portion of the \$3.88 billion, if any, related to DFSC financial data. In addition, significant deficiencies in the internal control structure related to DFSC unliquidated obligation financial data, and the DFAS and DFSC reconciliation of general ledger accounting data with supporting records added to our inability to express an opinion. Also, management did not provide us a management representation letter that addressed all material issues related to the accuracy, completeness, and presentation of DFSC financial data. Since we determined that it was not practical for us to perform, nor did we perform, sufficient alternative audit procedures to enable us to express an opinion, we do not express an opinion on the DFSC financial data included in the Division's financial statements.

## **Additional Information**

Our audit was conducted for the purpose of forming an opinion on DFSC financial data described above. During the audit, we reported deficiencies to DLA and DFAS in the form of a draft audit report (Part VI). Management did not respond to the findings and recommendations in the report. We have reviewed the financial information related to the DFSC financial data presented in management's Overview of the Division. The information presented in the Overview is presented for the purpose of additional analysis. We have not audited that information; therefore, we are not expressing an opinion on it. The information is addressed, however, in Part III, Compliance with Laws and Regulations, in accordance with OMB Bulletin No. 93-06.

## **Part II - Internal Controls**

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## Introduction

We have audited the internal control structure for the Defense Fuel Supply Center (DFSC) financial data included in the financial statements of the Defense Logistics Agency Supply Management Division (the Division) of the Defense Business Operations Fund for the year ended September 30, 1992. We also analyzed the form and content of the Division's financial statements taken as a whole. Such audits are a requirement of the Chief Financial Officers Act of 1990 (the CFO Act), November 15, 1990.

Management of the Division and the Defense Finance and Accounting Service (DFAS) is responsible for establishing an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that the following are met.

- o Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets.

- o Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

- o Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and any other laws and regulations that the Office of Management and Budget (OMB), entity management, or the Inspector General, DoD, have identified as being significant for which compliance can be objectively measured and evaluated.

- o Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

## Objectives and Scope

The objective of the audit was to determine whether material internal control weaknesses existed. Specifically, we determined whether the internal control structure was established to ensure that the financial statements were free of material misstatements. We considered the internal control structure in determining audit procedures that were needed in order to express an opinion on the financial statements. We obtained an understanding of the internal control policies and procedures and assessed the level of control risk relevant to all significant cycles, classes of transactions, and account balances. For those

significant control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed.

For purposes of this report, we have classified the significant internal controls, policies, and procedures into the following categories: general ledger, inventories, transaction processing, and financial reporting. We also evaluated the process by which DFAS and DFSC identify and evaluate weaknesses reported under the Federal Managers' Financial Integrity Act (FMFIA) as it relates to DFSC financial data. Our consideration of the internal control structure would not necessarily disclose all conditions that might be reportable and, accordingly, would not necessarily disclose all conditions that are also considered to be material weaknesses.

We conducted our audit in accordance with generally accepted Government auditing standards, issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance on whether the Principal Statements are free of material misstatements. We applied those standards to DFSC financial data included in the Division's financial statements and to the form and content of the Division's statements taken as a whole.

## Prior Audit Coverage

Internal control issues related to DFSC financial data were addressed in the following Inspector General (IG), DoD, and the General Accounting Office (GAO) audits.

GAO Report No. GAO/AFMD-87-30 (Office of the Secretary of Defense Case No. 7327), "Internal Controls - Defense Fuel Supply Center's Recording and Reporting of Accounts Payable," May 13, 1987, reported that DFSC had inadequate controls to ensure the proper recording and reporting of accounts payable. GAO recommended that DFSC conduct accounts payable reviews required by DLA regulations or, if resources were not considered adequate, develop alternatives for complying with the requirements. Management concurred with the recommendation and stated that contract closeout procedures had been strengthened and additional personnel had been hired to resolve the situation. However, our audit found that there were still inadequate controls to ensure accounts payable were properly recorded and reported.

IG, DoD, Inspection Report No. 88-INS-06, "Defense Management of Wholesale Fuels," September 29, 1988, concluded that the lack of integrated, automated financial and disbursement systems affects DFSC's ability to ensure the accuracy of financial accounting records, hinders reconciliation of financial data, affects cash flow, and increases the possibility of overpayment of funds.

## Internal Controls

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DLA agreed with the report's conclusion and stated that DLA is continuing its efforts to correct systems deficiencies. Our audit found that there were still problems with the accuracy of financial accounting records.

IG, DoD, Audit Report No. 91-111, "Controls Over Fuel Payments," July 16, 1991, reported that DFSC controls over the recording and collection of overpayments on bulk fuel purchases were inadequate. The report recommended that DFSC promptly record all overpayments as accounts receivable, bill contractors for overpayments when immediate offsets cannot be made, and assess interest on overpayments retained by contractors in excess of 30 days after billing to comply with provisions of the Debt Collection Act. Management concurred and stated that corrective actions had been taken.

IG, DoD, Audit Report No. 92-129, "Defense Stock Fund Financial Statements (Materiel Managed Under the Standard Automated Materiel Management System) for FY 1991," August 26, 1992, reported that DFSC was not performing reconciliations to ensure general ledger accounts were accurate and supported by subsidiary records. Management concurred and stated that corrective actions would be taken. Our audit found that the reconciliations were still not being performed.

IG, DoD, Inspection Report No. 92-INS-11, "Verification Inspection of the Defense Management of Wholesale Fuels," September 8, 1992, was a follow-up of selected observations in Report No. 88-INS-06 to ensure that corrective actions were taken or completed. The report concluded that DLA had not taken actions to reconcile undistributed disbursement financial data, even though DLA had stated implementation of an automated voucher examination disbursement system would correct the condition. The report deferred recommending corrective action until our present audit had been completed. Our audit found that undistributed disbursements still have not been completely reconciled.

## Results of Audit

Internal control weaknesses existed that we consider to be material and reportable conditions under standards established by OMB Bulletin 93-06. Reportable conditions are matters that come to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information to manage and evaluate operational performance. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors would be in amounts material to the statements being audited, or material to a performance measure or aggregation of related performance measures, and might not be detected in a timely period by employees in the normal course of performing their assigned functions.

**DFSC Financial Management System.** The following is a summary of material and reportable internal control weaknesses related to the DFSC financial management system. Part VI of this report contains additional details and the recommendations for corrective action that were in our draft audit report.

**Unliquidated Obligations.** DFAS and DFSC were not performing required reviews of unliquidated obligations (ULOs). The DLA "Accounting and Finance Manual," DLAM 7000.1, states that ULOs will be reviewed quarterly, at a minimum, to ensure the accuracy and completeness of recorded obligations, to provide a basis for certifying that the obligation data comply with United States Code, title 31, and to detect system deficiencies. Since required reviews were not performed, inaccuracies, such as \$355.7 million of negative ULOs, were not corrected. Negative ULOs indicate problems with the accounting system. As of September 30, 1992, the DFSC ULO general ledger account balance was \$2.95 billion.

**Reconciliation Process.** DFAS and DFSC were not properly implementing DoD Manual 7220.9-M, "DoD Accounting Manual," which requires that general ledger accounts be reconciled to subsidiary records and supporting documentation. In addition, procedures to describe how reconciliations that would require input from both organizations would be corrected, such as accounts payable, were nonexistent.

**Inadequate Audit Trails.** DFAS and DFSC had not established adequate audit trails to enable managers or auditors to verify accounts payable and undelivered order financial data for transportation expenses (\$137 million), manual journal vouchers (\$219.5 million), undistributed disbursements (\$492.7 million), and undistributed collections (\$356 million).

**Billing Procedures.** DFSC procedures did not provide for timely recording of sales and billings for fuel sales at military installations (post, camp, and station). The DoD Accounting Manual states that billings will be made within 30 days after the month in which the work or service occurred. On the average, customer billings and entries to the accounting records to record the sales were not done until 60 to 90 days after payments were made to suppliers.

**Prior Period Adjustments.** DFSC erroneously recorded financial data for adjustments of prior period transactions in FY 1992 financial data. As a result, FY 1992 income was understated by \$159.7 million. Prior period adjustments should be reported as adjustments to previously reported results.

**Federal Managers' Financial Integrity Act.** DFSC and DFAS Columbus Center/DFSC Office implementation of the FMFIA was inadequate. Additionally, DFSC did not report its implementation of the FMFIA as a material weakness.

**Supply Management Division's Financial Statements.** The following is a summary of material and reportable internal control weaknesses related to

## Internal Controls

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the Division's financial statements taken as a whole. Part VI of this report contains additional details and the recommendations for corrective action that were in our draft audit report.

**Financial Data.** DLA Headquarters' financial data of \$.9 billion and operation and maintenance financial data of \$1.8 billion were not supported by subsidiary records or developed from official accounting records. The DoD Accounting Manual states that financial transactions shall be adequately supported with pertinent documents and source records. The financial data related to accounts payable, accounts receivable, undistributed disbursements and undistributed collections. In addition, subsidiary records were not available to support Other Adjustments of \$2.74 billion in the Division's Statement of Cash Flows and \$1.14 billion of Other Unfunded Expenses in the Division's Statement of Budget and Actual Expenses.

**Notes to Financial Statements.** The Division's financial statements did not contain footnote disclosures required by DoD guidance on the form and the content of financial statements. Footnotes were not prepared for property and equipment totaling \$26.9 million, depreciation practices related to property and equipment, revolving fund balance of \$12.0 billion, and other expenses of \$.5 billion.

**Division's Overview and Supplemental Information.** The Division's overview and supplemental schedules did not contain information related to the financial results and condition of the Division. Performance and financial measures were presented, but contained no narrative or analysis to describe how the measures compared to the Division's mission and goals and objectives, and if applicable, the reasons goals or objectives were not achieved and the plans for achieving or modifying the objectives in subsequent years.

**Crosswalk of General Ledger Accounts to Financial Statements.** Documented procedures were nonexistent to show which DLA general ledger accounts were used to develop the various lines on the Division's financial statements. DoD guidance on the form and content of FY 1992 financial statements provides a crosswalk from the various lines on the financial statements to the DoD uniform chart of general ledger accounts.

**Overall Reliability and Accuracy of Financial Statements.** In February 1993, DLA responded to a memorandum from the Deputy Comptroller, DoD, regarding the accuracy of the FY 1992 financial statements. DLA stated that there must be improvements in the interaction between DLA and DFAS in order to make corrections to the financial reports in a timely manner. DLA further stated that in its synopsis of problems encountered in the preparation of the FY 1992 financial statements, DFAS viewed the need to meet a due date as paramount to the need to have accurate financial statements. We agree with the DLA assessment. DFAS did not provide the FY 1992 financial statements to DLA in sufficient time for DLA to determine if the statements were reliable and accurate. In addition, even if the statements had been

provided in a timely manner, no detailed procedures were available for DLA to determine the source of the data (general ledger accounts or other data) to support the financial statement lines.

In May 1993, the Assistant Comptroller General provided testimony on financial management of the Defense Business Operations Fund before the House Subcommittee on Readiness, Committee on Armed Services. The Assistant Comptroller General stated that there was confusion as to which Defense organization was responsible for the accuracy of the data in the financial reports and that the lack of adherence to existing policies and procedures for data handling, review, and verification continue to be a major problem.



## **Part III - Compliance with Laws and Regulations**

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## Introduction

We tested the Defense Fuel Supply Center (DFSC) financial data included in the financial statements of the Defense Logistics Agency Supply Management Division (the Division) of the Defense Business Operations Fund for material instances of noncompliance with laws and regulations as of and for the year ended September 30, 1992. Such audits are required by the Chief Financial Officers Act of 1990.

## Objectives and Scope

The objective of our audit was to assess DFSC's compliance with laws and regulations for transactions and events that have a direct and material effect on the financial statements. Material instances of noncompliance are failures to follow requirements of, or violations of prohibitions contained in laws or regulations. Such failures or violations are those that cause us to conclude that the aggregation of the material misstatements resulting from those failures or violations is material to the financial statements, or those whose sensitive nature would cause them to be perceived as significant by others.

Compliance with laws and regulations applicable to the Division is the responsibility of Defense Logistics Agency and Defense Finance and Accounting Service management. As part of obtaining reasonable assurance about whether the DFSC financial data are free of material misstatements, we tested compliance with laws and regulations that may directly affect DFSC financial data and certain other laws and regulations designated by OMB and DoD. The laws and regulations are identified in Part IV, Appendix A.

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA). We also compared the DFSC's most recent FMFIA reports with the evaluation we conducted of the entity's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the Overview of the Reporting Entity. However, our objective was not to provide an opinion on overall compliance with such provisions.

We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance that the Principal Statements are free of material misstatements. We applied those standards to DFSC financial data included in the Division's financial statements.

## **Prior Audit Coverage**

Compliance issues related to DFSC financial data were addressed by the same audits discussed in Part II of this report, "Report on Internal Controls."

## **Results of Audit**

The results of our tests indicate that with respect to the items tested, except for noncompliance described in Part II of this report, "Report on Internal Controls," management complied in all material respects with the laws and regulations referred to in Part IV, Appendix A. We considered the instances of material noncompliance in forming our opinion on DFSC financial data included in the Division's financial statements. With respect to items not tested, nothing came to our attention that caused us to believe that management had not complied, in all material respects, with the provisions identified above.



## **Part IV - Additional Information**

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## **Appendix A. Laws and Regulations**

Federal Managers' Financial Integrity Act of 1982, Public Law 97-255

Chief Financial Officers Act of 1990, Public Law 101-576

Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies," August 1987

Title 31, United States Code

Office of Management and Budget (OMB) Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992

OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993

OMB Circular A-123, "Internal Control Systems," August 4, 1986

OMB Circular A-127, "Financial Management Systems," December 19, 1984

DoD Directive 5010.38, "Internal Management Program," April 14, 1987

DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983

DoD Regulation 7420.13-R, "Stock Fund Operations," June 1986

DoD Guidance on Form and Content of Financial Statements for FY 1992 Financial Activity, October 1992

Defense Logistics Agency Manual 7000.1, "Accounting and Finance Manual," August 1980

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## **Appendix B. Organizations Visited or Contacted**

### **Office of the Secretary of Defense**

Office of the Comptroller and Chief Financial Officer of the Department of Defense,  
Washington, DC

### **Department of the Army**

Fort Dix, Base Supply, Wrightstown, NJ

### **Department of the Navy**

Naval Fuel Mayport Depot, Naval Supply Center, Jacksonville, FL  
Navy Petroleum Office, Cameron Station, VA

### **Department of the Air Force**

Davis-Monthan Air Force Base, Tucson, AZ  
March Air Force Base, Riverside, CA  
McClellan Air Force Base, Sacramento, CA  
Dover Air Force Base, Dover, DE  
Eglin Air Force Base, Fort Walton Beach, FL  
Patrick Air Force Base, Cocoa Beach, FL  
Moody Air Force Base, Valdosta, GA  
Bitburg Air Base, Bitburg, Germany  
Rhein-Main Air Base, Frankfurt, Germany  
Spangdahlem Air Base, Spangdahlem, Germany  
Hickam Air Force Base, Honolulu, HI  
Scott Air Force Base, Belleville, IL  
Kadena Air Base, Okinawa, Japan  
Osan Air Base, Osan, Korea  
Barksdale Air Force Base, Shreveport, LA  
Kessler Air Force Base, Biloxi, MS  
Kirtland Air Force Base, Albuquerque, NM  
McGuire Air Force Base, Wrightstown, NJ  
Griffiss Air Force Base, Rome, NY  
Kelly Air Force Base, San Antonio, TX  
Randolph Air Force Base, Universal City, TX  
Sheppard Air Force Base, Wichita Falls, TX  
Royal Air Force Lakenheath, Lakenheath, United Kingdom  
Royal Air Force Upper Heyford, Upper Heyford, United Kingdom

## Appendix B. Organizations Visited or Contacted

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### Defense Logistics Agency

Headquarters, Defense Logistics Agency, Cameron Station, VA  
Headquarters, Defense Finance and Accounting Service, Washington, DC  
Defense Finance and Accounting Service, Columbus, OH  
Defense Fuel Supply Center, Cameron Station, VA  
Defense Fuel Region - West, San Pedro, CA  
Defense Fuel Region - Europe, Stuttgart, Germany  
Defense Fuel Region - Pacific, Camp Smith, HI  
Defense Fuel Region - Northeast, McGuire Air Force Base, NJ  
Defense Fuel Region - Southwest, Houston, TX  
Defense Fuel Supply Point - Calnev Pipeline, CA  
Defense Fuel Supply Point - Ozol, CA  
Defense Fuel Supply Point - Point Molate, CA  
Defense Fuel Supply Point - San Pedro, CA  
Defense Fuel Supply Point - Naval Supply Center, Jacksonville, FL  
Defense Fuel Supply Point - Naval Air Station, Jacksonville, FL  
Defense Fuel Supply Point - Savannah, GA  
Defense Fuel Supply Point - Hanau, Germany  
Defense Fuel Supply Point - Speyer, Germany  
Defense Fuel Supply Point - Pearl Harbor, HI  
Defense Fuel Supply Point - Gaeta, Italy  
Defense Fuel Supply Point - Milazzo, Italy  
Defense Fuel Supply Point - Sasebo, Japan  
Defense Fuel Supply Point - Tomakomai, Japan  
Defense Fuel Supply Point - Plantation Pipeline, LA  
Defense Fuel Supply Point - Cincinnati, OH  
Defense Fuel Supply Point - Drumright, OK  
Defense Fuel Supply Point - Roosevelt Roads, Puerto Rico  
Defense Fuel Supply Point - Melville, RI  
Defense Fuel Supply Point - Amerada Hess Corp., Houston, TX  
Defense Fuel Supply Point - Craney Island, Norfolk, VA  
Defense Fuel Supply Point - Norfolk, VA  
Defense Fuel Supply Point - Puget Sound, WA  
Defense Fuel Quality Assurance Residency, Naples, Italy

### Non-Defense Organizations

U.S. General Accounting Office, Washington, DC  
Patrick Henry Airport, Newport News, VA  
St. Augustine Airport, Aero Sport, Inc., St. Augustine, FL

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Assistant Secretary of Defense (Production and Logistics)  
Assistant to the Secretary of Defense for Public Affairs  
Comptroller and Chief Financial Officer of the Department of  
Defense  
Deputy Comptroller (Management Systems)  
Director, Management Systems  
Deputy Chief Financial Officer of the Department of Defense

### **Department of the Army**

Secretary of the Army  
Inspector General  
Auditor General, U.S. Army Audit Agency

### **Department of the Navy**

Secretary of the Navy  
Assistant Secretary of the Navy (Financial Management)  
Director, Naval Audit Service

### **Department of the Air Force**

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

### **Defense Agencies**

Director, Defense Contract Audit Agency  
Director, Defense Finance and Accounting Service  
Director, Defense Finance and Accounting Service, Columbus Center  
Director, Defense Logistics Agency  
Director, Defense Logistics Studies Information Exchange  
Commander, Defense Fuel Supply Center  
Inspector General, Defense Intelligence Agency

## **Non-Defense Federal Organizations**

Office of Management and Budget

U.S. General Accounting Office

National Security and International Affairs Division, Technical Information Center

National Security and International Affairs Division, Defense and National

Aeronautics and Space Administration Management Issues

National Security and International Affairs Division, Military Operations and

Capabilities Issues

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Government Operations

House Subcommittee on Legislation and National Security,

Committee on Government Operations

**Part V - Defense Logistics Agency Supply  
Management Division Financial  
Statements - FY 1992**

*DEFENSE LOGISTICS  
AGENCY DEFENSE  
BUSINESS OPERATIONS  
FUND*

*OVERVIEW*

## DLA Supply Management Division Financial Statements - FY 1992

### FY 1992 OVERVIEW SUPPLY MANAGEMENT BUSINESS AREA DEFENSE LOGISTICS AGENCY

The Supply Management Business Area consists of six inventory control points and a small number of supporting activities. Operations, material investment, and capital investment (equipment and minor construction) are costs associated with this area. Materiel investment consists of eight separate commodity groups and a retail operating division. The commodity groups are:

- o Clothing and Textiles
- o Medical
- o Subsistence
- o General
- o Industrial
- o Construction
- o Electronics
- o Fuel

Approximately three percent of the number of items that DLA manages are clothing, subsistence, medical, and petroleum products. These items, however, account for over 70 percent of the dollar value of DLA sales. DLA manages approximately 60 percent of the items in the Federal Catalog System and receives more than 26 million requisitions annually, which is approximately 74 percent of all requisitions in the Defense Department. DLA items comprise roughly one-half of the hardware items used by the Armed Forces. Nearly 90 percent of DLA's procurement dollars are awarded competitively.

In FY 1992 DLA's material replacement rate was significantly reduced because:

- o Contract awards for support of Operation Desert Storm could not be terminated or reduced without substantial cost to the Department. As peacetime demand is substantially lower, these inventories were and will be used to satisfy Military Service requirements as they occur without the need to obligate additional funds. Where possible, extensions of the delivery period were negotiated and product was received in FY 1992 and in a few instances will be received in FY 1993.

- o Materiel not used during Operation Desert Storm was returned to U.S. to the wholesale manager or, in some instances, was retained by the Military Services.

DLA nonfuel inventory increased significantly in FY 1992 by \$1 billion dollars. This increase will continue in FY 1993, FY 1994, and FY 1995 as consumable items are transferred from the

FY 92 Overview - Supply Management Business Area Defense  
Logistics Agency

Military Services to DLA for management. The Military Services are decapitalizing their inventory as transfers occur. DLA capitalizations in FY 1992 totaled \$2 billion. Without these capitalizations, DLA inventory would have decreased by over \$1 billion in FY 1992.

The program performance measures for this business area include:

- o Fill Rate/Stock Availability - An output measure that is defined as the percentage of demands processed by the supply system without interruption.

- o Requisition Processing Time - An output measure of timeliness that is defined as the average number of days from receipt of demand to shipment.

- o Acquisition Lead Time - An output measure of effectiveness that is defined as the result of dividing the yearly sales by the average month-end inventory.

**DEFENSE LOGISTICS AGENCY**

**DEFENSE BUSINESS OPERATIONS FUND**

**OVERVIEW  
AND  
SUPPLEMENTAL FINANCIAL  
AND MANAGEMENT INFORMATION  
FOR THE FISCAL YEAR 1992  
FINANCIAL STATEMENTS**

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MANAGEMENT INFORMATION

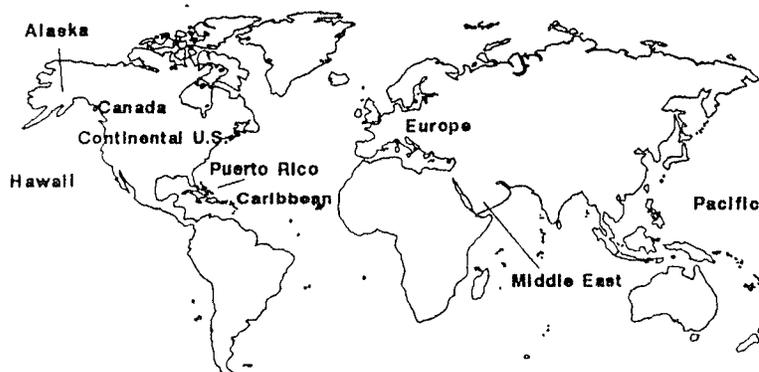
DEFENSE LOGISTICS AGENCY  
OVERVIEW, SUPPLEMENTAL FINANCIAL AND  
MANAGEMENT INFORMATION  
FISCAL YEAR 1992 FINANCIAL STATEMENTS

**DLA MISSION**

The mission of DLA, as a combat support agency, is to provide effective and efficient worldwide logistics support to the Military Departments and the Unified and Specified Commands. DLA provides support under conditions of peace and war to the Military Departments, as well as to other DoD components, Federal agencies, and foreign governments. The agency provides effective logistic support in the areas of contracting, material management, distribution, contract administration and technical support. Our goal is to provide support at the lowest possible cost. DLA manages over three million consumable items. These items include food, fuels, clothing, medical, general, electronics, industrial and construction supplies.

We carry out our worldwide logistics mission from facilities located throughout the continental United States, Alaska, Hawaii, Puerto Rico and Canada. Our overseas facilities operate from locations throughout Europe, the Pacific, the Middle East, and the Caribbean.

**DLA ACTIVITIES WORLDWIDE**



The Defense Construction Supply Center, located in Columbus, Ohio manages 833,000 national stock numbers that include construction equipment and components, lumber and automotive parts

The Defense Electronics Supply Center located in Dayton, Ohio, manages 1,009,000 national stock numbers that include communication equipment and integrated circuits

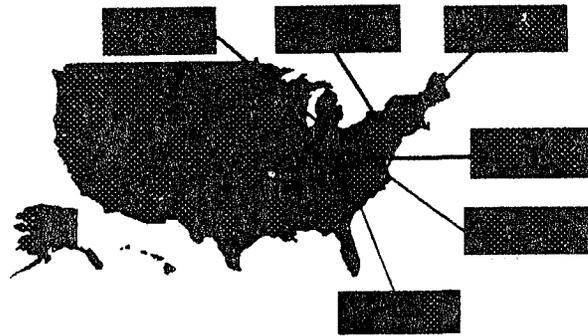
The Defense Fuel Supply Center, located in Alexandria, Virginia, manages petroleum products, natural gas and coal.

The Defense General Supply Center, located in Richmond, Virginia, manages 498,000 national stock numbers that include photographic equipment and supplies, packaged petroleum products and food service equipment.

The Defense Industrial Supply Center, located in Philadelphia, Pennsylvania, manages 960,000 national stock numbers that include industrial hardware items such as bearings, wire and a variety of hardware supplies

The Defense Personnel Support Center, located in Philadelphia, Pennsylvania, manages 105,000 national stock numbers that include food, clothing and textile items and medical supplies.

DLA SUPPLY CENTERS



# DLA Supply Management Division Financial Statements - FY 1992

## DEFENSE BUSINESS OPERATIONS FUND FY 1992 OVERVIEW DEFENSE LOGISTICS AGENCY

### SUPPLY OPERATIONS MISSION

DLA provides logistics services directly associated with furnishing material commodities and items of supply that have been determined to be appropriate for integrated management by a single agency on behalf of all DoD components, or that have been otherwise specifically assigned. DLA also administers assigned Department-wide logistics management systems, programs, and activities, including the provision of technical assistance, support, services, and information.

Supply Operations manages, procures, stores, and issues over three million consumable items. This is accomplished through a network of six inventory control points, three distribution regions and thirty depots.

### EXPANSION OF DLA SUPPLY OPERATIONS MISSION - CONSUMABLE ITEM TRANSFERS

Fiscal year 1992 marked the transfer of management responsibility for approximately a quarter million items from the Military Services to DLA. This was the first year of a phased three year transfer program with slightly more than one-half million items yet to transfer. The initial transfers were accomplished on an automated basis, while maintaining uninterrupted and efficient customer support. Increased assets of \$2 billion dollars and a sales gain of \$140 million were realized as a result of the first year consumable item transfers.

### EMERGENCY SUPPLY OPERATIONS MISSION

The HQ DLA Emergency Supply Operations Center (ESOC) acts as DLA's single focal point to execute supply support in national emergencies, and for disaster relief and humanitarian assistance operations, both foreign and domestic. The most recent examples of ESOC support of disaster relief and humanitarian assistance include:

- o Los Angeles Riot                      Apr 1992
- o Hurricane Andrew                      Aug 1992
- o Haitian Refugee Support              On-Going
- o Operation Provide Comfort            On-Going

DBOF FY 92 Overview Defense Logistics Agency

#### DEPOT CONSOLIDATION

Fiscal year 1992 also marked the acceleration of DMRD 902 which consolidated all former Military Service distribution depots under DLA control. These facilities consist of 30 depots and 62 sites. They have been divided into three geographic regions; Defense Distribution Regions, West, Central, and East; and a stand alone depot at Ogden which includes the Hill and Tooele facilities. Master Memorandums of Agreement with all the Military Services have been signed and depot profiles have been completed. DMRD 902 will save the DoD \$1.2 billion through 1997. To date, \$179.9 million in documented savings have been achieved. The savings consist of \$72 million in personnel costs equating to over 2000 positions; \$68.8 million in canceled military construction projects; and \$39.1 million in unnecessary warehouse equipment and improvements.

#### SECURITY ASSISTANCE

During fiscal year 1992, DLA supported our allies' requirements for clothing and textiles, medical supplies, subsistence items, and repair parts for weapons systems. The programs and the support provided varied significantly. The assistance from DLA included: furnishing DLA managed items and services; providing distribution and transportation functions; providing staging materiel for onward movement to the countries; and drawing down excess from Southwest Asia and Europe. Some of the assistance provided was:

- o Drug Interdiction Program - Mexico (Presidential Determination)
- o UN Peacekeeping Forces - Liberia, Bosnia, Cambodia, Somalia (Presidential Determination and Foreign Military Sales)
- o Disaster Relief - Pakistan (Presidential Determination)
- o Multi-million dollar FMS cases for major defense equipment

#### DEFENSE REUTILIZATION AND MARKETING SERVICE (DRMS)

The fiscal year 1992 DRMS workload increased significantly from fiscal year 1991. DRMS processed \$20.6 billion worth of excess property, which was a 78 percent increase over the \$11.6 billion for fiscal year 1991. The acquisition value of property reutilized increased 46 percent from \$1.1 billion to \$1.7 billion. Transfers/donations increased by 27 percent, and sales proceeds from reusable property rose from \$68.4 million in fiscal year 1991 to \$102 million in fiscal year 1992 for an increase of 49 percent. The increased workload was accomplished with little increase in resources.

## DLA Supply Management Division Financial Statements - FY 1992

DBOF FY 92 Overview Defense Logistics Agency

### FINANCIAL PERFORMANCE

Effective October 1, 1991, the Defense Business Operations Fund (DBOF) was implemented. DBOF is an expansion of the revolving fund concept to a larger number of Defense support functions. The primary goal of the change is to provide a management structure that allows more DoD managers and non-managers the ability to provide the best support at the lowest cost. A major feature of this structure is charging customers for the total cost of industrial and commercial-type services. Reimbursements from the customers provide the working capital for the fund. DBOF operates under a cost per output (referred to as unit cost) basis. Under this basis, all costs incurred within a defined business area are related to the output of that business area.

The DLA portion of the Defense Business Operation Fund consists of the following five business areas:

- o Supply Management
- o Distribution Management
- o Clothing Factory
- o Reutilization and Marketing
- o Industrial Plant Equipment

Unit cost goal achievement is one of the key indicators to measure financial performance of a business area. DLA's unit cost goals and actual unit costs are shown below: (figures are rounded)

<u>BUSINESS AREA</u>	<u>GOAL</u>	<u>FY92</u>	<u>ACTUAL</u>
Supply Management			
Commodity Group:			
Fuel costs per barrel	\$ 30.55		\$ 28.52
Avg Non-Fuel costs per dollar of sales	.75		.73
Distribution Depots			
Cost per Line Items Received & Shipped	\$ 27.48		\$ 24.53
Reutilization & Marketing			
Cost per Haz L/I	\$ 224.82		\$ 264.51
Cost per \$ of proceeds	.64		.53
Industrial Plant Equipment			
Cost per:			
Repair/Rebuild	\$ 68,435		\$ 50,432
Value of New Procurement	48		32
On-site Items Completed	2,027		983

DLA Supply Management Division Financial Statements - FY 1992

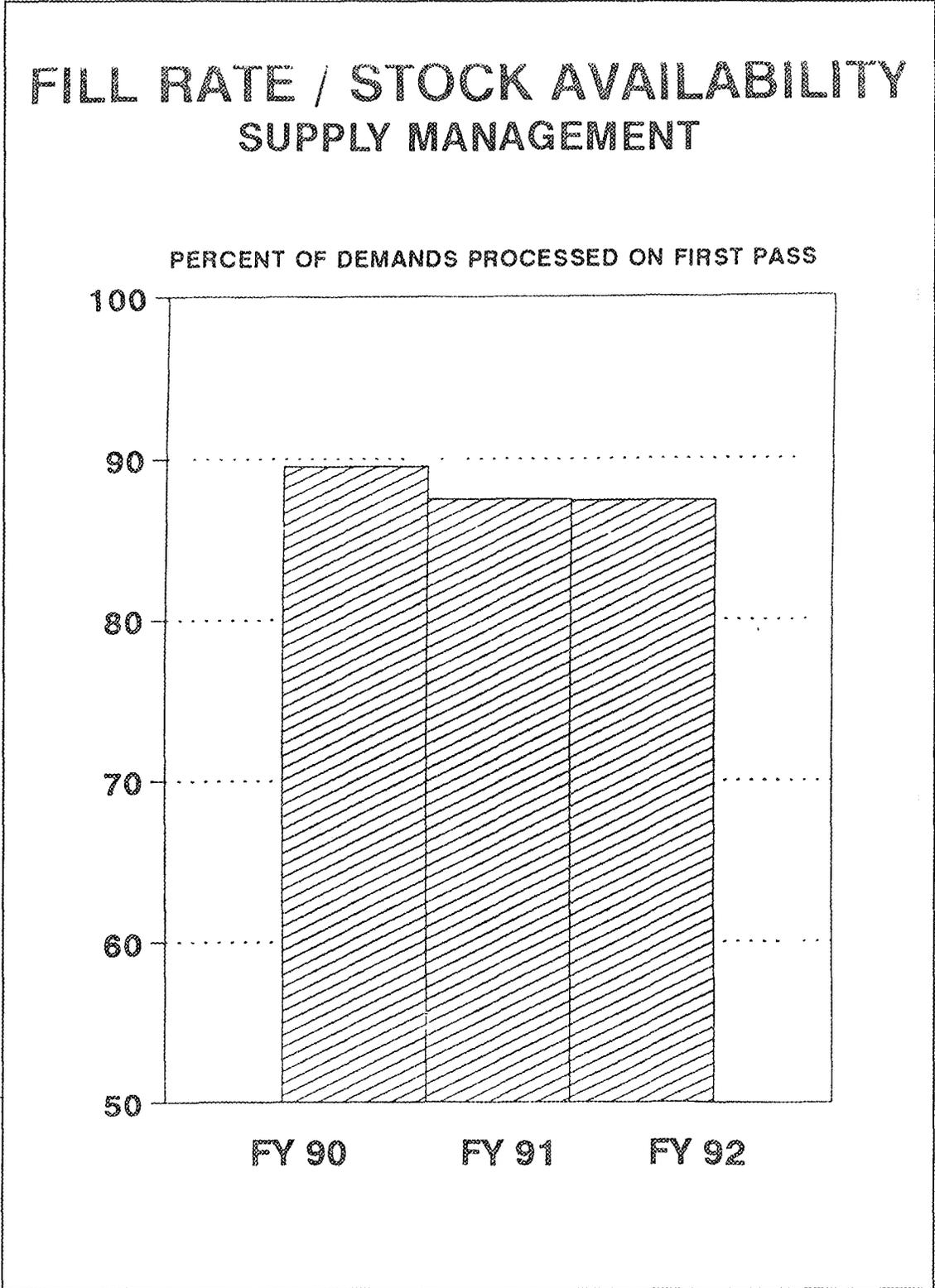
DDOF FY 92 Overview Defense Logistics Agency

<u>BUSINESS AREA</u>	<u>GOAL</u>	<u>FY92</u>	<u>ACTUAL</u>
Clothing Factory (Costs shown are total costs as this business area was not budgeted on a unit basis )	\$ 37.7 Mil		\$ 33.5 Mil
Technical Info Services Cost per Product/Service	\$ 8.48		\$ 9.91
Mission transferred from DLA effective 21 July 1991, DLA reporting according to DoD guidance			

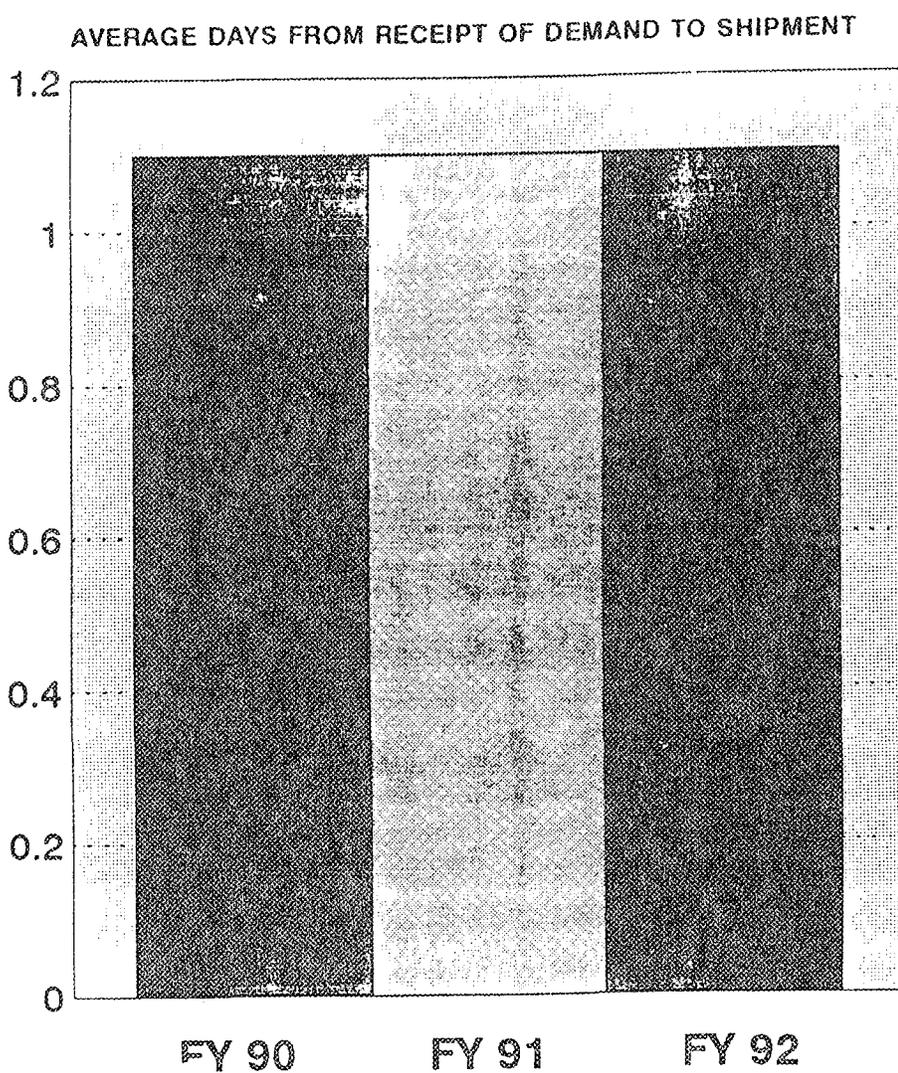
Total inventory after writedowns for fiscal year 1992 increased from fiscal year 1991 (then year dollars) by \$0.403 billion. The Consumable Item Transfers (CIT) were responsible for a \$1.46 billion increase in assets. Excluding CIT, the inventory decreased in value by \$1.046 billion dollars. The inventory was revalued by a writedown of inventories classified as potential reutilization/disposal and inventory for cost of repair. This writedown was responsible for a \$0.606 billion decrease in value of inventory in fiscal year 1992 as compared to fiscal year 1991. Sales at cost exceeded receipts from both procurement and creditable customer returns by \$1.012 billion. Net disposals for fiscal year 1992 were \$0.186 billion greater than fiscal year 1991.

The following table shows obligations, gross sales, and orders/demands for the last three fiscal years:

	<u>FY 90</u>	<u>FY 91</u>	<u>FY 92</u>
Obligations	\$12.1	\$14.8	\$ 9.1
Gross Sales (STD)	\$11.1	\$17.2	\$12.0
Orders/Demands (STD)	\$11.1	\$18.1	\$12.0

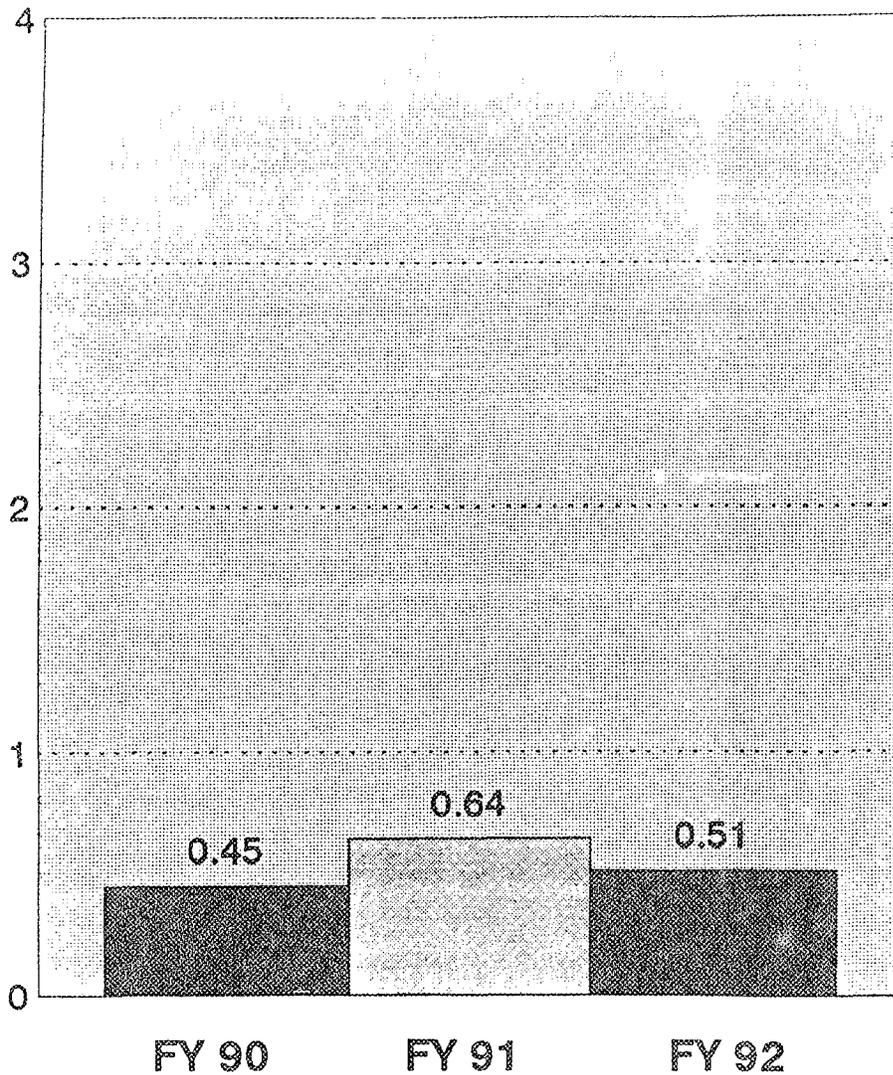


## REQUISITION PROCESSING TIME SUPPLY MANAGEMENT IMMEDIATE ISSUES - ICPs



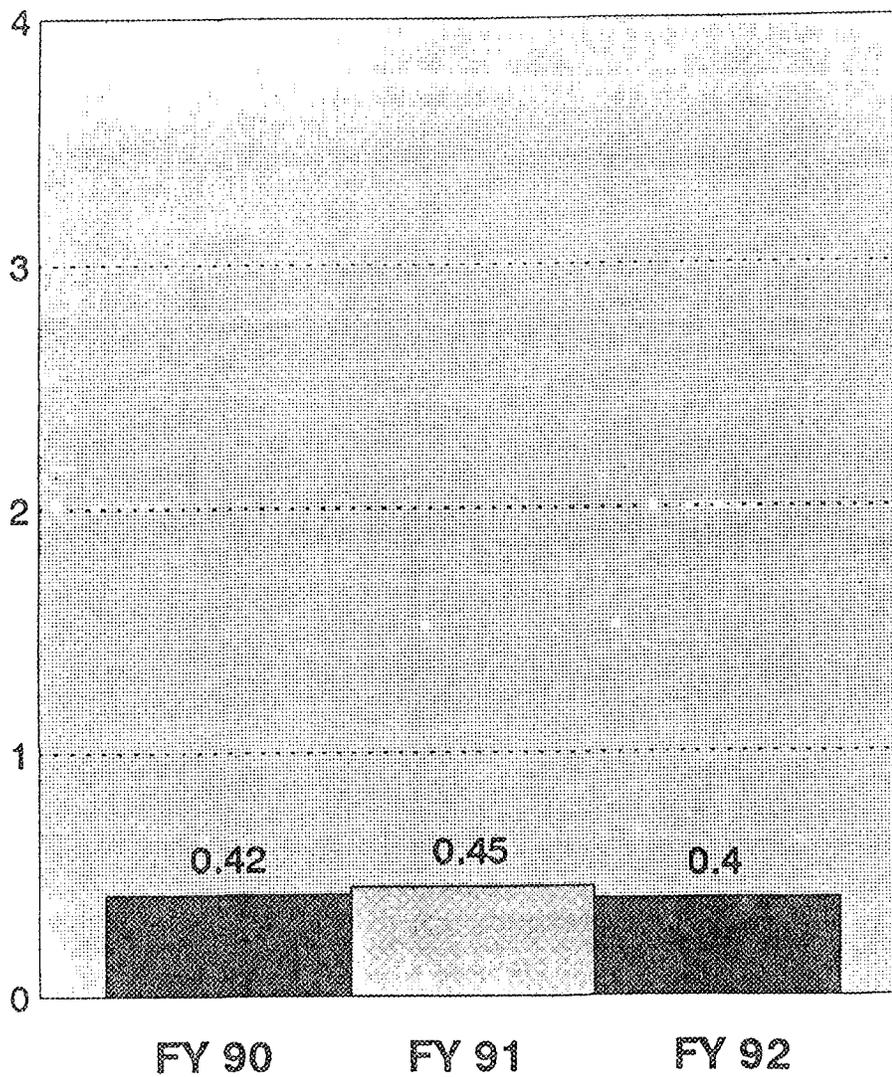
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - CLOTHING & TEXTILES

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



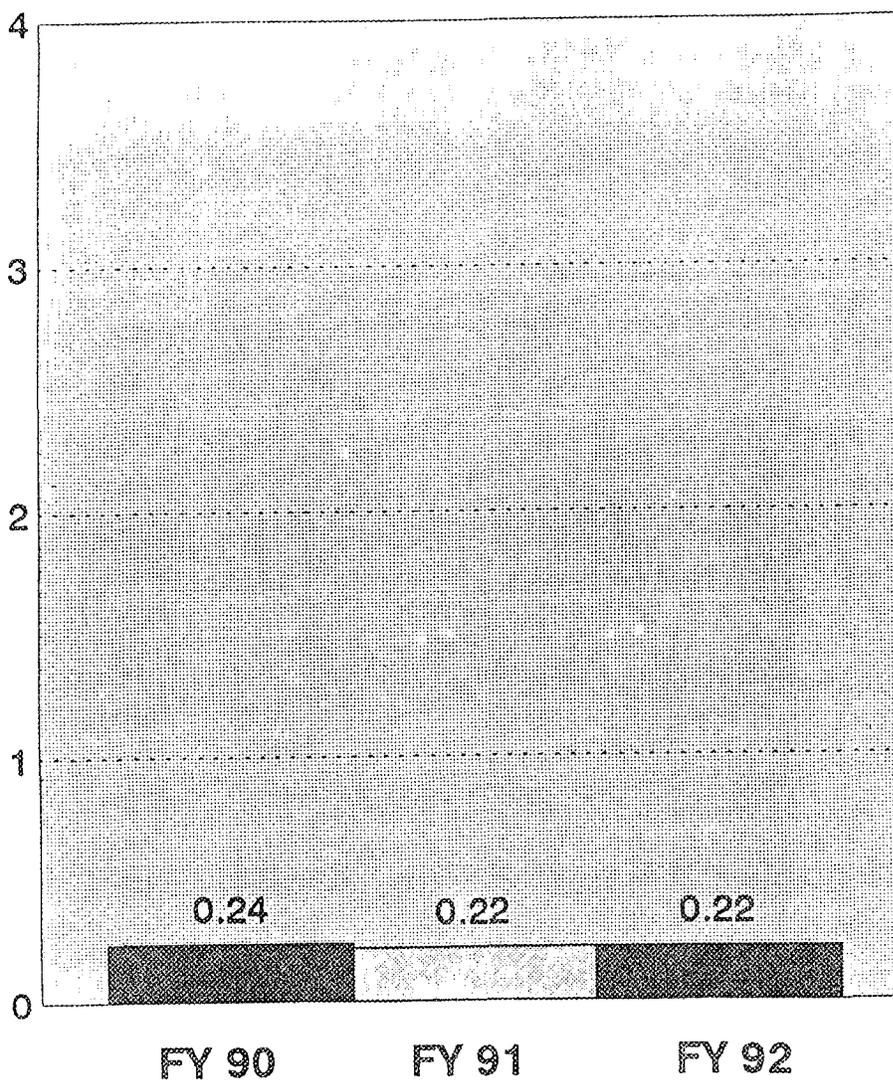
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - CONSTRUCTION

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



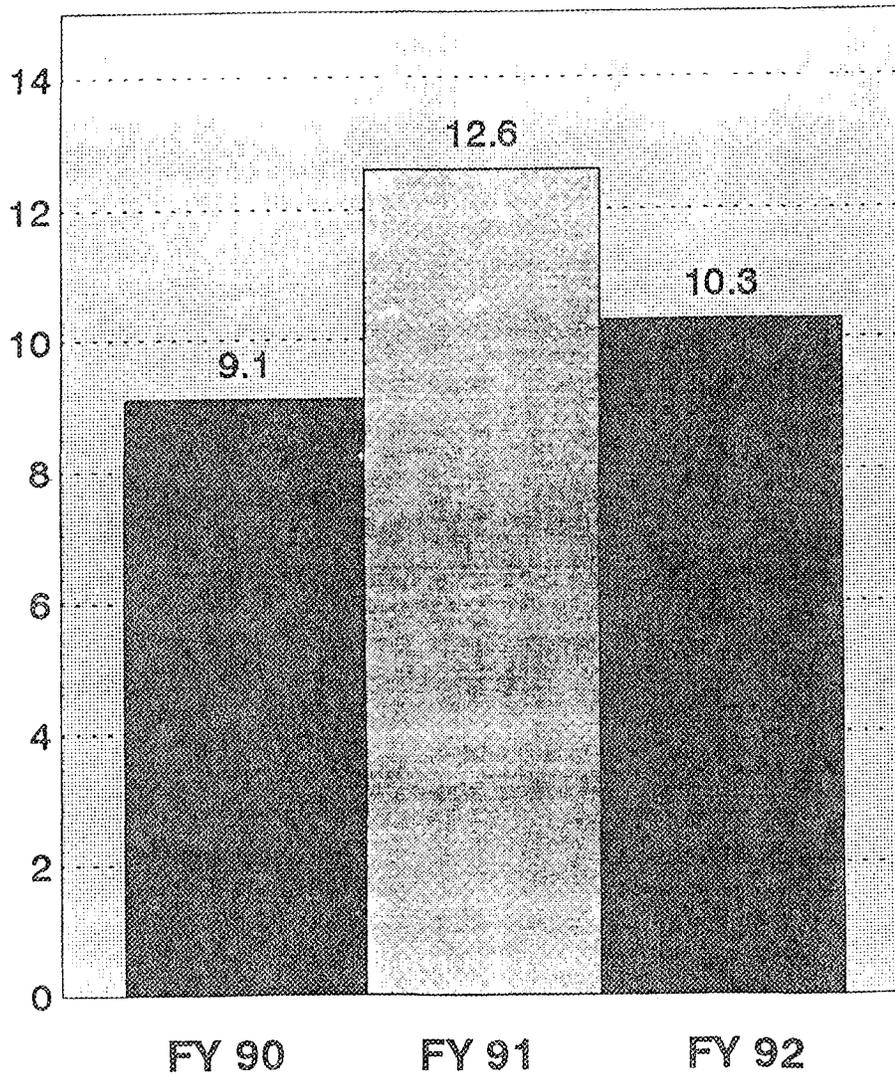
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - ELECTRONICS

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



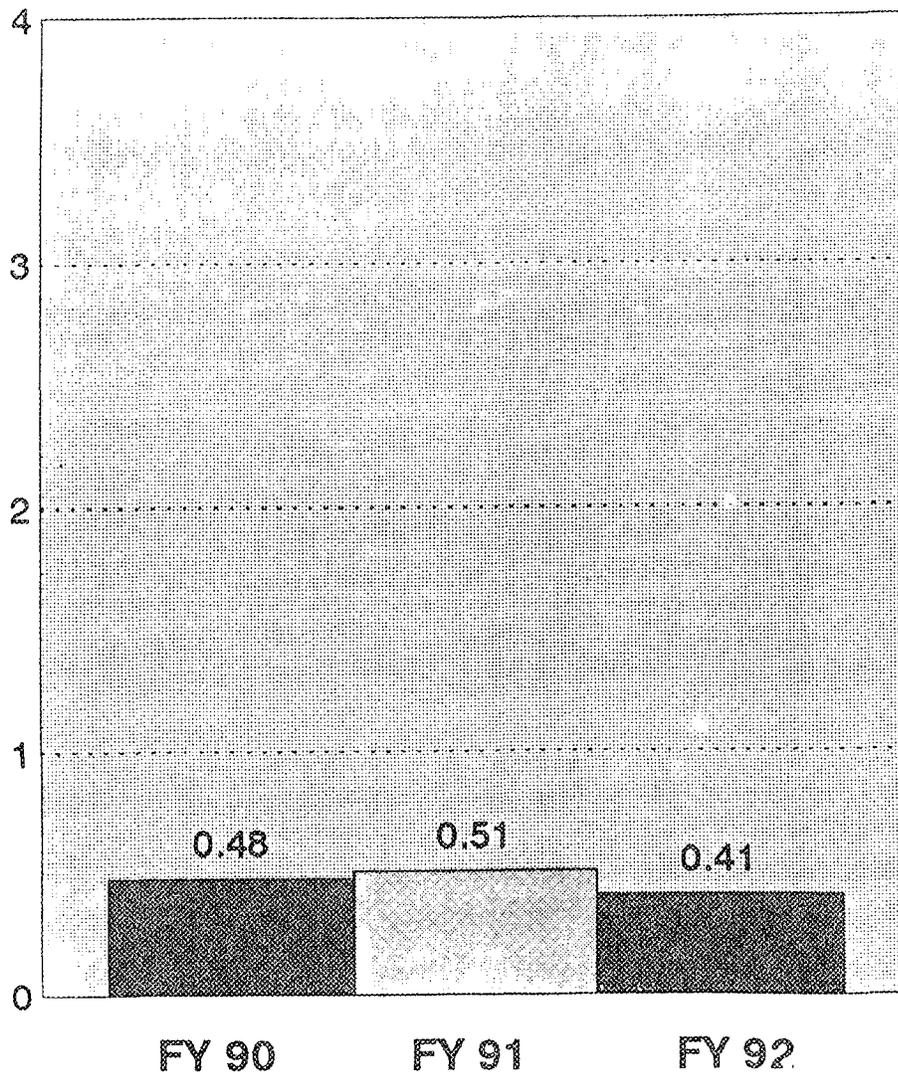
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - FUEL

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



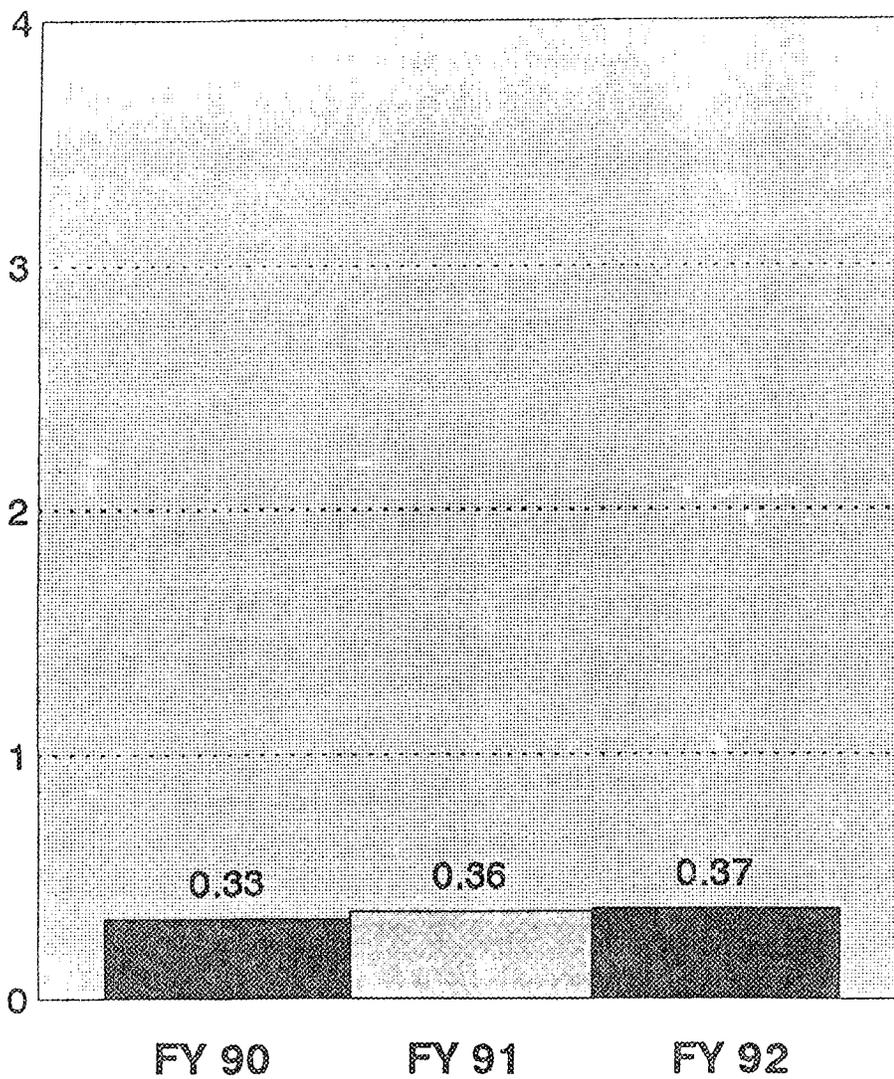
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - GENERAL

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



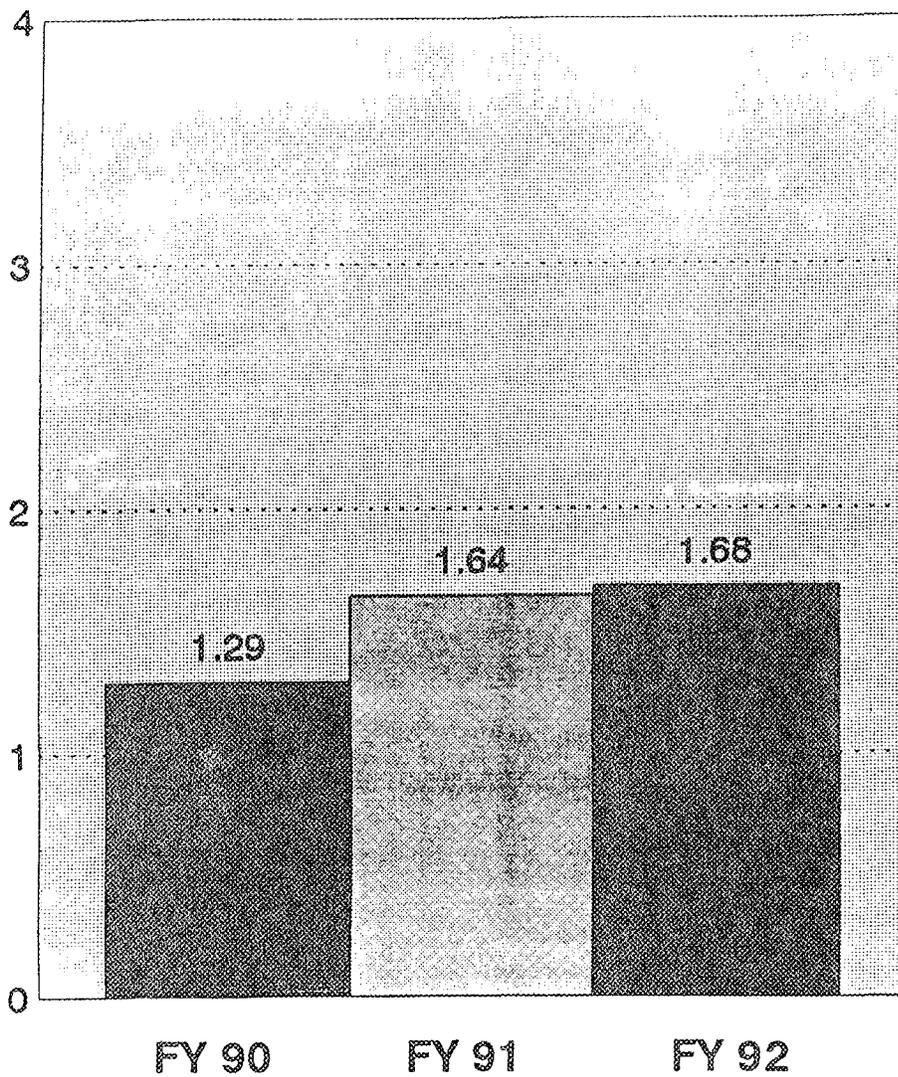
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - INDUSTRIAL

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



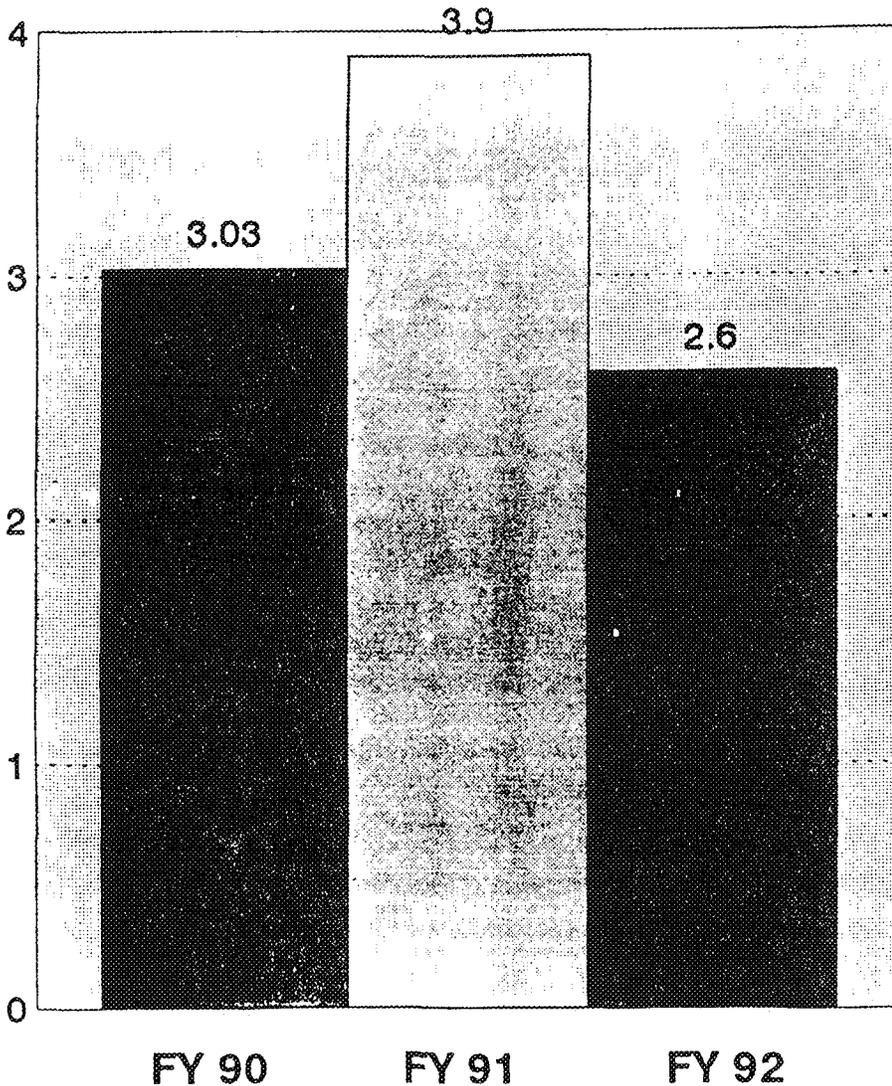
## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - MEDICAL

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



## ACQUISITION LEAD TIME/STOCK TURN SUPPLY MANAGEMENT - SUBSISTENCE

STOCK TURN = YEAR SALES/AVG MONTH-END INVENTORY



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Financial Statements V-4-1-1

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***DEFENSE LOGISTICS  
AGENCY DEFENSE  
BUSINESS OPERATIONS  
FUND SUPPLY  
MANAGEMENT  
  
FINANCIAL STATEMENTS***

DLA Supply Management Division Financial Statements - FY 1992

Financial Statements V-4-1-3

Department/Agency: Department of Defense  
 Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
 Statement of Financial Position  
 as of September 30, 1992  
 (Dollars)

ASSETS	1992
<b>1 Financial Resources:</b>	
a Fund Balances with Treasury	\$375,373,208
b Cash	
c Foreign Currency	
d Other Monetary Assets	
e Investments, Non-Federal	
f Accounts Receivable, Net - Non-Federal	125,440,240
g Inventories Held for Sale, Net	10,997,794,030
h Loans Receivable, Net - Non-Federal	
i Advances and Prepayments, Non-Federal	347,772,578
j Property Held for Sale	
k Other, Non-Federal	
l Intragovernmental Items:	
(1) Accounts Receivable, Federal	1,443,577,577
(2) Loans Receivable, Federal	
(3) Investments, Federal	
(4) Other, Federal	
m Total Financial Resources	<u>\$13,289,957,642</u>
<b>2 Non-Financial Resources:</b>	
a Resources Transferable to Treasury	
b Inventories Not Held for Sale	
c Property, Plant and Equipment, Net	26,887,807
d Other	7,543,646
e Total Non-Financial Resources	<u>\$34,431,453</u>
<b>3 Total Assets</b>	<u>\$13,324,389,095</u>
<b>LIABILITIES</b>	
<b>4 Funded Liabilities</b>	
a Accounts Payable, Non-Federal	239,744,455
b Accrued Interest Payable	
c Accrued Payroll and Benefits	7,652,860
d Accrued Entitlement Benefits	
e Lease Liabilities	
f Debt	
g Guarantees Payable	
h Other Funded Liabilities, Non-Federal	

The accompanying notes are an integral part of these statements

V-4-1-4 Financial Statements

Department/Agency: Department of Defense  
 Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
 Statement of Financial Position  
 as of September 30, 1992  
 (Dollars)

LIABILITIES Continued	1992
i Intragovernmental Liabilities	
(1) Accounts Payable, Federal	\$840,067,718
(2) Debt	
(3) Deferred Revenue	238,494,922
(4) Other Funded Liabilities, Federal	<u>3,088,925</u>
j Total Funded Liabilities	<u>\$1,329,048,879</u>
5 Unfunded Liabilities:	
a. Accrued Leave	29,004,282
b. Lease Liabilities	
c. Pensions and Other Actuarial Liabilities	
d. Other Unfunded Liabilities	
e. Total Unfunded Liabilities	<u>\$29,004,282</u>
6. TOTAL LIABILITIES	\$1,358,053,161
 NET POSITION	
7. Fund Balances:	
a. Revolving Fund Balances	11,995,340,216
b. Trust Fund Balances	
c. Appropriated Fund Balances	
d. Total Fund Balances	<u>\$11,995,340,216</u>
8. Less Future Funding Requirements	<u>29,004,282</u>
9 Net Position	<u>\$11,966,335,934</u>
10 Total Liabilities and Net Position	<u>\$13,324,389,095</u>

The accompanying notes are an integral part of these statements

## Financial Statements V-4-1-5

Department/Agency: Department of Defense  
 Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
 Statement of Operations (and Changes in Net Position)  
 for Period Ended September 30, 1992  
 (Dollars)

REVENUES AND FINANCING SOURCES	1992
1. Appropriations Expensed	
2. Revenues from Sales of Goods	
a. To the Public	
b. Intragovernmental	\$11,961,558,585
3. Interest and Penalties, Non-Federal	
4. Interest, Federal	
5. Taxes	
6. Other Revenues and Financing Sources	28,018,476
7. Less: Taxes and Receipts Returned to the Treasury	
8. Total Revenues and Financing Sources	<u>\$11,989,577,061</u>
EXPENSES	
9. Cost of Goods or Services Sold	
a. To the Public	10,302,717
b. Intragovernmental	10,113,723,864
10. Program or Operation Expenses	1,677,315,729
11. Depreciation	259,267
12. Bad Debts and Write-offs	
13. Interest	
a. Federal Financing Bank/Treasury Borrowing	
b. Federal Securities	
c. Other	523,861,293
14. Other Expenses	<u>523,861,293</u>
15. Total Expenses	<u>\$12,325,462,870</u>
16. Excess (Shortage) of revenues and Financing Sources Over Total Expenses Before Adjustments	(335,885,809)
17. Plus (Minus) Adjustments:	
a. Extraordinary Items	(541,900,000)
b. Prior Period Adjustments	
18. Excess (Shortage) of Revenues and Financing Sources over Total Expenses	(\$877,785,809)
19. Plus: Unfunded Expenses	<u>29,004,282</u>
20. Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses	(\$848,781,527)

The accompanying notes are an integral part of these statements

V-4-1-6 Financial Statements

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Department/Agency: Department of Defense  
Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
Statement of Operations (and Changes in Net Position)  
for Period Ended September 30, 1992  
(Dollars)

EXPENSES Continued	1992
21 Net Position, Beginning Balance	
22 Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(\$877,785,809)
23 Plus (Minus) Equity Transfers	<u>12,844,121,743</u>
24. Net Position, Ending Balance	<u>\$11,966,335,934</u>

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The accompanying notes are an integral part of these statements.

Financial Statements V-4-1-7

Department/Agency: Department of Defense  
 Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
 Statement of Cash Flows (Indirect)  
 for the Period Ended September 30, 1992  
 (Dollars)

Cash Flows from Operating Activities:	1992
1 Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>(\$877,785,809)</u>
<b>Adjustments affecting Cash Flow:</b>	
2 Appropriations Expensed	
3 Decrease (Increase) in Accounts Receivable	(28,742,783)
4 Decrease (Increase) in Loans Receivable	
5 Decrease (Increase) in Other Assets	(661,988,017)
6 Increase (Decrease) in Accounts Payable	(747,309,373)
7 Increase (Decrease) in Debt	
8 Increase (Decrease) in Other Liabilities	(79,559,842)
9 Depreciation and Amortization	259,267
10 Other Unfunded Expenses	36,812,476
11 Other Adjustments	<u>2,741,490,202</u>
12 Total Adjustments	<u>\$1,260,961,930</u>
13. Net Cash Provided (Used) by Operating Activities	<u>\$383,176,121</u>
<b>Cash Flows from Non-Operating Activities:</b>	
14. Proceeds from Sales of Investments	
15. Proceeds from Sales of Property, Plant and Equipment	
16. Purchases of Investments	
17 Purchases of Property, Plant and Equipment	<u>7,802,913</u>
18. Net Cash Provided (Used) by Non-Operating Activities	<u>(\$7,802,913)</u>
<b>CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES</b>	
19 Appropriations (Current Warrants)	
20. Add:	
a. Restorations	
b. Transfers of Cash from Others	
21 Deduct:	
a. Withdrawals	
b. Transfers of Cash to Others	0
22. Net Appropriations	0

The accompanying notes are an integral part of these statements

V-4-1-8 Financial Statements

Department/Agency: Department of Defense  
 Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
 Statement of Cash Flows (Indirect)  
 for the Period Ended September 30, 1992  
 (Dollars)

CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES Continued	1992
23 Borrowing from the Public	
24 Repayments on Loans	
25 Borrowing from the Treasury and the Federal Financing Bank	
26. Repayments on Loans from the Treasury and the Federal Financing Bank	
27 Other Borrowings and Repayments	_____
28 Net Cash Provided (Used) by Financing Activities	
29 Net Cash Provided (Used) by Operating, Non-Operating and Financing Activities	375,373,208
30 Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	
31. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	<u><u>\$375,373,208</u></u>

The accompanying notes are an integral part of these statements

DLA Supply Management Division Financial Statements - FY 1992

Financial Statements V-4-1-9

Department/Agency: Department of Defense  
 Reporting Entity: Defense Logistics Agency DBOF - Supply Management  
 Statement of Budget and Actual Expenses  
 for the Period Ended September 30, 1992  
 (Dollars)

Program Name (s)	BUDGET			ACTUAL
	Resources	Obligations		Expenses
		Direct	Reimbursed	
Supply Management 97X4930 SC	\$11,989,577,061		\$10,008,649,328	\$12,325,462,870
<b>Totals</b>	<u>\$11,989,577,061</u>		<u>\$10,008,649,328</u>	<u>\$12,325,462,870</u>

**Budget Reconciliation**

A. Total Expenses	\$12,325,462,870
B. Add:	
(1) Capital Acquisitions	7,802,913
(2) Loans Disbursed	
(3) Other Expended Budget Authority	
C. Less:	
(1) Depreciation and Amortization	259,267
(2) Unfunded Annual Leave Expense	29,004,282
(3) Other Unfunded Expenses	<u>1,141,097,625</u>
D. Expended Appropriations	\$11,162,904,609
E. Less Reimbursements	<u>11,989,577,061</u>
F. Expended Appropriations, Direct	<u>(\$826,672,452)</u>

The accompanying notes are an integral part of these statements

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Footnotes V-4-1-11

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***DEFENSE LOGISTICS  
AGENCY DEFENSE  
BUSINESS OPERATIONS  
FUND SUPPLY  
MANAGEMENT  
  
FOOTNOTES***

**DEFENSE LOGISTICS AGENCY DEFENSE BUSINESS  
OPERATIONS FUND SUPPLY MANAGEMENT BUSINESS AREA  
FOOTNOTES**

**Note 1: General and Accounting Policies**

The Defense Stock Fund is one of four revolving funds established in the Department of Defense (DoD). The purpose of the stock fund is to procure and maintain an inventory of consumable items used throughout the department. The items are then distributed by sale to other components of the DoD and other government agencies. Sales proceeds are retained in the fund and are available to replenish the inventory.

The Defense Logistics Agency (DLA) is the assigned manager of the Defense Stock Fund and determines operating, budgeting, and accounting practices of the fund based on departmental policies. For management purposes, the fund is divided into 10 commodity and operating divisions. These are:

- Clothing and textiles
- Medical supplies and material
- Subsistence
- Construction supplies
- Electronics supplies
- General supplies
- Industrial supplies
- Bulk operating support
- National Security Agency

Each division is established as an accounting entity and maintains a complete accounting system based on the original standard general ledger for stock funds of the DoD. The reports presented are consolidated reports of all the above divisions.

**Note 2: Fund Balance with Treasury and Cash**

All cash resources available to the fund are included in the Treasury balance. No cash resources of the fund are maintained outside the Treasury account for the fund.

**Note 3: Accounts Receivable**

Receivables from federal agencies are for the sale of supply items in the ordinary course of business of the fund, and substantially all are collected within 30 days from time of sale. The amount of \$1.6 billion is due for sale to federal government contractors and nonfederal government entities. These are collectable 30 days from the time of billing. Noncurrent receivable of \$564,859 are claims against contractors for undelivered for

V-4-1-14 Footnotes

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nonquality material for which recovery of monies paid has been undertaken. Some of these accounts are known to be in bankruptcy and as determinations of uncollectable are made they will be written off. No allowance for uncollectable accounts is provided as amounts written off in any one accounting period are not material in relation to the assets and operating results of the fund.

**Note 4: Advance and Prepayments**

The amount of \$347.8 million represents progress and advance payments made to finance the early phases of contract performance on production contracts. These amounts are collectable against payments for deliveries made on the contract.

**Note 5: Inventories**

Inventories of \$11.0 billion represent the value of stocked material at acquisition cost or net realized value. In the accounting records, inventory is carried at its priced value for resale which includes acquisition cost plus amounts added to cover the cost of inventory management and shipment to customers. An amount of \$2,306 billion is classified as potential excess inventory and \$0.177 billion as unserviceable material. Using DoD guidance, the write down for the potential excess inventory was \$2.253 billion, and the estimated cost of repair of the unserviceable material was \$0.089 billion.

Inventories were adjusted by \$1.9 billion to reflect the correct inventory value of an erroneous acquisition unit price recorded based on incorrect information transferred from the Military Services.

**Note 6: Accounts Payable**

The amount of \$1.1 billion payable to other federal agencies principally consists of payments due other DoD funds for costs of operations of inventory control points and storage depots paid out of these other funds that are applicable to the stock fund. Amounts payable to the public are payments due contractors for delivery of material procured in the ordinary business of the fund.

**Note 7: Unearned Revenue**

Unearned revenue represents amounts received from the Military Services International Logistics Centers and the Defense Security Assistance Agency as the Defense Stock Fund portion of advances or deposits made by foreign countries in support of DoD stock fund inventory levels. There also is an amount received from the Military Services for which the actual sale has not yet been completed.

**Note 8: Other Liabilities**

The amount of \$3.1 million represents an allowance established to cover possible future payment of accounts payable that have been written off. Accounts payable are written off when invoices have not been submitted by contractors. They are considered other liabilities for the periods specified in the Uniform Commercial Code of most States.

**Note 9: Equity**

Cumulative results are reduced from the prior year balance by the net operating loss shown in the statement of operations.

**Note 10: Inventory Restrictions**

There are several restrictions on the use of inventory. Prepositioned War Reserve Material - Protectable was \$2.1 billion (acquisition price). The inventory breakouts were fuels, \$1.7 billion, and subsistence, \$0.4 billion. There is \$0.107 billion of Cooperative Logistics Supply Support Arrangement inventory that is commingled with DLA's inventory. The inventory investments are \$0.050 billion (SDAF) and \$0.057 billion (Military Services).

**Note 11: Expenses**

Current year expenses were adjusted by \$77.7 million for FY 91 expenses recorded on the books in FY 92. FY 92 statements reflect current year expenses only.

**Note 12: Contingencies**

There are no known contingencies that would affect the financial position of the fund.

**Note 13: Significant Events**

Effective 1 October 1991, all assets, liabilities, and capital of the fund were transferred to the Defense Business Operation - Defense Agency Supply Management Business Area. Beginning in April 1992, the inventory values and general ledger accounts were adjusted due to the conversion from standard price to latest acquisition price. There was an increase in the value of inventory and the number of items managed due to the transfer of consumable items from the Military Services.

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Supplemental VI-4-1

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***DEFENSE LOGISTICS  
AGENCY DEFENSE  
BUSINESS OPERATIONS  
FUND***

***SUPPLEMENTAL***

DEFENSE BUSINESS OPERATIONS FUND  
SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION  
DEFENSE LOGISTICS AGENCY  
FY 1992

The following definitions of the financial performance measures stem from DoD guidance. We have provided them here to clarify the graphs on the following pages which depict these measures for each business area.

Definitions of Financial Performance Measures:

Net Operating Costs - The total expenditures minus non-tax revenues and reimbursements received.

Current Ratio - An indicator of financial condition, it is calculated by dividing current assets by current liabilities.

Operating Results - The difference between net operating costs and appropriations, (DBOF is not appropriated funds).

Financial Obligations - The total of current and long-term liabilities.

Capital Investments - The capital expenditures minus the depreciation/disposal of capital assets.

Fund Balance - The fund balance with the Treasury is the impact on DBOF cash.

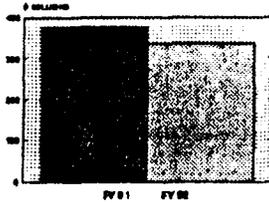
FINANCIAL PERFORMANCE - SUPPLY MANAGEMENT

The Net Operating Cost in FY92 was \$335,885,809. Conversely the Operating Result was -\$335,885,809. The graph for this measure does not include the writedown of inventory as part of the operating results as an inventory writedown (from latest acquisition cost to historical cost) should be classified as an unrealized holding loss, a nonoperating change. The Financial Obligations were \$1,358,053,161. The Fund Balance was \$375,373,208 when 'operations and maintenance' cash was considered. The Current Ratio was 9.9995. The Capital Investments were \$7,543,646.

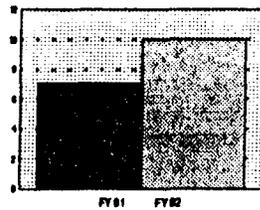
We were able to present FY91 financial information as the financial statements for the former Defense Stock Fund were available and accurately depicted this business area as an accounting entity for FY91.

## SUPPLY MANAGEMENT BUSINESS AREA

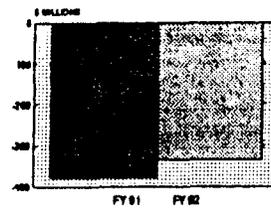
**NET OPERATING COSTS**  
TOTAL EXPENDITURES - REVENUE AND RECEIVABLES



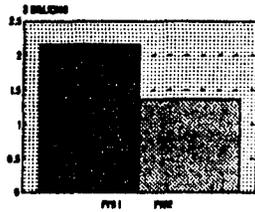
**CURRENT RATIO**  
CURRENT ASSETS / CURRENT LIABILITIES



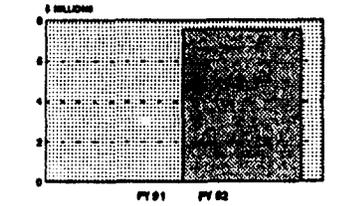
**OPERATING RESULTS**  
REVENUE - COSTS



**FINANCIAL OBLIGATIONS**  
CURRENT & LONG-TERM LIABILITIES

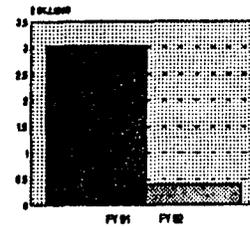


**CAPITAL INVESTMENTS**  
CAPITAL EXPENDITURES - DEPRECIATION



THE FORMER BIP (P&L) DID NOT FUND CAPITAL ACQUISITIONS FOR SUPPLY BIP

**ENDING FUND BALANCE**



**Part VI - Other Issuances Related to this  
Audit**

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## **Draft Report on the Financial Statements of the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund, Issued May 20, 1993**

The following findings, recommendations, and suggested changes to the financial statements were contained in the draft report issued to the Defense Logistics Agency (DLA), Defense Fuel Supply Center, and the Defense Finance and Accounting Service (DFAS). Comments on the draft report were requested by June 10, 1993. Comments from DLA were received too late to be included in the report and neither comments nor revised financial statements were received from DFAS. The findings and recommendations are provided for comment in response to this report.

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## **Finding A. DFSC Financial Management System**

DFSC general ledger account balances were inaccurate and not supported by subsidiary records, accounting procedures were outdated and not properly documented, and the management representation letter provided to us was incomplete. The deficiencies occurred because DFAS and DFSC did not comply with DoD and DLA accounting guidance and there was a lack of procedures addressing the coordination required between DFAS and DFSC to ensure that financial data were accurate.

### **Background**

The Defense Fuel Automated Management System (DFAMS) is used to process, record, and report DFSC financial data. DFAMS records transactions in general ledger accounts provided in DLA Manual 7000.1, "Defense Logistics Agency Accounting Manual." The accounts to be debited or credited are determined by various document, action, and management codes contained in DFAMS transactions. At the end of each accounting month, DFAMS generates a trial balance for DFAS, DFSC, and DLA Headquarters use.

DFSC is responsible for the accuracy of information entered into DFAMS and reported on financial statements. DFAS is responsible for operating and maintaining financial systems, including ensuring the continued integrity of information after the information is entered into DFAMS. We evaluated DFSC FY 1992 trial balance data to ensure that the data were accurate and complete.

### **Unliquidated Obligations**

The DFSC general ledger account balance for unliquidated obligations (ULOs), valued at \$2.95 billion, were inaccurate and reviews to ensure that ULOs were properly recorded were not performed. An obligation is the amount of an order placed, a contract awarded, a service received, or a similar transaction that will require payment. Obligations include adjustments for the difference between the amount originally recorded as an obligation and the actual charges for the transaction. A ULO is an unpaid obligation comprised of either undelivered orders or accounts payable (orders that have been delivered but not paid).

Agency heads are responsible for ensuring that amounts reported as obligations include all known obligations and that documents support the obligations, as required by United States Code (U.S.C.), title 31, sections 1108, 1501, and 1502. The head of each agency is required to include in the agency's appropriation request to the President (through OMB) a certified statement that the obligations presented in the request are consistent with U.S.C., title 31.

## Draft Report Finding A. DFSC Financial Management System

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The certifications and records showing the obligated amounts supporting the certifications are to be maintained in a form that makes audits and reconciliations easy. Agencies are also required to submit quarterly Standard Form 225, "Report on Obligations," to the Secretary of the Treasury to assist the Secretary in preparing reports on the financial operations of the Government.

**DFAS and DFSC Review of Unliquidated Obligations.** DFAS and DFSC were not performing the required reviews of ULOs. The DLA Accounting Manual states that ULOs will be reviewed quarterly, at a minimum, to ensure the accuracy and completeness of recorded obligations, to provide a basis for certifying that the obligation data comply with U.S.C., title 31, and to detect system deficiencies. The guidance further provides that workpapers and records supporting the verification, adjustment, or deobligation of ULOs will be retained in a manner to facilitate audit and reconciliation, and the results of the review will be reported to the certifying official. Since required reviews were not performed, inaccuracies in DFSC ULO accounting data were not corrected.

**Support for Unliquidated Obligations.** Subsidiary records did not support \$2.95 billion of ULOs recorded in the DFSC trial balance. DFSC Manual 4730.2, "DFAMS Users Manual," states that the financial status report provides summary support for entries made to the general ledger ULO account. In accordance with the Manual, DFSC maintains aged listings of accounts payable and undelivered orders that provide details, such as contract number, contract line number, and payable or undelivered dollar value, to support the financial status report. The value of the ULOs shown in the FY 1992 reports totaled \$2.73 billion, \$.22 billion less than the ULO general ledger account.

DFSC personnel advised us that support for the \$.22 billion could be found in manual journal vouchers made to supplement DFAMS data. They provided us summary data showing the value of manual journal vouchers for accounts payable and undelivered orders. The summary figures supported the \$.22 billion. However, a review of the summary figures showed that there were negative ULOs of approximately \$355.7 million. Negative ULOs are errors and indicate problems with the accounting system. Negative ULOs were recorded in accounts payable and undelivered orders.

- For accounts payable, the sum of the manual journal vouchers amounted to approximately \$70 million. Yet our analysis of DFSC financial data showed that in FY 1992 the credits for accounts payable manual journal vouchers exceeded debits by \$240.4 million. The discrepancy means that if the \$70 million is correct, the FY 1992 beginning balance for accounts payable would have been a negative \$170.4 million; again, indicating a problem with the accounting system.

- For undelivered orders, the sum of the manual journal vouchers amounted to \$149.5 million. However, the \$149.5 million was a net figure of \$334.8 million of positive undelivered orders and \$185.3 million of negative undelivered orders. Negative ULOs are errors in the accounting system.

## Draft Report Finding A. DFSC Financial Management System

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Details to support the summary figures for the manual journal vouchers were not maintained in a manner that the auditors, DFAS, or DFSC personnel could reasonably review. To determine the details (contract numbers, contract line items, etc.), all supporting lines for every manual journal voucher would have to be reviewed for subsequent matching with expenditure transactions. Manual journal voucher data should be aged and contain the same information provided in the aging listings for DFAMS accounts payable and undelivered orders.

**Audit Review of Unliquidated Obligations.** Because details to support the manual journal voucher portion of the ULO account balances were not in a condition for audit, we limited our review to data in the DFAMS payables and undelivered aging reports. We reviewed transportation expenses, service expenses, and bulk fuel reports. We judgmentally selected contract or agreement lines in the reports to verify the accuracy of the payables or undelivered order balances to the supporting documents. As discussed below, payables or undelivered order balances were inaccurate or unsupported.

**Transportation Expenses.** Payables totaled \$160.5 million and undelivered orders totaled \$2.3 million for transportation expenses. Approximately \$137 million were payable for expenses related to Government bills of lading (GBLs). We attempted to verify the validity of the payables, but we were unable to identify the specific GBLs that made up the payables. The aged accounts payable register categorized the payables under the caption "contract agreement no.," which showed the fiscal year that the payable was established. Budget personnel assigned the contract agreement number to control funds. Approximately \$93 million of the \$137 million were payables over 120 days old. DFSC personnel advised us that the payables probably had been paid and were not valid. We did not evaluate the \$2.3 million of undelivered orders.

**Service Expenses.** For service expenses, payables totaled \$14.8 million and undelivered orders totaled \$662.4 million. Service expenses include costs for contractor-operated bulk fuel terminals and commercial testing of fuel samples. We selected a judgment sample of \$1.4 million of the accounts payable and found that \$1.1 million was invalid because payments were made and the payables were not liquidated.

In analyzing the \$662.4 million of undelivered orders, we found that there were negative undelivered orders of \$22.2 million (negative undelivered orders indicate a problem with the accounting system). We also selected a judgment sample of \$109.7 million of the undelivered orders and found that \$72.9 million were invalid because the services had been provided, the payments had been made, but the undelivered orders had not been liquidated.

**Bulk Fuel.** Payables for bulk fuel totaled \$279.1 million and undelivered orders totaled \$1.62 billion. For accounts payable, contracts with payables of \$45 million were completed and paid for in past periods and retired to the National Records Center. Retiring records with outstanding payables was previously reported in our FY 1991 audit of DLA financial data.

## Draft Report Finding A. DFSC Financial Management System

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We selected a judgment sample of \$10.7 million of payables and found that \$1.4 million was invalid because payments had been made to liquidate the payables.

Regarding the undelivered orders of \$1.62 billion, we concentrated our review on the \$241.4 million that was undelivered for more than 360 days. Of the \$241.4 million, \$154.9 million was invalid primarily because modifications to decrease the obligation amount were not processed against the undelivered orders.

### Reconciliation Process

DFAS and DFSC were not properly implementing DoD guidance that requires general ledger accounts to be reconciled to supporting records. The DoD Accounting Manual states that accounting systems shall include adequate controls to promote the accuracy of the financial accounts and the data produced from the accounts. The Manual further provides that procedures shall be established for periodic verification of general ledger account balances with related balances in subsidiary records, and for periodic verification of subsidiary records with related supporting documents.

**Reconciliation of General Ledger Account Balances.** In 1989, the DLA Financial Systems Evaluation Office (DFSEO), currently DFAS Headquarters (Accounting Directorate, FMFIA Division, Richmond Detachment), evaluated DFAMS and other accounting operations at DFSC to determine whether DoD, OMB, and GAO criteria for adequacy of systems operations, systems integrity, and support for management were met. DFSEO reported that the reconciliation of general ledger control accounts for assets and liabilities to subsidiary records was not performed. DFSEO recommended that monthly reconciliations be performed and adjustments be processed when appropriate.

In 1990, DFSEO did a follow-up to its 1989 evaluation to determine the status of corrective actions taken. DFSEO reported that the reconciliation method being used was to reconcile monthly activity for all general ledger accounts, instead of reconciling to subsidiary support. DFSEO also reported that DFSC had supportable opening balances on October 1, 1989, and concluded that the reconciliation of monthly activity was more effective. We disagree. Regardless of whether or not the October 1, 1989, account balances were reconciled (we have no basis to evaluate if the opening balances were accurate), DoD guidance requires that general ledger account balances, which would include beginning balances and new activity, be reconciled to subsidiary records and related supporting documents. Unless the required reconciliations are performed, there is no assurance that general ledger account balances are accurate. As shown in this report, general ledger account balances for some accounts were inaccurate.

**DFAS and DFSC Coordination.** Procedures to describe how reconciliations that would require input from both organizations, such as accounts payable, ULOs, and financial inventory accounts would be conducted

was nonexistent. DFSC is responsible for the accuracy of information entered in financial systems and reported on financial statements. DFAS is responsible for operating and maintaining financial systems, including the continued integrity of information after it is entered into financial systems. To ensure that DFSC financial data are accurate, timely, and properly recorded, close coordination between DFAS and DFSC is required. However, detailed procedures on reconciliations were not developed to ensure that financial data were accurate and that the reconciliation process works as intended.

## **Undistributed Disbursements and Collections**

Monthly disbursement and collection data were available, but were not maintained in sufficient detail to support undistributed disbursements of \$492.7 million and undistributed collections of \$356 million. Collection and disbursement transactions processed by a disbursing officer increase or decrease the cash available for disbursement by the U.S. Treasury. The undistributed disbursements and undistributed collections general ledger accounts are used by DFSC to control and reflect the differences between the cash collections and disbursements made by disbursing officers in a given period. The validated cash collection and disbursement vouchers are posted to DFSC accounting records in the same period that collections and payments of accounts receivable and payable are made. At the end of the accounting year, undistributed disbursements are closed to accounts payable and undistributed collections are closed to accounts receivable.

DLA accounting procedures state that the balances in undistributed disbursement and collection accounts affect the validity of the financial statements and assets and liabilities of the entity. Accordingly, a reconciliation is required each month to identify and prove the balances in those accounts. The DFAS Columbus Center/DFSC Office reported a material weakness related to reconciling undistributed disbursements in its FY 1992 FMFIA report. This internal control weakness was first reported in FY 1987.

## **Claims Receivable**

The claims receivable general ledger account balance of \$11.3 million was not supported by subsidiary records. Claims receivable are amounts due from commercial carriers and vendors for damages and losses related to shipments of material. Subsidiary records to support the account were \$167,000 less than the general ledger account. We compared the details in the subsidiary records to data maintained by DFSC supply and legal directorates. We found numerous differences, such as claim amounts and claims on supply and legal records, that were not in the subsidiary records and vice versa. For example, legal records showed claims of \$15.3 million while the subsidiary records related to legal claims showed only \$7.4 million. This disparity was reported in our FY 1991 audit of the DLA Defense Stock Fund financial statements.

## **Post, Camp, and Station Billings**

DFSC procedures did not provide for timely recording of sales and billings for fuel sales at military installations. The DoD Accounting Manual states that DoD Components performing work or services on a customer order shall bill the customer within 30 days after the month in which the work or service occurred. DFSC was not billing post, camp, and station (PC&S) customers in accordance with the DoD guidance.

DFSC awards contracts for the Services' PC&S fuel requirements. The requirements are primarily for fuel oils, motor gasoline, and diesel fuels at individual military installations. Customers order fuel from suppliers, citing DFSC funds, and send copies of each order and receipt to DFSC for payment to the supplier and billing to the customer. DFSC PC&S sales in FY 1992 were approximately \$270 million.

DFSC uses a two-step process to record the transaction and pay PC&S suppliers and bill PC&S customers. It prepares disbursement vouchers from customer order and receipt documentation to record PC&S purchases and cost of sales in the accounting records and to process payments to suppliers. Customer billings and entries to the accounting records to record the sales, on the average, are not done until 60 to 90 days after payments are made to the suppliers. We found no reconciliation process between disbursements and sales to ensure that all purchases were billed. Untimely billing was reported in DFSC's 1989 FMFIA report. Additionally, in October 1991, a draft PC&S billing procedure was developed to correct the untimely billing and to reconcile disbursements to sales, but the procedure was not implemented.

## **DFAMS Procedures**

DFSC accounting procedures were not properly documented, and the DFAMS Users Manual was outdated and not available. GAO Policy and Procedures Manual For Guidance of Federal Agencies (Title 2), states that an agency's accounting system, including manual and automated components, must be documented. The documentation must be complete, current, and maintainable and of sufficient scope to provide management, users, and auditors with an understanding of the system's design and operation. User documentation should focus on financial management and accounting aspects; document how users interact with and use the system; describe coordination needed with other groups or systems; and provide users with accounting policies, processes, and procedures.

The DFAMS Manual was printed in February 1984 and has been updated once, in June 1986. Additionally, only a few copies were available for our use and for the activity's use. Significant events have occurred since 1986 that affect DFAMS, but they are not included in the Manual. Those events include the establishment of DFAS; system changes to improve operations, such as the implementation of the Automated Voucher and Disbursement System; and

implementation of corrective actions to address GAO; IG, DoD; and DFSEO recommendations addressing problems with financial and accounting operations. The lack of adequate written guidance creates uncertainty as to the proper methods to be used by personnel in processing and accounting for financial transactions.

## **Manual Journal Vouchers**

DFSC had no procedures to require management level review and approval of manual journal vouchers. The DFSC trial balance included data processed through DFAMS and financial data from manual journal vouchers. Manual journal vouchers are prepared to record financial data for transactions not processed through DFAMS and to correct financial data previously entered into DFAMS. The accounting technician who prepared the voucher and the supervisor who approved the voucher must sign the voucher. DFSC FY 1992 financial data showed that manual journal vouchers accounted for 5,021 individual debit and credit transactions valued at \$77.7 billion.

In some cases vouchers were incorrectly prepared, and an individual who was subordinate to the individual that prepared the voucher approved it. For example, financial data used to record the revenue for general ledger surcharge accounts for inventory losses, transportation, and operation and maintenance (O&M) on manual journal vouchers were incorrectly computed. The computation understated the revenue in the general ledger accounts by \$37.3 million. The individual who approved the voucher was not in a supervisory position. Because of the significant dollar value of manual vouchers, procedures need to be developed to describe the management level required to review and approve the vouchers. Different levels could be established based on the value of individual vouchers.

## **Prior Period Adjustments**

DFSC was erroneously recording financial data for adjustments of prior period transactions in FY 1992 financial data. The financial data were entered into the trial balance from manual journal vouchers. There were net adjustments to revenue general ledger accounts of \$4.2 million (\$4.7 million debits and \$8.9 million credits) and net adjustments of expense general ledger accounts of \$163.9 million (\$217.8 million debits and \$381.7 million credits). As a result, FY 1992 income was understated by \$159.7 million. Prior period adjustments should not be charged against current year operations, but should be reported as adjustments to previously reported results. This condition was reported in our FY 1991 audit of DLA Defense Stock Fund financial statements.

## **Management Representation Letter**

The management representation letter provided by DFSC was incomplete. The American Institute of Certified Public Accountants auditing standard No. 19, "Client Representations," requires auditors to obtain written representations from management as part of an audit performed in accordance with generally accepted auditing standards. Written representations from management ordinarily confirm oral representations given to auditors, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.

The specific representations obtained by the auditor depend on the circumstances of the audit and the basis of presentation of the financial statements. The representation letter should be signed by members of management who are responsible for and knowledgeable, directly or through others in the organization, about the matters covered by the representation. Management's refusal to furnish a written representation letter constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion on the financial statements.

On February 12, 1993, we requested that the Commander, DFSC, provide us a representation letter from DFSC management, and since the preparation of the financial data was a joint responsibility of DFAS and DFSC, we also requested that the Commander provide us a representation letter from DFAS. Along with the request, we provided samples of letters that included the representations that we believed were material to DFSC financial data. On March 9, 1993, the DFSC provided us a representation letter signed by the Director, Directorate of Resource Management.

The letter did not contain all the DFSC representations suggested in our sample letter and stated that since DFAS is responsible for finance and accounting support on behalf of DLA, and in an effort to preclude further delay, we should solicit a management representation letter directly from DFAS.

Regarding the DFSC representations, the letter did not include seven of the nine representations included in our sample letter. The seven representations addressed material issues that we believe are DFSC responsibilities or matters that, if aware of them, DFSC should disclose. Examples of representations not addressed are listed below.

- o DFSC is responsible for the fair presentation of general trial balance data in conformity with accounting principles and standards as defined in the DoD Accounting Manual.

- o There are no violations or possible violations of laws or regulations of which effects should be considered for disclosure in the financial statements or a basis for recording a loss contingency.

- o No events have occurred subsequent to the balance sheet date that would require adjustment to or disclosure in the financial statements.

We disagree with DFSC's statement that we should solicit management representations directly from DFAS. The accuracy of the trial balance data is DFSC's responsibility, and the process to ensure that the financial data are accurate and properly presented in financial statements should be a coordinated effort between DFAS and DFSC. Such action is part of the normal accounting process, not based solely on financial data subject to audit. Our position is supported by guidance issued by the Acting Comptroller, DoD. In a September 25, 1992, memorandum, "Financial Management Responsibilities," the Acting Comptroller stated that DoD Components are responsible for the accuracy of information entered into financial systems and reported on financial statements. Concerning DFAS responsibilities, the memorandum stated that DFAS is responsible for operating and maintaining financial systems, including ensuring the continued integrity of information after it is entered into financial systems by various DoD Components.

## **Recommendations for Corrective Action**

1. We recommend that the Director, Defense Logistics Agency (DLA), and the Director, Defense Finance and Accounting Service (DFAS):

a. Perform the required quarterly reviews of Defense Fuel Supply Center (DFSC) unliquidated obligations (ULOs) to ensure that the ULO general ledger account balance is accurate and complete. Additionally, DLA and DFAS should ensure that documentation is maintained to support the reviews.

b. Develop procedures to age and provide detail support for DFSC accounts payable and undelivered order balances related to manual journal vouchers. The level of support should be the same as Defense Fuel Automated Management System (DFAMS) accounts payable and undelivered order aging reports.

c. Revise the DFSC aged accounts payable register for transportation expenses to identify specific Government bills of lading that are payable.

d. Revise the FY 1992 financial statements to provide accurate data for DFSC ULOs, accounts payable, undistributed disbursements, undistributed collections, and claims receivable general ledger accounts or footnote the statements to disclose the conditions identified. Additionally, revise the statements to record DFSC prior period adjustments of \$159.7 million as adjustments to previously reported results.

e. Develop procedures to reconcile DFSC general ledger account balances, not just monthly activity for an account, with subsidiary records and to periodically validate subsidiary records with related supporting documentation. The procedures should also address the coordination required between DFAS and DFSC to ensure that the reconciliations are properly performed.

## **Draft Report Finding A. DFSC Financial Management System**

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f. Develop procedures to ensure that DFSC billings for post, camp and station sales are billed in a timely manner, in accordance with the DoD Accounting Manual, and that disbursements for post, camp, and station purchases are reconciled to billing data.

g. Update the DFAMS Users Manual so that it is complete, current, and maintainable. The manual should be of sufficient scope to provide management and users with an understanding of the systems design and operation. Additionally, provide sufficient copies of the Manual for internal and external use.

h. Develop procedures for the management level review and approval of manual journal vouchers for DFSC financial data.

i. Develop procedures and controls to ensure that material prior period adjustments are reported as adjustments to previously reported results and not charged against current year operations.

2. We recommend that the Commander, DFSC, revise the March 9, 1993, management representation letter to include all representations in the sample DFSC management letter we provided, and obtain a representation letter from DFAS that addresses representations included in the sample DFAS letter we provided.

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## **Finding B. Supply Management Division's Financial Statements**

Financial data in the Supply Management Division's (the Division) financial statements were not properly supported and information in the notes, overview, and supplemental financial and management information portions of the financial statements were incomplete and inaccurate. The conditions existed because DLA and DFAS did not follow DoD accounting procedures and DoD guidance for preparing financial statements; and reviews were not done to ensure that data in the Division's financial statements were accurate and properly supported. As a result, the financial statements contained inaccurate data and did not provide useful information.

### **Background**

"DoD Guidance on the Form and Content of Financial Statements for FY 1992 Financial Activity" provides instructions necessary to prepare FY 1992 financial statements. The guidance states that DLA and DFAS are jointly responsible for preparing the financial statements and that their efforts should be coordinated.

The Division's financial statements included financial data for its 10 commodity and operating divisions, DLA Headquarters financial data, and O&M financial data recorded in the DFAS Appropriation Accounting System (AAS). Commodity and operating divisions' financial data are for transactions related to procuring, storing, and selling consumable supplies. DLA Headquarter's financial data primarily relate to accounts payable and accounts receivable not recorded in commodity and operating divisions' financial records. O&M financial data primarily relate to personnel and overhead costs incurred to support the mission of the commodity and operating divisions.

### **Financial Data**

DLA Headquarters' financial data of \$.9 billion and O&M financial data of \$1.8 billion included in the Division's financial statements were not supported by subsidiary records or developed from official accounting records. The DoD Accounting Manual states that financial transactions shall be adequately supported with pertinent documents and source records.

**DLA Headquarters Financial Data.** DLA Headquarters' financial data of \$.9 billion was not supported by subsidiary records. The financial data included account balances of \$367 million of undistributed disbursements, \$160 million of accounts payable, and \$418 million of undistributed collections.

## Draft Report Finding B. Supply Management Division Financial Statements

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Neither DLA nor DFAS personnel were able to provide us documentation to support the account balances. In addition, when undistributed disbursements and collections were closed out at year end, the accounts payable balance was a negative \$206.6 million and the accounts receivable balance was a negative \$418.3 million. Neither account should have a negative balance.

**Operation and Maintenance Financial Data.** O&M financial data of \$1.8 billion was not developed from official accounting records. The Division's financial statements showed Federal accounts receivable of \$1.44 billion and Federal accounts payable of \$840.1 million. The O&M portion was \$1.21 billion (84 percent) of the receivables and \$543.3 million (65 percent) of the payables. The O&M financial data were not supported by the AAS trial balance. Trial balance general ledger accounts showed a \$134.3 million debit in Federal receivables, a \$120.5 million debit in undistributed collections, a \$611.6 million credit in Federal payables and a \$1.4 billion credit in undistributed disbursements. After closing out the undistributed collections and disbursements at year end, the trial balance Federal accounts receivable equaled \$254.8 million (a \$955.2 million difference than reported) and Federal accounts payable equaled \$2.01 billion (a \$1.47 billion difference than reported). The GAO "Policy and Procedures Manual for Guidance of Federal Agencies" states that, except where estimates are clearly appropriate, information included in external reports required by OMB should be from the general ledger or accounts under general ledger control. If financial data or reports are based on sources other than the agency's official system, their basis should be clearly explained. The financial statements contained no footnotes related to O&M Federal accounts receivable or payable.

We did not perform a detailed review of the O&M Federal receivables and payables data included in the Division's financial statements or shown on the trial balance. However, an analytical evaluation of the data raises serious concerns about the accuracy of the reported data and the trial balance. The \$1.21 billion of reported accounts receivable is not consistent with the reported annual revenue of \$267.2 million. The trial balance showed a \$120.5 million debit in undistributed collections when the normal account balance is a credit, and a \$1.4 million credit balance for undistributed disbursements when the normal account balance is a debit. In January 1992, DFAS-Columbus Center issued a memorandum to DFAS Headquarters describing DFAS-Columbus Center's inability to reconcile detail collections and disbursements to the summary totals reported through the U.S. Treasury. The DFAS Columbus Center summary data did not provide details of secondary business areas such as O&M. As a result, DFAS-Columbus Center could not reconcile undistributed disbursements and maintain overall accounting integrity.

The computation of O&M adjustments affecting cash flows included in the Division's Statement of Cash Flows was not consistent with the commodity divisions' computation. The commodity divisions determined the adjustment by computing the change in account balances between the end of FY 1991 and FY 1992. O&M adjustments were computed only on FY 1992 financial activity because DFAS considered the ending FY 1991 balance to be zero. The computation is not correct since the adjustments are computed on asset and liability accounts that would include an ending FY 1991 balance.

**Division's Financial Statements.** Subsidiary records were not available to support Other Adjustments of \$2.74 billion in the Division's Statement of Cash Flows and \$1.14 billion of Other Unfunded Expenses in the Division's Statement of Budget and Actual Expenses. The figures were plugged based on other data in the statements. Other Adjustments should comprise the net of the periods cash transfer transactions, prior period adjustments, and extraordinary items. Other Unfunded Expenses include all current period expenses, except depreciation and unfunded accrued annual leave, for which budget authority will be provided in future years' appropriations and for allocating the costs of assets capitalized in prior years.

## **Notes to Financial Statements**

The Division's financial statements did not contain required footnote disclosures. DoD guidance on the form and content of principal statements provides footnote formats for basic disclosure needs of reporting entities. Footnotes should provide information that may affect the use, understanding, and interpretation of the financial statements.

Footnotes were not prepared for property and equipment of \$26.9 million, depreciation practices related to property and equipment, the revolving fund balance of \$12.0 billion, and other expenses of \$.5 billion. Additionally, the footnotes did not contain all relevant information about the Division, and some of the footnotes contained inaccurate information. Examples are below.

- o Footnotes stated that sales proceeds of the Division are retained in the Division and are available to replenish inventory. Revenue or cash generated from the fund are not retained in the fund but are maintained at the DoD level.

- o Footnotes did not disclose information related to O&M financial data accumulated in the DFAS AAS.

## **Division's Overview and Supplemental Information**

The Division's overview and supplemental schedules did not contain information related to the financial results and condition of the Division. Performance and financial measures were presented, but contained no narrative or analysis to describe how the measures compared to the Division's mission, goals and objectives, and if applicable, the reasons goals or objectives were not achieved and the plans for achieving or modifying the objectives in subsequent years.

DoD guidance on the form and content of financial statements states that the overview portion of the statements must provide readers with a clear and concise understanding of the reporting entity's activities, accomplishments, financial results and condition, problems, and needs. The preparer of the

overview must consider performance measures and data relevant to the entity's mission; analyze the data and discern what the data disclose about the entity's accomplishments or lack thereof; determine whether and why the results might vary from established standards; and write succinct, candid narratives. Important aspects of the reporting entity's financial operations should be discussed and relevant trends identified. The guidance further provides that each financial statement shall include financial performance measures. Supplemental information presents details on information found in the overview, or information that would otherwise enhance an understanding of the financial condition and operations of the entity.

## **Crosswalk of General Ledger Accounts to Financial Statements**

Documented procedures were nonexistent to show which DLA general ledger accounts were used to develop the various lines on the Division's financial statements. DoD guidance on the form and content of FY 1992 financial statements provides a crosswalk from the various lines on the financial statements to the DoD uniform chart of general ledger accounts. The guidance does not crosswalk all lines because there is no single ledger account associated with certain lines on the statements.

The 10 commodity and operating divisions and the DFAS AAS did not use the DoD uniform chart of accounts. The DLA Accounting Manual prescribes a chart of accounts for the commodity and operating divisions and another for the AAS. Therefore, to prepare the financial statements, DFAS personnel had to crosswalk both sets of DLA general ledger accounts to the DoD uniform chart of accounts, then crosswalk the DoD accounts to the lines on the financial statements.

To determine how the individual lines were developed, we discussed each line with DFAS personnel to determine the source of data used (general ledger account, adjustment vouchers, etc.) to develop the financial data on each line. We believe that the crosswalk process should be documented to provide a consistent methodology and an audit trail to support the financial statements that would facilitate management and audit review of the statements to ensure that the financial data are accurate.

## **Recommendations for Corrective Action**

We recommend that the Director, Defense Logistics Agency (DLA), and the Director, Defense Finance and Accounting Service (DFAS):

1. Evaluate the trial balance financial data for DLA Headquarters and operation and maintenance Federal accounts payable and Federal accounts receivable financial data used to develop the Supply Management Division's

## **Draft Report Finding B. Supply Management Division Financial Statements**

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financial statements to determine if the data are accurate and properly supported. If the data are inaccurate, correct the data or disclose the conditions in the footnotes to the financial statements.

2. Evaluate the rationale for not using the Appropriation Accounting System (AAS) general ledger accounts to determine operation and maintenance Federal accounts receivable and Federal accounts payable. If the general ledger accounts do not provide accurate data, develop procedures to correct the AAS.

3. Evaluate the inconsistency in computing adjustments affecting cash flows between the commodity divisions and operation and maintenance. If the operation and maintenance computation was improper, correct the data. If the computation was proper, disclose the rationale for the computation in the footnotes to the statements.

4. Develop procedures and controls to ensure that DLA Headquarters and operation and maintenance financial data used to develop the Supply Management Division's financial statements are properly supported. The procedures should address the DFAS-Columbus Center's inability to reconcile undistributed collections and disbursements that were raised in its January 1992 memorandum to DFAS Headquarters.

5. Provide support for the general ledger accounts and reporting entity, commodity division or operation and maintenance, for Other Adjustments of \$2.74 billion on the Division's Statement of Cash Flows and Other Unfunded Expenses of \$1.14 billion on the Statement of Budget and Actual Expenses. If support is not available, disclose the conditions in the footnotes to the financial statements.

6. Revise the footnotes to the financial statements to ensure that the footnotes are accurate and that all footnotes required by "DoD Guidance on the Form and Content of Financial Statements for FY 1992 Financial Activity" are provided.

7. Revise the Supply Management Division's overview and supplemental financial and management information portion of the financial statements to ensure that the data provided are accurate and to provide a narrative discussion and analysis of financial results and condition of the Supply Management Division along with information describing how the performance and financial measures compared to the Supply Management Division's mission and goals.

8. Develop procedures to describe the process used to prepare the financial statements. At a minimum, the procedures should crosswalk DLA general ledger accounts to the various lines on the financial statements.

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## **Finding C. Federal Managers' Financial Integrity Act**

DFSC and DFAS Columbus Center/DFSC Office implementation of the FMFIA was inadequate. Additionally, DFSC did not report its implementation of the FMFIA program as a material weakness. The conditions occurred because internal management control reviews (IMCRs) did not determine whether subsidiary ledger accounting records were periodically verified to supporting documentation, material weaknesses were not properly tracked or reported, and procedures had not been established to describe the coordination required between DFSC and DFAS to comply with DoD policy on implementing the FMFIA. As a result, some general ledger account balances and the FY 1992 DFSC and DFAS Columbus Center/DFSC Office FMFIA reports were not accurate.

### **Background**

The FMFIA was enacted in September 1982 to strengthen internal control and accounting systems throughout the Federal Government. The FMFIA requires the head of each executive agency to prepare and submit annual reports to the President and the Congress that reflect the results of assessments and detailed reviews of the internal accounting and administrative control systems. Section 2 of the FMFIA requires that agency systems of internal accounting and administrative controls provide reasonable assurance that revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets.

"DoD Guidance on the Form and Content of Financial Statements for FY 1992 Financial Activity" states that the quality of the financial statements depends on the adequacy of the internal controls underlying the statements. It places emphasis on full and complete implementation of the FMFIA.

In January 1991, DFAS was established to manage accounting and finance operations previously performed by the Services and Defense agencies. In May 1991, DLA and DFAS signed a memorandum of understanding to document the relationship and responsibilities for the systems that support finance and accounting functions transferred from DLA to DFAS. DFAS agreed to provide finance and accounting support for DLA and its field activities. The DFAS Columbus Center/DFSC Office provides support to DFSC. OMB Bulletin 93-06 requires that we review the process by which weaknesses are identified, evaluated, and reported under the FMFIA. We evaluated the DFSC and DFAS FMFIA process related to fuels financial data.

## DFSC Internal Management Control Program

DFSC and DFAS Columbus Center/DFSC Office implementation of the FMFIA was inadequate. Additionally, DFSC did not report its lack of adequate implementation of the FMFIA program as a material weakness in its FY 1992 FMFIA report to DLA Headquarters.

DoD Directive 5010.38, "Internal Management Control Program," provides policy and procedures for DoD's program for internal management control. An IMCR is a detailed examination of a system of internal management control to determine whether adequate internal control measures exist and are implemented in a cost-effective manner to prevent or detect the occurrence of waste, loss, unauthorized use, or misappropriation of assets. Primary level field activities of DLA and DFAS are responsible for conducting IMCRs.

**DFSC's FY 1992 FMFIA Report.** DFSC did not report its lack of adequate implementation of the FMFIA program as a material weakness, even though a November 1992 report prepared by DFSC's internal review office reported that DFSC did not properly implement the FMFIA. The DFSC Office of Internal Review issued a report, "Internal Review of the Internal Management Control Program," November 5, 1992, that discussed DFSC's implementation of the FMFIA for FYs 1990 and 1991. The report concluded and management generally concurred that DFSC's implementation of the FMFIA internal management control (IMC) program was inadequate. The report made 42 recommendations to improve the IMC program. Examples of some of the conditions in the report follow.

- o The entire DFSC IMC program appears to be deficient in the areas of understanding, reporting, training, assessment reviews, and material weakness tracking.

- o Internal control operations regarding open material weaknesses appears to be progressing toward closure on paper, but were not in fact corrected within each reporting organization.

- o During FYs 1990 and 1991, no documentation was available to support material weaknesses with a duration of 6 months or longer and key material weaknesses were not tracked to ensure that corrective action was implemented.

- o No DFSC assessable unit listings were maintained for FYs 1990 and 1991. The lack of current assessable unit listings allowed the various assessable units to report inaccurate assessments.

- o The DFSC IMC program manager did not interact with the IMC representatives, supervisors, and mid- and top-level managers.

- o The lack of IMC program manager internal guidance to devise up-to-date policies for reporting internal control maintenance allowed the IMC program to deteriorate at DFSC and its Regional offices.

## **Draft Report Finding C. Federal Managers' Financial Integrity Act**

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DFSC did not report in its FY 1992 FMFIA Statement of Annual Assurance to DLA that material weaknesses had been identified in its FMFIA program. Instead, DFSC reported that its system of internal accounting and administrative control, along with other mechanisms of DFSC in effect during FY 1992, provided reasonable assurance that the objectives of the FMFIA were achieved within prescribed limits. The conditions that its internal review office noted were reported in Section A of the FMFIA report, "Description on the Concept of Reasonable Assurance and How the Evaluation was Conducted."

DFSC personnel advised us that they had taken steps to correct conditions noted in the internal review report and they believed actions taken negated reporting the FMFIA program as a material weakness. We agree that DFSC took some steps to improve the FMFIA program. However, improvements in key deficiencies of the program, such as inadequate documentation to support internal management control reviews, tracking of material weaknesses, and inadequate vulnerability assessments will not be known until DFSC's implementation of the program in FY 1993. As a result, we believe that the DFSC FMFIA process should have been reported as a material weakness.

Because of the findings of the internal review office, we limited our analysis to reviewing IMCRs to determine whether the IMCRs addressed the DoD Accounting Manual requirement that activities periodically verify subsidiary accounting records with related supporting documents. Documentation available to support the results of the IMCRs showed that this process was not evaluated.

**DFAS Columbus Center/DFSC Office FY 1992 FMFIA Report.** The DFAS Columbus Center/DFSC Office did not report all material weaknesses related to DFSC financial operations in its FY 1992 FMFIA report. The FMFIA report addressed one material weakness related to undistributed disbursements. The report stated that the subsidiary components of the undistributed disbursements account had not been completely reconciled. Responsibility for the material weakness along with three other weaknesses related to DFSC financial data were transferred from DFSC to DFAS. DFSC considered the three weaknesses as closed (corrective actions had been taken). We found no documentation to show that corrective actions had been taken to correct two of the three weaknesses reported as closed. The two weaknesses included inadequate reconciliation of accounts payable to the general ledger and untimely billing for posts, camps, and stations. Additionally, our analysis of the two weaknesses showed that the conditions still existed (Finding A).

**DFSC and DFAS Columbus Center/DFSC Office FMFIA Coordination.** Procedures were nonexistent to describe how IMCRs that would require input from DFSC and DFAS Columbus Center/DFSC Office, such as evaluations of controls over ULOs and financial inventory accounts, would be conducted. To ensure that the accuracy, timeliness, and proper recording of DFSC financial data are addressed in the FMFIA process, close coordination between DFSC and DFAS is required. However, detailed procedures were not developed to describe the coordination required to ensure that controls over the accuracy of financial data are working as intended.

## **Recommendations for Corrective Action**

1. We recommend that the Director, Defense Logistics Agency, and the Director, Defense Finance and Accounting Service (DFAS):

a. Require that internal management control reviews conducted under the Federal Managers' Financial Integrity Act (FMFIA) determine that subsidiary accounting records are periodically verified to supporting documentation.

b. Develop procedures to describe the coordination required between the Defense Fuel Supply Center (DFSC) and DFAS to properly implement the FMFIA program of each entity to ensure that DFSC financial data are accurate.

2. We recommend that the Commander, DFSC, correct the conditions in the DFSC's internal review report, "Internal Review of the Internal Management Control Program." If the conditions are not corrected, the weakness should be reported in the DFSC FY 1993 FMFIA report.

3. We recommend that the DFAS Columbus Center/DFSC Office include the weaknesses related to the untimely billing of posts, camps, and stations and inadequate reconciliation of accounts payable to the general ledger in its FMFIA evaluation process.

# Audit Team Members

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