Audit Report

AUTOMATED SYSTEMS USED TO PREPARE THE DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND FINANCIAL STATEMENTS

Report No. 00-027 October 28, 1999

Office of the Inspector General
Department of Defense

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Acronyms

BOSS	Base Operation Support System
DFAS	Defense Finance and Accounting Service
DFAMS	Defense Fuels Automated Management System
DISMS	Defense Integrated Subsistence Management System
DLA	Defense Logistics Agency
DSS	Distribution Standard System
FAS	Fuels Automated System
OMB	Office of Management and Budget
SAMMS	Standard Automated Materiel Management System
USGSGL	United States Government Standard General Ledger
WCF	Working Capital Fund

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October 28, 1999

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT Audit Report on Automated Systems Used to Prepare the Defense Logistics Agency Working Capital Fund Financial Statements (Report No 00-027)

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

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The comments from the Deputy Comptroller, Defense Logistics Agency were generally responsive to recommendations A.2, A.3, A.4, B.2, and B.4. However, we request additional information and documentation pertaining to recommendations A.3, B.2, and B 4. Comments were not responsive to recommendations A.1, B.1, and B.3. We request that the Defense Logistics Agency provide the additional information, documentation, and comments on the recommendations by December 27, 1999.

We appreciate the courtesies extended to the audit staff For additional information on this report, please contact Mr James L Kornides at (614) 751-1400, extension 11 (jkornides@dodig.osd.mil), or Mr. Timothy F. Soltis at (614) 751-1400, extension 13 (tsoltis@dodig osd.mil) See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Report No. 00-027 **October 28, 1999**
(Project No. 9FJ-2005.02)

Automated Systems Used to Prepare the Defense Logistics Agency Working Capital Fund Financial Statements

Executive Summary

Introduction. Prior audits of the Defense Logistics Agency (DLA) Working Capital Fund financial statements have shown that significant deficiencies existed in the way automated systems were designed and how they processed financial data. The inability of DLA and the Defense Finance and Accounting Service to overcome the deficiencies has been a major factor preventing DLA from obtaining favorable audit opinions.

Because of the size and complexity of its Working Capital Fund, DLA relies extensively on automated systems to carry out programs, manage resources, and report program cost and performance information. The automated systems processed and summarized transactions that comprised assets of $12.7 billion, liabilities of $1.8 billion, revenues of $14 3 billion, and program costs of $14 0 billion that were reported on the FY 1998 consolidated financial statements. Most of the automated systems that DLA used were designed primarily to manage programs and functions (such as inventory, property, and fund control) However, many of the systems also process the financial data that the Defense Finance and Accounting Service used to prepare the Working Capital Fund financial statements

Objectives. The overall objective of the audit was to determine whether DLA and the Defense Finance and Accounting Service Columbus Center, Columbus, Ohio, adequately identified and evaluated key automated systems to determine whether they provide complete and reliable information to prepare the FY 1999 DLA Working Capital Fund financial statements. We also evaluated applicable management controls See Appendix A for a discussion of the scope and methodology and the management control program.

Results. DLA and the Defense Finance and Accounting Service Columbus Center did not adequately identify and evaluate critical accounting, finance, and feeder systems Specifically:

- Although DLA and the Defense Finance and Accounting Service Columbus Center performed limited reviews of their accounting and finance systems, they did not identify and fully document the system problems. As a result, insufficient information was available to adequately describe the current system environment and to develop transition plans to attain systems that comply with Federal requirements Additionally, the DLA annual statement of assurance did not adequately reflect the effect that the system and related control deficiencies had on DLA's ability to prepare reliable financial statements (finding A)

- DLA did not define and evaluate the complete system architecture it used to capture the financial data that the Defense Finance and Accounting Service Columbus Center used to prepare the DLA Working Capital Fund financial statements. As a result, DLA did not have an adequate basis to determine the impact that potential feeder system deficiencies have on its financial statements or the effort required to correct the deficiencies. Costly system modifications could result if the requirements are not considered when new systems are fully implemented (finding B).

Summary of Recommendations. We recommend that the Director, DLA, in conjunction with the Defense Finance and Accounting Service Columbus Center, perform comprehensive reviews of the DLA accounting and finance systems, document the results, and provide specific milestones when system deficiencies will be corrected We also recommend that the Director coordinate the DLA strategy and milestones with the Director, Defense Finance and Accounting Service Columbus Center; assign specific responsibilities to DLA personnel; identify all critical DLA feeder systems; document transaction processing, and establish a formal review process to evaluate the feeder systems Further, we recommend that the Director report its inability to prepare reliable financial statements as a material weakness in its annual statement of assurance

Management Comments. The Deputy Comptroller, DLA, partially concurred with the recommendations and stated that DLA is committed to improving its automated systems He stated that DLA has reviewed the accounting and finance systems, coordinated a strategy to replace the systems with the Defense Finance and Accounting Service, assigned specific responsibilities for corrective action, and identified and evaluated all feeder systems. A discussion of management comments is in the Findings section of the report and the complete text is in the Management Comments section.

Audit Response. Management comments were partially responsive. DLA indicated it had performed limited reviews of its automated systems and determined that none of them substantially complied with Federal requirements. However, DLA did not identify all feeder systems that supply financial data to the accounting and finance systems. Additionally, the reviews that were done were not comprehensive enough to document the flow of transactions through the systems and to determine the impact that system deficiencies had on the financial statements. Further, DLA did not provide documentation showing that it had assigned specific responsibilities to DLA personnel for correcting each system deficiency. Also, information about DLA's analysis of what financial information resides in the integrated logistics systems (including the Fuels Automated System), the sources of that information, how DLA tested the reliability of the system data, and how DLA crosswalked the information to the general ledger accounts was not provided. We request that DLA provide the additional information and comments on the recommendations by December 27, 1999.

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Background

Prior audits and management self-disclosures have shown the need for improved automated systems and related controls to enhance financial reporting. Specifically, deficiencies in the way the automated systems processed financial transactions and their inability to produce adequate audit trails have been major factors preventing the Defense Logistics Agency (DLA) from receiving favorable audit opinions. This audit focused on the adequacy of the processes that DLA and the Defense Finance and Accounting Service (DFAS) Columbus Center, Columbus, Ohio, used to evaluate key accounting, finance, and feeder systems

Defense Logistics Agency Working Capital Fund. The DLA Working Capital Fund (WCF) provides supply support and logistics services to U S. military forces worldwide. The DLA WCF finances five business activity groups located throughout the U.S. and overseas, encompassing supply management, materiel distribution, excess materiel reutilization and sale, information services, and printing services. The FY 1998 DLA WCF consolidated financial statements reported assets of $12.7 billion, liabilities of $1 8 billion, revenues of $14.3 billion, and program costs of $14.0 billion. Major functions performed by the activity groups include the following

- Activity groups perform integrated management of more than 4 million repair parts that support more than 1,400 weapon systems. The repair parts that DLA managed account for about 82 percent of the total number of supply items that DoD organizations manage.

- Activity groups maintain accountable records for approximately 6 million line items, valued at more than $90 billion (standard price)[1] and stored at 20 DLA distribution depots. The depots encompass about 266 million cubic feet of occupied storage space and process approximately 26 million receipt and issue transactions annually

- Activity groups coordinate the reuse and sale of billions of dollars of excess, surplus, and hazardous DoD property.

- Activity groups provide printing and document automation services for DoD and other Federal agencies

Federal Systems Requirements. The Federal requirements for compliant financial management and feeder systems are described in Public Law 104-208, the "Federal Financial Management Improvement Act of 1996," September 30, 1996; Office of Management and Budget (OMB) Circular No. A-127, "Financial Management Systems," July 23, 1993; and a series of Federal Financial

[1] The $90 billion represents the unadjusted total value of all inventory and other property stored at the DLA distribution depots at the end of FY 1998 It does not equal the total inventory value reported in the DoD consolidated financial statements because different valuation methods are used for financial statement reporting

Management System requirements published by the Joint Financial Management Improvement Program. See Appendix B for details of the requirements.

DoD Plan to Comply With Federal Requirements. The National Defense Authorization Act of 1998 directed DoD to create a Biennial Financial Management Improvement Plan (Biennial Plan) The Biennial Plan sets out the Department's first ever attempt to describe current and future financial management operations in DoD.

The Biennial Plan encompasses the DoD accounting and finance systems and the program feeder systems that originate and provide an estimated 80 percent of the data processed by the accounting and finance systems The Biennial Plan provides two parallel tracks to achieving compliant systems. The first track addresses accounting and finance systems and is being implemented by the Under Secretary of Defense (Comptroller) and DFAS. The second track requires the DoD Components, including DLA, to address system deficiencies of the feeder systems In both cases, the Biennial Plan provides the general strategy for converting outdated unreliable systems to fully integrated and compliant systems. Key elements of the Biennial Plan include the following

- **Concept of Operation.** The concept of operation addresses the financial management roles and responsibilities, financial management policy, system architecture, oversight, and technical infrastructure needed to comply with existing Federal requirements.

- **Current Environment.** The current environment describes the system environment at the time of review Defining the current system architecture and gaining a detailed understanding of key system processes and interdependencies, transaction flow, and system strengths and weaknesses is essential to developing realistic transition plans.

- **Transition Plan.** A transition plan documents the actions needed to move from the current environment to an operating environment envisioned in the concept of operation. The transition plan must include specific milestones and action plans to convert existing systems or to procure new systems.

Objectives

The overall objective of the audit was to determine whether DLA and the DFAS Columbus Center adequately identified and evaluated key automated systems to determine whether they provide complete and reliable information to prepare the FY 1999 DLA WCF financial statements. We also evaluated applicable management controls. See Appendix A for a discussion of the scope and methodology and the management control program.

A. Defense Logistics Agency Working Capital Fund Accounting and Finance Systems

Although DLA and the DFAS Columbus Center performed limited reviews of their accounting and finance systems, they did not identify and fully document system problems because they did not have an adequate review process or transition plan. Specifically, their process and plan need improvement for the following reasons

- The review process used to evaluate the accounting and finance systems followed outdated DFAS criteria for evaluating automated systems.
- The review process did not consider all relevant Federal requirements In addition, system users did not adequately document the flow of financial transactions and other data through the systems.
- Previous transition plans were not funded, were abandoned, changed significantly, or were not completed on time. The current plan did not assign specific responsibility to DLA and DFAS personnel or allocate funds to fix the system problems.
- DFAS and DLA did not adequately coordinate their plans in terms of strategy and milestones.

As a result, insufficient information was available to adequately describe the current system environment (including the extent of the system deficiencies and their effect on the DLA Working Capital Fund financial statements) and to develop transition plans to attain systems that are compliant with Federal requirements. Additionally, the DLA annual statement of assurance did not adequately reflect the effect that the system and related control deficiencies had on its ability to prepare reliable financial statements and to process financial transactions correctly.

Accounting and Finance Systems

DFAS uses the DoD accounting and finance systems to compile financial data and to prepare financial statements. According to OMB Circular No. A-127, accounting and finance systems are used to do the following:

- collect, process, maintain, transmit, and report data about financial events,
- support financial planning and budgeting events;
- accumulate and report cost information; and
- support the preparation of financial statements.

During FY 1998, DFAS tasked the Military Departments and Defense agencies (DoD Components) to identify their critical accounting, finance, and feeder systems. The DoD Components initially identified 192 systems used to prepare the financial statements The initial list included four accounting and finance systems that the DFAS Columbus Center used to prepare the DLA WCF financial statements The systems were the Standard Automated Materiel Management System (SAMMS), the Defense Fuels Automated Management System (DFAMS), the Defense Integrated Subsistence Management System (DISMS), and the Base Operation Support System (BOSS). The list also included DoD-wide systems such as contractor pay, property, and payroll systems that process a large portion of the DLA disbursements.

DLA and DFAS Self-Disclosures

DoD policy requires the Director, DLA, on an annual basis, to provide an assurance statement with respect to agency management controls Management controls must provide reasonable assurance of the following·

- compliance with applicable laws and regulations,
- safeguarding of funds, property, and other assets against waste, loss, unauthorized use, or misappropriation; and
- reliable financial reporting Reliable financial reporting means that transactions are executed according to applicable requirements, are consistent with the purposes authorized, and are recorded according to Federal accounting standards

Section two of annual statement of assurance requires an assessment of the overall system of management controls and a report on whether they provide reasonable assurance that the control objectives have been met Section four of the statement requires a separate report on whether the agency's accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General DLA and the DFAS Columbus Center reported in section four of their respective FY 1998 assurance statements that the four key accounting and finance systems did not substantially comply with Federal accounting and finance system requirements outlined in Appendix B. Management disclosures about each system are summarized as follows

Standard Automated Materiel Management System. SAMMS is an integrated logistics system that supports DLA wholesale supply business operations for commodities in construction, electronics, general items, medicine, clothing and textiles, and industry. A SAMMS financial module performs functions for funds control, inventory accounting, the general ledger, billing and collections, and vendor payment. DLA used SAMMS to manage approximately 4 million items (including tracking procurement histories and pricing data) and to account for about $9.1 billion of on-hand inventory.

DLA personnel reported that the SAMMS general ledger account structure did not follow the prescribed United States Government Standard General Ledger (USGSGL)[2] or DoD format. In addition, SAMMS did not properly account for prior period adjustments, in-transit materiel, and extraordinary items.

The DFAS Columbus Center planned to replace the SAMMS financial module with a commercial off-the-shelf system. However, the DFAS Columbus Center did not set a date to select a replacement.

Defense Fuels Automated Management System. The DFAMS is an automated logistics support system used to track the procurement, inventory, and distribution of bulk fuel and petroleum products. DLA used DFAMS to purchase about $2.4 billion in petroleum products annually and to track on-hand inventories valued at about $1.1 billion and stored at more than 400 sites worldwide.

The DFAMS general ledger account structure did not follow the USGSGL or DoD account structure for assets, liabilities, revenues, and expenses Also, significant differences existed between the subsidiary ledger and the general ledger accounts for accounts receivable DLA reported that the Automated Voucher Examination Disbursing System, a component of the DFAMS, was compliant with Federal requirements

DLA was in the process of replacing DFAMS with the Fuels Automated System (FAS). The estimated implementation date was FY 2000. Consequently, no efforts were underway to address the DFAMS deficiencies

Defense Integrated Subsistence Management System. The DISMS is a logistics support system that DLA used to manage subsistence items. DISMS has three major subsystems covering distribution, requirements determination, and procurements. DLA used DISMS to buy more than $1.1 billion worth of food products for more than 1,800 troop issue and resale commissaries worldwide Also, DLA used the system to account for about $247 million of inventory stored at more than 100 locations

[2] The USGSGL accounts are used to record the same types of financial transactions and balances that aggregate to specific classifications on the financial statements They were established so that agencies can establish control over their financial transactions and balances, meet the basic financial reporting requirements, and integrate budgetary and financial accounting in the same general ledger

DISMS was not an integrated accounting system. The chart of accounts did not comply with the USGSGL, and control accounts were not supported by detailed subsidiary ledger accounts.

In September 1988, DLA began a six-phase approach to address the DISMS deficiencies, and five of the six phases had been implemented by FY 1995. However, phase six, the financial module for DISMS, was not implemented because it did not have funding or a revised plan The revised plan was to replace DISMS with a commercial off-the-shelf system Thus, DLA and the DFAS Columbus Center made no further improvements to DISMS. No milestones were in place to implement a replacement system.

Base Operation Support System. The BOSS is an on-line system that supports the management of retail level supplies, rentals, and other services. BOSS supports DLA supply centers, depots, support centers, and one contract management district. BOSS is an integrated system with procurement, supply, and financial modules. BOSS tracks DLA obligations of about $30 million each year.

Problems with BOSS include the need for additional general ledger account codes, lack of a billing module for retail supplies, and its inability to pass accurate cost and budget data to the Defense Business Management System. Additionally, the lack of system interfaces resulted in untimely transaction postings.

DLA had several ongoing system changes to make BOSS compliant with Federal requirements by the end of FY 1999. However, DLA personnel indicated that BOSS would not be compliant until at least FY 2000.

Adequacy of the Review Process

Although DLA and the DFAS Columbus Center assessed the accounting and finance systems for compliance with key DoD accounting requirements, they did not identify and document the full extent of system problems because the review process was not adequate. As a result, DLA and the DFAS Columbus Center did not have a complete picture of the current system environment to adequately develop a transition plan to attain systems that are compliant with the Chief Financial Officers Act

Federal Financial Management Improvement Act Requirements. The Federal Financial Management Improvement Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the USGSGL at the transaction level The law also requires each agency to report on whether its systems and interfaces comply with the requirements When systems do not comply, the law requires agencies to disclose all facts about the noncompliance, including the following

- the nature and extent of noncompliance,
- the primary causes of noncompliance,
- the entity or organization responsible,
- any relevant comments from responsible officers, and
- a statement of remedial actions

In regard to the terminology used in the Biennial Plan, agencies need the information about noncompliances so that they can describe the current system environment and develop transition plans to achieve systems that are compliant with the Chief Financial Officers Act

DFAS Criteria. The DLA and DFAS Columbus Center review processes followed outdated DFAS criteria for evaluating automated systems. DFAS established a guide to measure compliance with Federal requirements, called the "Guide to Federal Requirements for Financial Management Systems," April 14, 1998 (Bluebook). The Bluebook provides a comprehensive list of financial management system requirements that are applicable to DoD accounting, finance, and feeder systems. Several agencies and organizations have promulgated the authoritative regulations and guidance cited in the guide. Principal among them are OMB, the Department of the Treasury, the General Accounting Office, the Joint Financial Management Improvement Program, the Federal Accounting Standards Advisory Board, and the DoD Financial Management Regulation. The Bluebook provides a useful tool to assess automated systems, and DLA and the DFAS Columbus Center should incorporate its requirements into their review process.

Earlier Criteria Used to Assess Accounting and Finance Systems. Before DFAS developed the Bluebook as a tool in the system evaluation process, DoD organizations based the criteria for evaluating accounting and finance systems on system manager user reviews covering 13 key accounting requirements outlined in DoD Regulation 7000.14R, "Financial Management Regulation," Volume 1, May 1993 The review process required a self-assessment by system users. It was developed before all of the Federal accounting and system requirements were established. Accordingly, it did not stay current on Federal requirements in place at the time of the audit. In addition, as part of the review process, the system users did not adequately document the flow of financial transactions and other data through the systems The DLA and DFAS Columbus Center system review process should consider all Federal requirements and document the flow of financial transactions through the systems.

System Environment. One key element of the Biennial Plan is to define and describe the system environment. Such a description should provide detailed documentation showing the status of the systems and the weaknesses that exist. Before enhancing or replacing existing systems, management must have a detailed understanding about systems at that time in terms of functionality, interdependencies, strengths, and weaknesses The understanding must include

any narratives and flowcharts needed to show how the systems process financial transactions. That type of information is essential to developing transition plans.

DLA and the DFAS Columbus Center identified most system deficiencies in their annual statements of assurance in general terms, using the system manager user review process. Therefore, the process that they used was not designed to adequately describe the environment at that time or to test systems extensively enough to determine the extent to which they complied with all relevant Federal requirements. Because they did not perform comprehensive reviews and testing,

DLA and the DFAS Columbus Center did not have an adequate basis to fully describe the current environment, determine the problems that existed, and develop realistic transition plans

Transition Plans

Past efforts of DLA and the DFAS Columbus Center to transition to compliant systems and processes were ineffective. Transition plans to fix known system deficiencies or replace systems were not funded, were abandoned, changed significantly, or were not completed on time.

Purpose for Transition Plans. According to the Biennial Plan, a transition plan should identify and document the specific actions required to bridge the gap between the systems environment at that time and the one in the future. It includes goals and strategies, corrective action plans, data flows, system architectures, and organization changes necessary to move DLA through the transition from its environment of unreliable and outdated systems to a future environment of compliant systems.

Prior Year Plans. Plans to correct previously identified system deficiencies or to replace the four accounting and finance systems were ineffective. Before FY 1996, DLA had developed various plans to correct deficiencies that it identified in the four accounting and finance systems. However, the plans were often delayed because of revisions or lack of funding, or the plans were abandoned. Beginning in FY 1996, DoD took a new approach to addressing deficiencies in accounting and finance systems DFAS established the Defense Accounting System Program Management Office in 1996 to achieve a uniform and efficient accounting system architecture throughout DoD A program office was also created at the DFAS Columbus Center to address problems with the accounting and finance systems that it operated. A primary mission of the program offices was to eliminate unneeded or obsolete legacy systems and modify systems, where necessary, to meet accounting system requirements The overall DFAS goal was to make all migratory systems compliant with the Chief Financial Officers Act by FY 2003

A migratory system is a system that was to be used until the process of evaluating functional migration accounting systems was completed. Migratory systems may be used until the transition is made to the envisioned new standard accounting

systems. DFAS selected SAMMS, DISMS, DFAMS, and BOSS as DLA interim migratory systems.

In FY 1997, the DFAS Columbus Center Program Management Office contracted with an outside consulting firm to conduct an analysis of alternatives for the four systems The analysis looked at nine alternatives, including modifying the existing systems. The analysis also included an evaluation of three DFAS systems, the Corps of Engineers Financial Management System; the Standard Accounting, Budgeting, and Reporting System; and the Standard Accounting and Reporting System, and it evaluated two commercial systems, Digital Systems Group's Integrated Financial Management Information System and the Oracle Government Financials package. The study recommended that DFAS replace the four accounting and finance systems with the Oracle Government Financials package. The rationale for this decision was that the Oracle system would provide the most comprehensive "core" competencies and would be the least costly to deploy and maintain.

The next step that the Program Management Office would have taken was to solicit a contract to implement the Oracle Government Financials package. The Office developed a solicitation package, but later retracted it because of a bid protest by a potential vendor. As of July 1999, the Program Management Office was in the preliminary stages of developing a new strategy, and no formal plan or milestones had been developed.

Some systems covered by the DFAS Columbus Center strategy, such as SAMMS, DISMS, and DFAMS, are not used exclusively for financial purposes. The systems also perform critical logistics functions such as determining inventory requirements, tracking inventory location and condition, placing orders with vendors, managing stock levels, and performing other program management functions. The DFAS Columbus Center's strategy, when it is established, was to address only the financial portion of the systems. DLA was responsible for making any additional corrections needed to other parts of the systems. Some DLA personnel expressed concern that DFAS efforts to address accounting deficiencies in the integrated DLA logistics systems, such as SAMMS, could adversely affect mission-critical logistics functions. In the past, DLA and the DFAS Columbus Center did not coordinate their efforts to address known deficiencies in the accounting and finance systems. To ensure that both strategies are consistent, the DFAS Columbus Center and DLA must work closely to identify all significant deficiencies, determine the most appropriate strategy, assign specific responsibilities, and set realistic milestones. The milestones must address each system deficiency and estimate the funding requirements

Future Plans. DLA recently developed a draft 5-year plan, the "DLA Chief Financial Officers Strategic Plan (FY 1999-2003)," which focused on the accuracy, timeliness, and usefulness of DLA financial information In addition, the plan was intended to help DLA get a favorable opinion on its financial statements by FY 2003. The draft plan identified the major goals, objectives, and implementing instructions to meet that goal. DLA considered its draft 5-year plan a living document that was to be updated as progress was made and new issues were identified.

The plan represents a good start for DLA to chart a course toward compliant systems However, the plan is highly dependent on the DFAS actions to correct system deficiencies in the four systems as well as other DoD-wide accounting and finance systems. For example, systems such as the Mechanization of Contract Administration Services system (used to process more than 100,000 DLA invoices, valued at about $2.4 billion) and the Defense Civilian Payroll System (used to disburse about $1.6 billion for more than 27,000 DLA employees) are critical to preparing reliable DLA financial statements Successful implementation of the DoD-wide systems and standard data and interfaces that ensure that data can pass freely between the DoD-wide and DLA systems is essential to preparing the DLA financial statements. Accordingly, DLA must play an active role in DFAS efforts to implement new systems that process a significant number of DLA transactions Otherwise, DLA may end up with problems communicating with and obtaining data from the new systems. In addition, the plan depends on DLA identifying, evaluating, and addressing problems with its feeder systems (finding B) and tying funds to specific system development or replacement efforts.

Adequacy of DLA Self-Disclosures

DLA did not adequately report in its annual statement of assurance the impact that automated system deficiencies and related control weaknesses had on preparing reliable financial statements.

DLA Annual Statement of Assurance. Section two of the DLA Annual Statement of Assurance must provide an assessment overall DLA system of management controls and report whether they provide reasonable assurance that the control objectives have been met The report must also identify weaknesses in the agency's system of controls and provide a specific plan for correcting each weakness.

One critical control objective that DLA should have established was to meet the requirements of the Chief Financial Officers Act of 1990, the Federal Financial Management Improvement Act of 1996, and other related legislation concerning reliable financial reporting. An agency's ability to prepare financial statements that report all transactions, classified in ways that faithfully represent the underlying events, is itself an indication that certain essential controls for financial reporting are in place and operating effectively DLA and the DFAS Columbus Center were not able to prepare reliable financial statements for the DLA Working Capital Fund since FY 1993. Although a major reason for unreliable statements was system problems, other policy and control deficiencies further exacerbated the system problems.

In its annual statement of assurance, DLA listed the following 11 uncorrected material weaknesses:

- insufficient guidance for administration of other transactions;
- weaknesses in general ledger control and financial reporting at the Defense Automated Printing Service;
- an inadequate DoD small-arms serialization program,
- an inadequate physical inventory program;
- untimely contract termination at wholesale inventory control points;
- weaknesses in the DoD demilitarization program and lack of accurate coding for items in its inventory;
- inadequate DoD demilitarization program internal regulations,
- inadequate accountability of excess property in-transit to disposal;
- inadequate financial data maintenance regarding unmatched disbursements;
- inaccurate reporting of property, plant, and equipment accounts on the financial statements; and
- inadequate control reviews for inventory other than stock on hand

Some of the reported weaknesses, such as problems with general ledger accounts and inadequate control over physical inventories, pertain directly to preparing financial statements However, DLA did not include as a material weakness its inability to prepare reliable financial statements By including its inability to prepare reliable financial statements as a material management control weakness, DLA would be acknowledging the extent of the problem (current environment) and would bring it under the formal reporting and tracking mechanisms specified by DoD. The formal tracking mechanisms may help ensure that DLA achieves its goals and milestones for fixing the deficiencies.

Recommendations, Management Comments, and Audit Response

A. We recommend that the Director, Defense Logistics Agency:

1. In coordination with the Director, Defense Finance and Accounting Service Columbus Center, perform comprehensive reviews of the four accounting and finance systems. The reviews should:

a. **Follow the methodology prescribed by the Defense Finance and Accounting Service "Guide to Federal Requirements for Financial Management Systems," April 14, 1998, and address all relevant Federal accounting and system requirements.**

b. **Fully document the way that the systems process financial transactions and other related data.**

c. **Fully document the reviews performed and results of reviews.**

d. **Describe the system deficiencies in detail and the impact that the deficiencies have on preparing reliable financial statements.**

e. **Provide specific milestones for correcting each deficiency identified.**

f. **Estimate the amount of funding required to correct the system deficiencies and allocate the funds to specific system development efforts.**

Management Comments. The Deputy Comptroller, DLA, partially concurred with recommendations A 1 a through A 1.f and stated that DLA has completed comprehensive reviews of its accounting and finance systems and found them to be substantially noncompliant with Federal requirements. The Deputy Comptroller also stated that DLA has initiated a Business Systems Modernization effort that is striving to align business practices with best commercial practices and that it will probably require the reengineering of some logistics and financial information practices. The DLA integrated logistics accounting and finance legacy systems are targeted to be replaced with a commercial Enterprise Resource Planning solution that will interface DLA data to the DFAS corporate database.

Audit Response. Management comments were not responsive. We agree that DLA performed limited reviews of its accounting and finance systems and identified enough significant deficiencies to support the conclusion that none of the systems substantially complied with Federal requirements However, the reviews were not comprehensive enough to document the flow of transactions through the systems (including those generated by feeder systems) and to determine the impact that system deficiencies had on the ability of DFAS to prepare reliable financial statements for the DLA WCF Before enhancing or replacing existing legacy systems, DLA must have a detailed understanding about the existing systems in terms of functionality, interdependencies, strengths, and weaknesses. That understanding must include any narratives and flowcharts needed to show how the systems process financial transactions from the original source of data input until the information is summarized and reported in the financial statements These actions must be taken before DLA can be assured that its current transition plan will fix existing problems with the legacy systems and result in compliant replacement systems

The DLA response did not address our recommendations to document the scope of the reviews performed, provide specific milestones for correcting the deficiencies, and to estimate the amount of funding required to correct the

systems. Past efforts to transition from noncompliant to compliant systems were often not funded, were abandoned, were changed, or were not completed on time Implementing these recommendations may help prevent this situation from recurring with the current transition plan.

We request that DLA reconsider its response and provide comments to each specific element of this recommendation

2. **Coordinate with the Director, Defense Finance and Accounting Service Columbus Center, in terms of strategy and milestones for correcting each system.**

Management Comments. The Deputy Comptroller concurred with the recommendation and stated that DLA and DFAS held several meetings to discuss strategy and plans for replacing the noncompliant systems and formed an Integrated Product Team to define the financial functions that will migrate financial information through an Enterprise Resource Planning solution

3. **Assign specific responsibilities to Defense Logistics Agency personnel to complete all essential tasks that are the responsibility of the Defense Logistics Agency.**

Management Comments. The Deputy Comptroller concurred with the recommendation and stated that DLA, in conjunction with DFAS, has developed a business system modernization plan that assigns specific responsibilities for corrective actions

Audit Response. The DLA comments are responsive to the recommendation. However, during the audit, DLA did not provide us with a written plan that assigned specific responsibilities to DLA personnel to complete all the essential tasks needed to correct each system deficiency. We request that the DLA provide a copy of that plan with its comments to the final report.

4. **Report as a material weakness in the annual statement of assurance the inability to prepare reliable financial statements and the reasons for that deficiency. Include specific information about each system deficiency and milestones for corrective action in section four of the Defense Logistics Agency annual statement of assurance.**

Management Comments. The Deputy Comptroller concurred with the recommendation and stated that, in prior annual statements of assurance, DLA did not disclose how system deficiencies affected its ability to prepare reliable financial statements. The Deputy Comptroller stated that the system deficiencies, their effect on the financial statements, and milestones for corrective action would be reported in the FY 1999 annual statement of assurance. The action will be completed by November 15, 1999.

B. Defense Logistics Agency Working Capital Fund Feeder Systems

DLA developed a comprehensive list of the automated systems and applications it used to manage operations as part of its efforts to deal with the year-2000 issue. However, DLA did not use that list to define the complete system architecture that it used to capture the financial data that the DFAS Columbus Center used to prepare the DLA WCF financial statements. DLA did not define the system architecture because it did not identify and review all program management systems to determine the systems, applications, and processes that capture financial transactions In addition, DLA did not establish procedures to prioritize and evaluate the systems for compliance with Federal requirements and to determine the necessary corrective actions. As a result, DLA did not have an adequate basis to determine the impact that potential feeder system deficiencies have on its financial statements or the effort required to correct the deficiencies, and costly system modifications could result if the requirements are not considered when new systems are fully implemented.

Financial Transactions

Program Management Functions. The five business activity groups of the DLA WCF perform program management functions every time they acquire, allocate, transport, manage, use, and dispose of DoD resources. When a business activity group performs a program management function that affects the financial statements (such as incurring an obligation or changing the value of an asset or liability), a financial event occurs. Information about financial events (including financial transactions and other data) must correctly pass to DFAS for use in compiling the financial statements. DFAS also uses program information to prepare footnotes and other disclosures in the DoD Component financial statements.

Feeder Systems. Any automated system, application, interface, or process (including manual processes) used to capture, summarize, or transmit financial data to an accounting or finance system may be considered a feeder system. According to the Biennial Plan, approximately 80 percent of the financial data used to prepare the DoD financial statements are derived from feeder systems. Accordingly, to prepare reliable financial statements for the DLA WCF, the DFAS Columbus Center depends on the integrity of the DLA systems, processes, and controls used to pass data from feeder systems to the accounting and finance systems.

The first step to fully understanding the relationship between program management functions and financial transactions is for DLA to compile a comprehensive list of all automated systems, applications, and processes (system architecture) used to perform program management functions within DLA. DLA must start with all the systems and applications used to manage day-to-day

operations and provide its managers with cost, performance, and other essential management information. Next, DLA must analyze each system, application, and process to identify those that process financial transactions or provide other essential data used to prepare the financial statements. DLA must then prioritize the list of feeder systems for detail review. As part of the detail review, DLA must document and evaluate each feeder system to determine whether the systems process financial transactions consistent with Federal requirements. Documentation should include the objectives of each review, the applicable Federal requirements tested against, the tests performed, and the test results. If deficiencies are noted, DLA must establish detailed corrective action plans and milestones Going through such an evaluation process could provide DLA with an opportunity to eliminate, renovate, or reengineer inefficient and unneeded business processes, which would also help DLA to meet other legislative mandates such as improving performance and reducing operating costs

Identifying Feeder Systems

DLA relied extensively on automated systems to carry out its programs, manage resources, and report program costs and performance. However, DLA did not define the complete system architecture used to capture the financial data that the DFAS Columbus Center used to prepare the DLA WCF financial statements DLA did not define the complete system architecture because it did not identify and review all program management systems to determine the systems, applications, and processes that capture financial transactions. In addition, DLA did not establish procedures to prioritize and evaluate the systems for compliance with Federal requirements and to determine the necessary corrective actions.

List of Feeder Systems. As part of its efforts to solve the year-2000[3] problem, DLA identified 86 automated systems and applications used to manage operations. Most of the systems and applications were designed primarily to manage DLA programs and functions (such as inventory, property, and the status of funds). However, many of the systems also captured critical financial management data that must be incorporated into the financial statements

In addition to the four systems discussed in finding A, the DLA list included other automated systems and applications that are essential to preparing reliable financial statements Some examples follow

Distribution Standard System. Over the last several years, DLA implemented the Distribution Standard System (DSS) to help manage distribution operations at its depots. DLA used DSS, an automated perpetual inventory system, to account for approximately 6 million line items of inventory and related property and to support research of record discrepancies. DSS also tracked all materiel movement into and out from the depots, such as the approximately

[3] The year-2000 problem results from the inability of computer systems to correctly interpret recorded dates when only two digits are used to indicate the year, such as "98" for 1998 The most immediate challenge facing DLA is ensuring that key mission and business functions continue to operate after the year 2000.

26 million issue and receipt transactions. The DSS perpetual inventory records, which accounted for and served as the accountable property records for approximately 75 percent of the approximately $56 billion in DoD inventory, supplied much of the information in the financial and supply reports of DoD Transactions processed through DSS updated SAMMS logistics and financial records, which were used to prepare the DLA WCF financial statements and to support inventory purchase decisions.

Fuels Automated System (FAS). FAS was scheduled to replace DFAMS as the migratory system for DLA fuel operations. FAS is a multi-functional automated information system that provides point-of-sale data collection, inventory control, accounting and finance, procurement, and facilities management FAS was divided into two subsystems and was to provide interfaces to existing logistics and financial systems. FAS was to eventually handle most critical fuel functions such as tracking fuel inventories, buying fuel, paying vendors, and managing contracts.

Mechanization of Contract Administration Services. The Mechanization of Contract Administration Services system provided contract administration and payment functions for the Military Departments and DLA contracts For FY 1998, the system disbursed more than 100,000 payments, valued at $2 4 billion, on DLA contracts.

Defense Reutilization and Marketing Automated Information System. The Defense Reutilization and Marketing Automated Information System (including the National Sales Program module) helped DLA manage reutilization and disposal operations. The system tracked the receipt and disposal of billions of dollars in excess materiel annually. It also tracked assets, valued at about $172 million (at salvage value of about 2.7 percent of acquisition value), and sales proceeds of about $124 million

Defense Working Capital Fund Accounting System. The Defense Working Capital Fund Accounting System was implemented to improve the accounting for the Defense Automated Printing Service. For FY 1998, the Defense Automated Printing Service reported revenues of $377.8 million.

The new system's effectiveness was hampered by hardware capacity, data conversion errors, and system interface problems. That condition occurred, in part, because DFAS did not fully define DLA requirements, and DLA was not adequately involved in the system design effort.

Financial Statement Feeder Systems. Because DLA did not identify and evaluate all key feeder systems, only limited information was available for the way in which major systems such as DSS, FAS, and the Defense Reutilization and Marketing Automated Information System processed financial transactions

The reason DoD most frequently gave as to why most legacy systems did not meet Federal requirements is because they were designed before establishment of current Federal requirements and were programmed to operate in specific operating environments and support unique business practices Those business practices generally did not include the comprehensive financial accounting

functions needed to comply with existing Federal standards or provide adequate capability to share data between related computer applications. However, if DLA does not consider Federal requirements in developing new feeder systems, the new systems too are likely to be noncompliant with major elements of the Federal requirements despite spending millions of dollars on system implementation. Costly system modifications could result after systems are fully implemented In fielding major new systems such as DSS and FAS, DLA did not adequately consider Federal accounting and system requirements because its primary focus was on operations Comptroller personnel and others responsible for providing the DFAS Columbus Center with valid accounting data were not involved in developing, evaluating, fielding, and testing the systems DSS was already fielded at the distribution depots and it must be evaluated as a completed system However, because FAS is still under development, DLA should assess and update it, as needed, before FAS is fully implemented.

Because DLA personnel did not identify and adequately determine how feeder systems processed financial transactions, they did not fully document the process for generating financial data, did not know the extent to which system deficiencies may exist, and could not reasonably estimate the resources and timeframes needed to fix the deficiencies. Without that information, DLA could not establish realistic timeframes to have auditable financial statements and would continue to be in substantial noncompliance with the Federal Financial Management Improvement Act of 1996.

Required Actions

DLA must define the system architecture used to prepare the financial statements and provide the following minimum documentation about each feeder system and application

- the number and dollar value of transactions processed,
- narrative descriptions and flowcharts explaining the flow of financial transactions from the point of original data entry until data are passed to another automated system or summarized in the financial statements;
- functions and capabilities that must be retained and those that need to be eliminated, enhanced, or reengineered;
- the availability and adequacy of audit trails and record retention policies, and where audit trails are not available or kept for only short periods, provide alternative procedures to retain appropriate transaction data; and
- the applicable Federal requirements that the systems must be measured and tested against.

After identifying and fully documenting the system architecture, test plans must be developed and feeder systems and applications tested against all applicable Federal accounting and system requirements to determine the extent of compliance. The review process should be similar to the process described in finding A

At the time of this audit, DLA had a unique opportunity to capitalize on the methodology and lessons learned from the extensive year-2000 effort that had been ongoing for the last several years. DLA put forth a significant effort to remediate its mission-critical systems and ensure that its key operational missions would continue to function after the century date change. As part of that effort, DLA identified 86 critical systems and applications and spent millions of dollars to evaluate how they processed date-sensitive transactions. An assessment of how well DLA was meeting its year-2000 goals is beyond the scope of this audit. We have issued several reports and were working on other projects at the time of this audit, to assess the DLA efforts to address the year-2000 problem. The year-2000 efforts were to remain a priority until all year-2000 issues were resolved

After completing the year-2000 efforts, DLA needs to devote resources to evaluate its feeder systems. Actions must include those addressed in this audit report. Instead of looking for and correcting problems for only date-sensitive transactions, DLA personnel will need to identify financial transactions and assess how the feeder systems process those transactions Only after taking those actions will DLA be in a position to develop realistic transition plans and milestones to comply with all applicable Federal requirements

Recommendations, Management Comments, and Audit Response

B. We recommend that the Director, Defense Logistics Agency:

1. Using the 86 systems and applications identified as part of the lessons learned from the year-2000 effort as a starting point, compile a comprehensive list of all feeder systems and applications (system architecture) used to process financial transactions and provide other essential data used to prepare the financial statements. The systems should be prioritized for review.

Management Comments. The DLA Deputy Comptroller partially concurred with the recommendation and stated the DLA systems used to process financial

transactions are identified in the Biennial Financial Management Improvement Plan along with the system's deficiencies and an estimated costs projected to FY 2003.

Audit Response. The DLA comments are not responsive to the recommendation. The Deputy Comptroller's comments relate to the finance and accounting systems discussed in Finding A and listed in the Biennial Plan. Although those systems process most DLA financial transactions, they do not represent all of the feeder systems that interface with and provide the financial data that is used by DFAS to prepare the DLA Working Capital Fund financial statements Our recommendation pertains to DLA feeder systems such as the Distribution Standard System, the Defense Reutilization and Marketing Automated Information System, and other DLA feeder systems that provide critical information needed to prepare reliable financial statements. These feeder systems must be included as part of the system architecture that DLA needs to develop and evaluate as part of a formal evaluation process. This will ensure that the transaction flows and interfaces are proper and that they comply with all applicable Federal requirements This action is necessary to provide DLA with an adequate basis to determine the impact that potential feeder system deficiencies have on its financial statements, the effort required to correct the deficiencies, and reduce the risk of costly system modifications.

We request that DLA reconsider its position and provide additional comments pertaining to the need to compile a comprehensive list of all feeder systems and prioritize the systems for review.

2. **Fully document the flow of financial transactions through each system from the point of original entry until financial information is passed to an accounting or finance system, or information is posted to the appropriate general ledger account.**

Management Comments. The Deputy Comptroller, DLA, stated that in July 1999, DLA identified and documented all financial information resident in the integrated logistics financial legacy systems that should be reported in DLA's financial information systems and crosswalked that information to the appropriate general ledger accounts.

Audit Response. The DLA comments are responsive to the recommendation. However, during the audit, DLA did not provide us with their analysis showing what financial information resides in the integrated logistics systems, the sources of that information, how they tested the reliability of the systems and processes that produce the information, and how they crosswalked the information to the general ledger accounts We request that DLA provide us with that documentation with its comments to the final report.

3. **Establish a formal evaluation process for the feeder systems that requires the Defense Logistics Agency to devote sufficient resources, identify and incorporate applicable Federal requirements, develop test plans, fully test and validate systems, and fully document test results. Where DLA identifies deficiencies, take appropriate action to correct them.**

Management Comments. The Deputy Comptroller partially concurred with the recommendation and stated that DLA, in coordination with DFAS, established a Business Systems Modernization Steering Group to address all recommended actions for the replacement of legacy systems.

Audit Response. The DLA comments are not responsive to the recommendation. As was the case with Recommendation B.1, the DLA comments addressed only the systems listed in the Biennial Plan and those systems did not include all of the DLA feeder systems that compile financial data. DLA did not establish procedures to prioritize and evaluate all of its feeder systems for compliance with Federal requirements. Such reviews must be conducted and should document the objectives of each review, the applicable Federal requirements tested against, the tests performed, and the test results. If deficiencies are noted, DLA must establish detailed corrective action plans and milestones

Until DLA establishes a formal process to evaluate its feeder systems that fully tests and validates the interfaces with accounting and finance systems, DLA will not know the extent to which system deficiencies exist and not be able to reasonably estimate the resources and timeframes required to fix the deficiencies We request that DLA reconsider its position and provide additional comments pertaining to the need to establish a formal evaluation process for the feeder systems that includes applicable test plans

4. **Require Defense Logistics Agency personnel to consider applicable Federal requirements before the Fuels Automated System is fielded. Involve Comptroller personnel and other knowledgeable personnel in the evaluation process.**

Management Comments. The Deputy Comptroller partially concurred with the recommendation and stated that the system requirements for the Fuels Automated System do include applicable Federal requirements Also, Comptroller, DFAS, and other knowledgeable personnel have been continually involved in the Fuels Automated System evaluation process and applicable Federal requirements are being considered prior to fielding this system

Audit Response. The DLA comments are responsive to the recommendation. During the audit, DLA personnel provided no evidence that they tested the Fuels Automated System for compliance with Federal accounting and system requirements. We request that DLA provide us with documentation showing the test plans and completed test results for the Fuels Automated System along with its comments to the final report.

Appendix A. Audit Process

Scope

The audit was performed as part of our efforts to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994 Deficiencies in the way accounting, finance, and feeder systems were designed and how they processed financial transactions have been major factors preventing DLA from obtaining favorable audit opinions in FYs 1997 and 1998. The problems continued throughout FY 1999.

Work Performed. We performed audits of the DLA WCF financial statements for FYs 1997 and 1998 A major reason that we disclaimed an opinion on the financial statements was because of significant deficiencies in the accounting, finance, and feeder systems, which are an important part of the financial statement reporting process For this part of the audit, we evaluated the steps that DLA and DFAS were taking to correct the system deficiencies that both organizations acknowledged in past statements of assurance We reviewed the DoD Biennial Plan, the draft DLA strategic plan, DLA and DFAS Columbus Center annual statements of assurance, and management representation letters and prior audit reports. We reviewed the documents, reports and plans, and we talked with personnel to determine the extent to which DLA and the DFAS Columbus Center identified all accounting, finance, and feeder systems and evaluated them for compliance with Federal requirements.

Limitations to Audit Scope. We did not perform detailed analyses of accounting, finance, and feeder systems to try to determine the extent to which the systems complied with Federal requirements. In addition, we did not assess how well DLA was meeting its year-2000 goals The Inspector General, DoD, has issued several reports, and was working on other projects at the time of this audit, to assess the DLA efforts to address the year-2000 problem.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of Defense has established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting these objectives This report pertains to achievement of the objective to fundamentally reengineer DoD and achieve a 21st century infrastructure and the goal to reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals This report pertains to achievement of the following functional area objectives and goals

Financial Management Functional Area. Objective: Strengthen Internal Controls. **Goal:** Improve compliance with the Federal Managers Financial Integrity Act. **(FM-5.3)**

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

Methodology

We considered applicable Federal and DoD criteria in this audit. The Federal requirements for compliant financial management and feeder systems are described in the Federal Financial Management Improvement Act of 1996; OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, and a series of Federal Financial Management System requirements published by the Joint Financial Management Improvement Program principles (See Appendix B for further details).

Use of Computer-Processed Data. We did not use computer-processed data in performing this audit.

Audit Type, Dates, and Standards. We performed this financial-related audit from November 1998 through June 1999. Our review was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available upon request

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of those controls

Scope of the Review of the Management Control Program. We reviewed management controls pertaining to DLA and the DFAS Columbus Center methods to identify and evaluate their accounting, finance, and feeder systems to determine whether they provide complete and reliable information to prepare financial statements. We also reviewed the FY 1998 Annual Statements of Assurance that DLA and the DFAS Columbus Center issued to determine whether the issues addressed in this report were reported in the statements of assurance

Adequacy of Management Controls. Management controls were not adequate in that they did not ensure that the accounting, finance, and feeder systems were compliant with Federal requirements and that the full extent of system

weaknesses were fully identified. We consider this a material weakness. The recommendations in this report, if implemented, will address the deficiency. We will provide a copy of this report to the DLA and DFAS Columbus Center senior officials that are responsible for management controls

Adequacy of Management's Self-Evaluation. The FY 1998 DLA and DFAS Columbus Center annual statements of assurance reported material weaknesses in critical accounting and finance systems However, DLA did not reflect its inability to prepare reliable financial statements as a material weakness, although the problem had been present since DLA started preparing financial statements in FY 1993.

Summary of Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted numerous reviews related to financial statement issues. Last year we issued a disclaimer of opinion on the FY 1998 DLA WCF financial statements General Accounting Office reports can be accessed over the Internet at http://www gao gov Inspector General, DoD, reports can be accessed over the Internet at http://www dodig.osd.mil.

Appendix B. Criteria for Federal Financial Systems

Federal Systems Requirements. The Federal requirements for compliant DoD accounting, finance, and feeder systems are described in detail in this appendix.

Federal Financial Management Improvement Act of 1996. The Federal Financial Management Improvement Act of 1996 requires DoD organizations to report whether their financial management and critical feeder systems comply with Federal requirements. OMB policy requires that DoD annually report the core financial management and feeder systems that are critical to DoD-wide financial management, control, and reporting. The Improvement Act requires each agency to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the USGSGL at the transaction level The Improvement Act also requires auditors to report on whether the automated systems that DoD used are in substantial compliance with Federal requirements

Office of Management and Budget Circular No. A-127. OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, prescribes policies and standards for Federal agencies to follow in developing and operating financial management systems. Circular No. A-127 requires that each agency establish and maintain a single, integrated financial management system that complies with accounting principles, internal control standards, and other requirements. The circular defines a single, integrated financial management system as a unified set of financial systems, nonfinancial systems, and a combination of both that are planned for and managed together, operated in an integrated fashion, and linked together electronically to provide agency-wide financial system support. In addition, the circular lists the following characteristics for financial management system requirements:

- an agency-wide financial information classification structure,
- integrated financial management systems,
- application of the USGSGL at the transaction level,
- Federal accounting standards,
- financial reporting,
- budget reporting,
- internal controls, and
- documentation.

Joint Financial Management Improvement Program. The Joint Financial Management Improvement Program is a cooperative effort of OMB, the General Accounting Office, and the Department of the Treasury working collectively with other Federal agencies to improve financial management practices throughout the Government The Joint Financial Management Improvement Program publishes documents to provide overall objectives and strategies for achieving improved financial management. The Joint Financial Management Improvement Program published several documents under its Federal Financial Management System Requirements Series. The series includes "Framework for Federal Financial Management Systems" and "Core Financial Systems Requirements," which describe the elements of a model for integrated financial management systems and the systems architecture that each Federal agency should strive for in support of all levels of management decisionmaking and external reporting requirements.

DoD Implementation Guidance. DoD Regulation 7000 14-R, "Financial Management Regulation," provides procedures for evaluating accounting systems and reporting the results of the evaluations. To comply with Federal reporting requirements, the regulation requires annual self-appraisals by system managers and users and independent detailed evaluations on a cyclical basis every 3 years. The reviews form the basis for determining whether DLA and DFAS systems comply with Federal system requirements. To help the DoD Components assess their compliance with Federal requirements, DFAS issued a "Guide to Federal Requirements for Financial Management Systems," April 14, 1998 (Bluebook), which provides a compilation of financial management systems requirements that are applicable to DoD automated systems.

Federal Accounting Standards. An agency of the Federal Government is considered in substantial compliance with Federal accounting standards if the agency prepares audited financial statements in accordance with the hierarchy of the Federal accounting standards outlined in OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999. The hierarchy of Federal accounting standards, which constitutes generally accepted accounting principles for the Federal Government, is as follows:

- individual Statements of Federal Financial Accounting Standards agreed to by the Director of OMB, the Comptroller General, and the Secretary of the Treasury,
- interpretations related to the Standards issued by OMB in accordance with the procedures outlined in OMB Circular No. A-134, "Financial Accounting Principles and Standards",
- requirements contained in the OMB Form and Content Bulletin in effect for the period covered by the financial statements; and
- accounting principles published by other authoritative sources.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller) and Chief Financial Officer
  Deputy Chief Financial Officer
    Director, Accounting Policy
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence)
Deputy Under Secretary of Defense (Logistics)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
General Accounting Office
National Security and International Affairs Division
Technical Information Center

Congressional Committees and Subcommittees, Chairman and Ranking Minority Members

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 Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Affairs, Committee on Government Reform

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
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IN REPLY REFER TO DDAI

SEP 27 1999

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Automated Systems Used to Prepare the Defense Logistics Agency Working Capital Fund Financial Statements, August 19, 1999, Project No. 9FJ-2005

This responds to the findings and recommendations of subject report. DLA is committed to improving our feeder systems and getting an unqualified audit opinion of our financial statements. The systems used to prepare the financial statements have been identified and evaluated for compliance with Federal requirements and determined to be substantially noncompliant. The necessary corrective actions are identified in the DLA Annual Statement of Assurance. DLA has decided to replace the integrated logistics financial legacy systems with an Enterprise Resource Planning solution to interface to the DFAS accounting system

Attached are specific comments to the findings and recommendations contained in the report. The agency appreciates the opportunity to comment on the draft report.

WILLIAM P. STORMER
Colonel, USA
Deputy Comptroller

Attachment

Federal Recycling Program Printed on Recycled Paper

SUBJECT: Automated Systems Used to Prepare the DLA Working Capital Fund Financial Statements, 9FJ-2005.02

FINDING A: DLA Working Capital Fund Accounting and Finance System – DLA and DFAS Columbus Center assessed their accounting and finance systems. They did not identify and fully document system problems because they did not have an adequate review process or transition plan. As a result, insufficient information was available to adequately describe the current system environment and to develop transition plans to attain CFO-compliant systems. Additionally, the DLA annual statement of assurance did not adequately reflect the effect that the system and related control deficiencies had on its ability to prepare reliable financial statements and to process financial transactions correctly.

DLA COMMENTS:
DLA is committed to improving our feeder systems and getting an unqualified audit opinion on DLA's financial statements. DLA performed an extensive analysis of both risk and cost of several options to replace our legacy systems These included modernizing our legacy systems, rehosting our existing systems and replacing our systems with Commercial Off The Shelf (COTS) software. DLA and DFAS have made the decision to replace our integrated logistics financial management legacy systems with CFO compliant COTS solutions. Financial data resident in our logistics systems will feed the DFAS finance and accounting corporate database system from which financial statements will be prepared. In FY 99, DLA's Annual Statement of Assurance (ASA) Tab C will disclose existing legacy system materiel nonconformances.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
Concur; weakness will be reported in the DLA Annual Statement of Assurance

RECOMMENDATION A.1: Recommend that the Director, Defense Logistics Agency (DLA), in coordination with the Director, Defense Finance and Accounting Columbus Center, perform comprehensive reviews of the four accounting and finance systems The reviews should:

a. Follow the methodology prescribed by the Defense finance and Accounting service "Guide to Federal Requirements for Financial Management Systems," April 14, 1998, and address all relevant Federal accounting and system requirements.

b. Fully document the way that the systems process financial transactions and other related data.

c. Fully document the reviews performed and results of reviews.

d. Describe the system deficiencies in detail and the impact that the deficiencies have on preparing reliable financial statements.

e. Provide specific milestones for correcting each deficiency identified.

f. Estimate the amount of funding required to correct the system deficiencies and allocate the funds to specific system development efforts.

DLA COMMENTS:
Partially Concur. DLA and DFAS have completed a comprehensive review of the accounting and finance systems. DLA has initiated a Business Systems Modernization (BSM) effort that is striving to align business practices with bost commercial practices. This will probably require the reengineering of some logistics and financial information practices. DFAS has completed a comprehensive review using a guide to Federal Requirements for Financial Management Systems. The DLA integrated logistics accounting and finance legacy systems are targeted to be replaced with an Enterprise Resource Planning (ERP) solution that will interface data to the DFAS corporate database.

The review process used to evaluate DLA's Business System Modernization initiative, and the DFAS corporate database initiative, was updated after the April 98 publication of the Guide to Federal Requirements for Financial Management Systems. This process provides the in depth, as is analysis necessary to adequately identify all federal requirements. Critical to the process was the documentation of requirements for the systems processing of financial transactions, other related data, the review(s) performed and the results of the review(s)

DISPOSITION: Complete

RECOMMENDATION A.2: Recommend that the Director, DLA coordinate with the Director Defense Finance and Accounting Service Columbus Center in terms of strategy and milestones for correcting each system.

DLA COMMENTS:
Concur. DLA and DFAS have held several Business Systems Modernization meetings to discuss strategy and plans for replacing DLA's noncompliant financial information management systems. A DLA and DFAS Integrated Product Team was formed to define the financial functions that will migrate the DLA financial information to the DFAS corporate database through an Enterprise Resource Planning (ERP) solution. These financial considerations, will be incorporated in the DLA supply management ERP evaluation and solution as a result of the joint effort for this integration and modernization initiative.

DISPOSITION: Complete

RECOMMENDATION A.3: Recommend that the Director, DLA, assign specific responsibilities to DLA personnel to complete all essential tasks that are the responsibility of the DLA.

DLA COMMENTS:
Concur. DLA, in conjunction with DFAS, has developed a BSM implementation plan that assigns specific responsibilities for corrective actions, that upon completion will support the DOD efforts to obtain a clean audit opinion on DLA's financial statements

DISPOSITION: Complete

RECOMMENDATION A.4: Recommend that the Director, DLA, report as material weakness in the Annual Statement of Assurance the inability to prepare reliable financial statements and the reasons for that deficiency. Include specific information about each system deficiency and milestones for corrective action in section four of the DLA Annual Statement of Assurance.

DLA COMMENTS:
Partially Concur. DLA has historically identified in the Annual Statement of Assurance the specific Key Accounting Requirement deficiencies for each system. However, DLA has not reported that that these deficiencies impact the reliability of our financial statements preparation. System deficiencies will be reported in DLA's FY 99 Annual Statement of Assurance as will DLA's inability to prepare reliable financial statements.

DISPOSITION: Ongoing. ECD: November 15, 1999

FINDING B: DLA Working Capital Fund Feeder Systems – Although DLA developed a comprehensive list of the automated systems and applications used to manage operations as part of its efforts to deal with the year-2000 issue, it did not determine which feeder systems processed the financial transactions and other data that the DFAS Columbus Center used to prepare the financial statements. DLA did not have an adequate basis to determine the impact that potential feeder system deficiencies have on its financial statements or the effort required to correct the deficiencies and, costly system modifications could result if the requirements are not considered when new systems are fully implemented.

DLA COMMENTS:
It appears the finding suggests DLA has not identified the systems used to prepare the agency financial statements. DLA and DFAS did identify the systems used to prepare financial statements. Further, these systems were evaluated for compliance with Federal requirements and determined to be substantially noncompliant. The necessary corrective actions are identified in the DLA and DFAS Annual Statement of Assurances and the Biennial Financial Management Improvement Plan in accordance with the Guide to Federal Requirements for Financial Management Systems and the Financial Management Regulations (FMR). In the evaluation of these integrated logistics financial legacy systems targeted for replacement, DLA and DFAS used the above references as well as commercial accounting firms to recommend best business practices to assure we have identified the requirements needed for compliant systems. As a result of our review and evaluation, DLA decided to replace the integrated logistics financial legacy systems with an Enterprise Resource Planning solution to interface to the DFAS accounting system

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
Concur; weakness will be reported in the DLA Annual Statement of Assurance

RECOMMENDATION B.1: Recommend that the Director, DLA, using the 86 systems and applications identified as part of the lessons learned from the year-2000 effort as a starting point, compile a comprehensive list of all feeder systems and applications (systems architecture) used to process financial transactions and provide other essential data used to prepare the financial statements. The systems should be prioritized for review.

DLA COMMENTS:
Partially Concur. The DLA systems used to process financial transactions are identified in the Biennial Financial Management Improvement Plan. System's deficiencies are identified with estimated costs projected to FY 03. Transitioning to our new Enterprise Resource Planning solution will be based on the importance of the legacy system to DFAS mission.

DISPOSITION: Complete

RECOMMENDATION B.2: Recommend that the Director, DLA, fully document the flow of financial transactions through each system from the point of original entry until financial information is passed to an accounting or finance system, or information is posted to the appropriate general ledger account.

DLA COMMENTS:
Partially Concur. In July 1999, DLA identified and documented all the financial information resident in the integrated logistics financial legacy systems that should be reported in DLA's financial information systems. Crosswalks were done to validate that the financial information resident in the logistics end of the systems are reported to the appropriate general ledger accounts.

DISPOSITION: Complete

RECOMMENDATION B.3: Recommend that the Director, DLA, establish a formal evaluation process that requires the DLA to devote sufficient resources, identify and incorporate applicable Federal requirements, develop test plans, fully test and validate systems, and fully document test results Where DLA identifies deficiencies, take appropriate action to correct them.

DLA COMMENTS:
Partially concur. DLA, in coordination with DFAS, has established a dedicated Business Systems Modernization Steering Group (BSMSG) to address all recommended actions for the replacement of legacy systems. DLA and DFAS have identified the financial applications of SAMMS, DISMS, and BOSS as being substantially noncompliant accounting systems. These legacy systems are targeted to be replaced by the DLA Enterprise Resource Planning solution commercial off the shelf (COTS) systems. DLA and DFAS are only making system changes to legacy systems that are mandated by law, policies, directions or regulations.

DISPOSITION: Ongoing ECD: September 30, 2005

RECOMMENDATION B.4: Recommend that the Director, DLA, require DLA personnel to consider applicable Federal requirements before the Fuels Automated System is fielded. Involve Comptroller personnel and other knowledgeable personnel in the evaluation process.

DLA COMMENTS:
Partially concur. The system requirements for the Fuels Automated System (FAS) do include applicable Federal requirements. In the compilation of the financial reporting requirements, DLA in coordination with DFAS, used the Guide for Federal Requirements for Financial Systems, the DoD Financial Management Regulation, GAO Title 2 and 7 and OMB circular A-130. Comptroller, DFAS, and other knowledgeable personnel have been continually involved in the FAS evaluation process and applicable federal requirements are being considered prior to fielding this system

DISPOSITION: Complete

ACTION OFFICER: Jim O'Laughlin/Kerri Sawyer
REVIEW/APPROVAL: B.A. Blackman, Chief, Financial Policy, Systems and Control Group
COORDINATION: Annell W. Williams, DDAI

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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