# Audit Report

DEFICIENCIES IN FY 1998 DOD FINANCIAL STATEMENTS AND PROGRESS TOWARD IMPROVED FINANCIAL REPORTING

Report No. D-2000-041 November 26, 1999

Office of the Inspector General
Department of Defense

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**Acronyms**

| | |
|---|---|
| AFAA | Air Force Audit Agency |
| CFO | Chief Financial Officers |
| DFAS | Defense Finance and Accounting Service |
| DLA | Defense Logistics Agency |
| FFMIA | Federal Financial Management Improvement Act |
| PP&E | Property, Plant, and Equipment |
| SBR | Statement of Budgetary Resources |
| SFFAS | Statements of Federal Financial Accounting Standards |
| USD(AT&L) | Under Secretary of Defense for Acquisition, Technology, and Logistics |
| USD(C) | Under Secretary of Defense (Comptroller) |
| WCF | Working Capital Fund |
| Y2K | Year 2000 |

INSPECTOR GENERAL
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November 26, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Audit Report on Deficiencies in FY 1998 DoD Financial Statements and Progress Toward Improved Financial Reporting (Report No. D-2000-041)

We are providing this audit report for information and use. It identifies and summarizes the major deficiencies that prevented favorable audit opinions on the FY 1998 DoD financial statements. It also identifies and summarizes actions taken or planned to correct the deficiencies. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report were generally responsive, although they did not fully conform to the requirements of DoD Directive 7650.3. As part of our annual review of the Financial Management Improvement Plan, we will conduct followup work to determine if appropriate corrective actions were initiated and completed. Therefore, further comments on this final report are not necessary.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird at (703) 604-9159 (DSN 664-9159) (rbird@dodig.osd.mil) or Mr. Carmelo G. Ventimiglia at (317) 510-3852 (DSN 699-3852) (cventimiglia@dodig.osd.mil). See Appendix G for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. D-2000-041 November 26, 1999
(Project No. 8FI-2025.02)

# Deficiencies in FY 1998 DoD Financial Statements and Progress Toward Improved Financial Reporting

## Executive Summary

**Introduction.** This report summarizes the major deficiencies preventing favorable audit opinions on the FY 1998 DoD financial statements. It also provides an assessment of progress made in attaining auditable DoD financial statements. This is the fifth year in which we have issued a summary report on the major deficiencies preventing favorable audit opinions on the DoD financial statements. For FY 1998, DoD prepared and submitted for audit the DoD Agency-Wide financial statements and financial statements for 10 major funds. The Army Audit Agency, Naval Audit Service, and Air Force Audit Agency performed the financial statement audits for most of the DoD reporting entities. The FY 1998 DoD Agency-Wide financial statements reported $591.2 billion in total assets and $948.5 billion in total liabilities.

**Objectives.** The audit objectives were to identify and summarize the major deficiencies that prevented favorable audit opinions on the FY 1998 DoD financial statements and to identify the actions taken or planned to correct the deficiencies.

**Results.** Auditors identified and DoD financial managers acknowledged major deficiencies that prevented favorable audit opinions on the FY 1998 DoD financial statements. The overarching deficiency continues to be the lack of adequate financial management and feeder systems for compiling accurate and reliable financial data. Specifically, auditors were unable to render favorable audit opinions on the FY 1998 DoD Agency-Wide financial statements and supporting financial statements prepared for 9 of the 10 DoD reporting entities. The reasons were deficient financial management systems, insufficient audit trails, untimely submission of financial statements, lack of effective internal controls, and the resulting scope limitations that prevented auditors from auditing material lines on the DoD financial statements. Except for the unqualified audit opinion rendered on the DoD Military Retirement Trust Fund financial statements, auditors have been disclaiming opinions on DoD financial statements since FY 1988.

The General Accounting Office; the Inspector General, DoD; and the Military Department audit agencies have issued several hundred audit reports detailing DoD financial reporting deficiencies. In response, DoD financial managers have acknowledged significant problems with financial data and have been attempting to correct them. For example, DoD has established 10 implementation strategies, a set of action plans, to address the main barriers to compliance with Federal accounting standards and to achieve favorable audit opinions on the DoD financial statements.

DoD has numerous financial management system improvement initiatives in place to correct known deficiencies, but progress has been slow. Initiatives have been ongoing since August 1991, when the Defense Finance and Accounting Service developed plans to decrease the number of DoD financial management systems and correct system deficiencies. As of the end of FY 1998, DoD had 91 accounting systems, 18 finance systems, and 83 feeder systems. However, according to the 1998 DoD Biennial Financial Management Improvement Plan, compliant systems are not expected to be in place until FY 2003. In addition, the Plan identified feeder systems for which intermediate target dates extended beyond the FY 2003 milestone.

Until DoD deploys financial management systems that comply with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996, auditors will not be able to perform sufficient audit work on material financial statement line items to issue favorable audit opinions on the DoD financial statements. Because of the slow progress in correcting existing financial management system deficiencies, DoD needs to improve internal controls and visibility over initiatives to improve financial management systems. DoD could learn from its experience in bringing mission-critical systems into year 2000 compliance in a relatively short period of time. A similar management approach with a viable status reporting process would provide for more visible, accountable, and effective management of the financial management systems improvement effort.

**Summary of Recommendations.** We recommend that the Under Secretary of Defense (Comptroller), in coordination with the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Under Secretary of Defense for Personnel and Readiness; and the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), develop and implement a management plan, similar to the year 2000 conversion plan, to allow senior managers and Congress to track the status of DoD progress toward achieving financial management system compliance with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996.

**Management Comments.** The Under Secretary of Defense (Comptroller) provided comments on a draft of this report on October 25, 1999. The Under Secretary concurred with the intent of the recommendations. The Department recognized the benefits of a management plan, consisting of elements similar in nature to those followed in the DoD year 2000 approach, that allows senior managers within DoD to monitor the status of the DoD progress toward achieving systems compliant with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996. The complete text of the comments in the Management Comments section.

**Audit Response.** The comments from the Under Secretary of Defense (Comptroller) were generally responsive to our recommendations, although they did not specify actions that the Department would take to implement a year 2000 type plan or a process to monitor progress. As part of our yearly review of the Financial Management Improvement Plan, we will conduct followup work to determine what corrective actions are initiated and completed. In addition, effective application of the lessons learned from the year 2000 conversion should entail close coordination between this office and DoD management during the formulation of a more effective management control arrangement for financial management system improvement.

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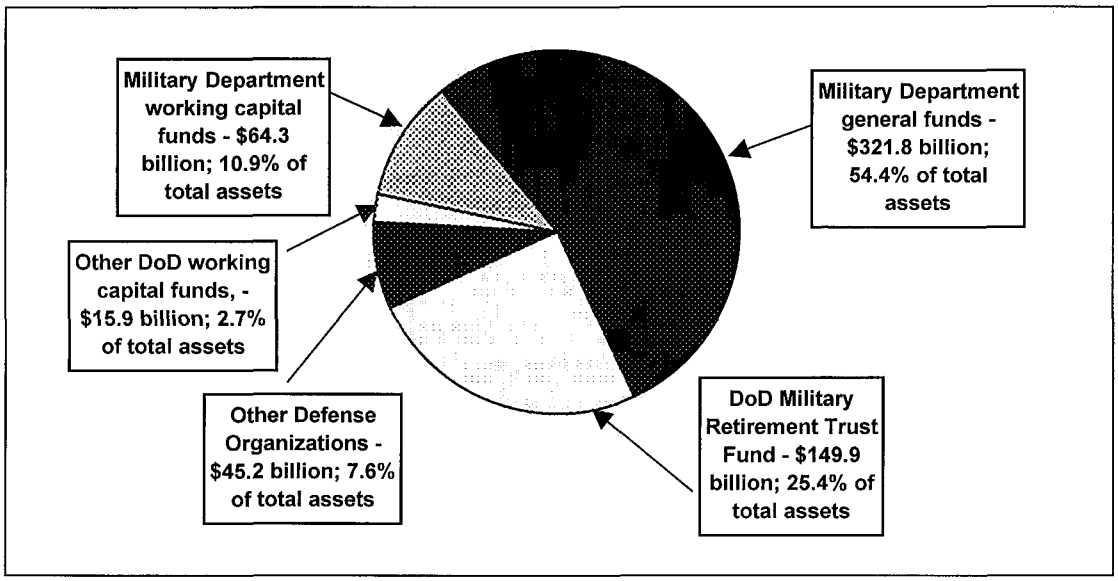
# Background

**Public Law.** Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments. The Chief Financial Officers Act of 1990 (CFO Act) requires the Inspectors General or appointed external auditors to audit the financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget. The Inspector General, DoD, and the auditors of the Military Departments, under the cognizance of the Inspector General, DoD, conducted the DoD audits. Public Law 103-356, the "Government Management Reform Act of 1994," October 13, 1994, requires DoD to prepare and submit to the Director, Office of Management and Budget, an audited financial statement for the preceding fiscal year for each DoD office, bureau, and organization.

**Magnitude of Assets.** In FY 1998, DoD prepared and submitted for audit the DoD Agency-Wide financial statements and 10 other financial statements for the Army, Navy, and Air Force general funds; the Army Corps of Engineers, Civil Works Program (the Corps); the Army, Navy, and Air Force Working Capital Funds; the Defense Logistics Agency (DLA) Working Capital Fund; the Defense Finance and Accounting Service (DFAS) Working Capital Fund; and the DoD Military Retirement Trust Fund. Although auditors reviewed the data on the "Other Defense Organizations" column of the DoD consolidating financial statements, DoD did not prepare individual financial statements for Other Defense Organizations. The FY 1998 DoD Agency-Wide financial statements reported total assets of $591.2 billion. The following figure shows the magnitude of the assets reported in the FY 1998 DoD Agency-Wide financial statements but does not reflect $5.9 billion (1 percent) of eliminating entries.




**FY 1998 DoD Consolidated Assets ($591.2 billion)**

In the figure, the DoD Components' asset totals add up to more than the DoD consolidated asset total because some receivables and advances for the DoD Military Department general funds were eliminated from the DoD consolidated asset total.

Appendix C shows total DoD assets for FY 1998, by reporting entity.

**Audit Opinions.** The objective of a financial statement audit by independent auditors is to render an audit opinion. The opinion is based on the auditors' determination of whether or not the financial statements present fairly, in all material respects, the financial position, the results of operations, and the cash flows of the audited organization. The auditors review the financial statements for conformity with generally accepted accounting principles and other comprehensive bases of accounting. Auditors render an opinion, or if required, disclaim an opinion. Auditors can render three types of audit opinions.

- An unqualified opinion states that the financial statements are fairly presented.
- A qualified opinion states that, except for stated qualifications, the financial statements are fairly presented.
- An adverse opinion states that the financial statements are not fairly presented.

When auditors cannot conduct an audit, they issue a disclaimer of opinion. A disclaimer states that the auditors are not rendering an opinion on the financial

statements. A disclaimer is appropriate when auditors have not performed an audit sufficient in scope to allow them to form an opinion on the financial statements. Restrictions on the scope of an audit, whether imposed by the client or by circumstances, may result from limitations on the timing of work, the inability to obtain sufficient evidence, or the inadequacy of accounting records.

**Previous Audits of DoD Financial Statements.** Audits of the DoD financial statements have been performed since FY 1988, when the General Accounting Office attempted to audit the Air Force General Fund. Except for unqualified opinions rendered on the DoD Military Retirement Trust Fund, auditors have rendered disclaimers of opinion on major DoD financial statements. The following table lists the audit opinions rendered on the FY 1998 DoD financial statements.

**Audit Opinions on the FY 1998 DoD Financial Statements**

| Reporting Entity | Audit Organization | Opinion |
|---|---|---|
| DoD Agency-Wide | Inspector General, DoD | Disclaimer |
| Army General Fund | Army Audit Agency | Disclaimer |
| Army Working Capital Fund | Army Audit Agency | Disclaimer |
| Army Corps of Engineers, Civil Works Program | Army Audit Agency | Disclaimer |
| Navy General Fund | Naval Audit Service | Disclaimer |
| Navy Working Capital Fund | Naval Audit Service | Disclaimer |
| Air Force General Fund | Air Force Audit Agency | Disclaimer |
| Air Force Working Capital Fund | Air Force Audit Agency | Disclaimer |
| DLA Working Capital Fund | Inspector General, DoD | Disclaimer |
| DFAS Working Capital Fund | Inspector General, DoD | Disclaimer |
| DoD Military Retirement Trust Fund | Inspector General, DoD | Unqualified |
| Other Defense Organizations* | Inspector General, DoD | – |

*Formal CFO financial statements were not produced, but data are part of the FY 1998 DoD Agency-Wide financial statements.

# Objectives

The objectives of the audit were to identify and summarize the major deficiencies that prevented favorable audit opinions on the FY 1998 DoD financial statements and to identify actions taken or planned to correct the deficiencies. See Appendix A for a discussion of the audit process and Appendix B for prior audit coverage.

# Impediments to Favorable Audit Opinions on the FY 1998 DoD Financial Statements

DoD financial managers have acknowledged significant long-standing problems that prevent favorable audit opinions on the FY 1998 DoD financial statements, which reported $591.2 billion in total assets, and have made financial management a top priority. DoD financial managers took numerous actions to address the problems, but progress has been slow. Since 1990, auditors continued to identify and report deficiencies that prevented favorable audit opinions on DoD financial statements. Favorable audit opinions were not possible because of the lack of adequate financial management and feeder systems for compiling accurate and reliable financial data. Other reasons for disclaimers of opinion on the FY 1998 DoD financial statements were insufficient audit trails, untimely submission of financial statements to the auditors, lack of effective internal controls, and the resulting scope limitations that prevented auditors from auditing material line items on the DoD financial statements. As a result, except for an unqualified opinion on the DoD Military Retirement Trust Fund, auditors disclaimed opinions on all FY 1998 DoD financial statements as they were not accurate and the financial management information was not reliable.

## DoD Agency-Wide Financial Statements

Auditors were unable to render an opinion on the FY 1998 DoD Agency-Wide financial statements. The FY 1998 financial statements reported $591.2 billion in DoD assets. Auditors continued to find significant deficiencies in the financial management systems and internal controls that prevented the preparation of accurate financial statements. Further, the auditors did not receive the FY 1998 DoD Agency-Wide financial statements in a timely manner. The accounting data were not reliable, and the auditors could not determine whether the data were accurate and complete.

**Financial Management Systems.** DoD financial managers acknowledged that the financial management systems supporting DoD financial data did not have integrated, double-entry, transaction-driven general ledgers to compile and report reliable and auditable information. The information was not auditable because the financial management systems could not produce an accessible audit trail of information from the occurrence of a transaction through its recognition in the accounting records and ultimately to the DoD financial statements. The lack of an audit trail presents a significant scope limitation and will continue to prevent favorable audit opinions on the major DoD financial statements. In addition, the DoD financial management and feeder systems did not fully comply with internal control objectives or Federal financial management systems requirements, which were established in Office of

Management and Budget Circular No. A-127, "Financial Management Systems," July 23, 1993. As a result, the financial information maintained by the systems was not always reliable. Inadequate systems and a lack of reliable information impede the compilation of accurate financial statements. Data common to or required by more than one system were not exchanged among the systems in a timely, effective, or efficient manner. The lack of effective and efficient system interfacing and integration contributes to unmatched disbursements.

**Federal Financial Management Improvement Act of 1996.** DoD was not in full compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA). For example, DoD financial management systems were not in compliance with Office of Management and Budget Circular No. A-127 and requirements that the Joint Financial Management Improvement Plan set forth. Identified weaknesses include the following.

- DoD did not have an integrated financial management system.
- Army, Navy, Air Force, and DFAS financial management systems did not maintain adequate audit trails and documentation requirements for journal entries.
- The DFAS financial management systems did not selectively generate the transactions required for year-end closing procedures and the carryover of general ledger account balances.
- The Navy did not have an integrated financial management system from which to extract financial data for use in preparing the financial statements.
- Many DoD feeder systems had significant deficiencies in general and application controls such as accreditation, configuration management, separation of duties, and access controls and were unable to provide data that could be relied upon for financial management reporting purposes.

In addition, the financial management systems that supported DoD did not substantially comply with Federal accounting standards. Specifically, DoD financial management systems did not comply with the following provisions of Statements of Federal Financial Accounting Standards (SFFAS), which are agreed to by the Director of the Office of Management and Budget, the Comptroller General of the United States, and the Secretary of the Treasury. SFFAS and Concepts are listed in Appendix D.

- DoD financial management systems did not properly account for accounts receivable and payable in accordance with SFFAS No. 2.

- DoD financial management systems and methodology for valuing inventory were not consistent with SFFAS No. 3.

- DoD financial management and feeder systems were unable to account for and report costs in accordance with SFFAS No. 5, particularly for intra-agency transactions.

- DoD financial management systems did not value and depreciate property, plant, and equipment (PP&E) in accordance with SFFAS No. 6.

**Timeliness of Financial Statements.** DoD did not provide the DoD Agency-Wide financial statements for FY 1998 in time for auditors to perform all of the necessary audit work to verify reported amounts. For example, we did not receive the FY 1998 DoD Agency-Wide financial statements until March 1, 1999. As a result, auditors had to rely on the line item totals of the DoD Components' financial statements for audit procedures and conclusions.

**Real and Personal Property.** DoD was not in compliance with Federal-wide standards in accounting for real and personal property. General ledger control over property, which is used to better ensure that all financial transactions are recorded in the official accounting records, was often inadequate. Recent financial audits identified unreliable balances reported for real and personal property.

**Government-Furnished Property.** DoD did not have accurate, complete, and auditable financial data for approximately $90 billion of Government property (acquisition value) in the custody of contractors. The system used to report the Government property did not apply capitalization thresholds, did not compute depreciation, did not distinguish between assets of the general funds and working capital funds (WCFs), and did not provide data in time to meet financial statement reporting milestones.

**Liabilities.** DoD had problems with accurately reporting the $34 billion of environmental liabilities. For FY 1997, the DoD Components did not consistently report all environmental cleanup costs. For FY 1998, the data supporting the DoD environmental liabilities were not accurate, complete, or supportable because of the following:

- DoD did not provide adequate criteria for reporting environmental liabilities,

- the process for estimating cleanup costs was not adequately documented,

- DoD used inconsistent cost estimating procedures, and

- DoD did not include significant liabilities for weapon system disposal and overseas cleanup in the reported liability balance.

As a result, environmental liabilities reported as part of the Other Liabilities line-item on the FY 1998 DoD Agency-Wide financial statements are unreliable and likely to be materially understated.

**Problem Disbursements.** Although DoD reported progress in reducing the dollar values of disbursements that were not matched with corresponding obligations in the accounting records, DoD continued to have at least $20.7 billion in disbursements that were not properly recorded in the accounting records. Also, no progress had been made in reducing aged in-transit disbursements and problem disbursements for the Army and some Defense agencies. Therefore, financial statements showing the status of budgetary resources were unauditable and may have been materially misstated. The risks of overdisbursement and potential Antideficiency Act violations remain unacceptably high.

**Accounting Adjustments.** DFAS adjusted financial data to agree with various data sources and to add new data. DFAS made the adjustments without properly researching and reconciling differences between the accounting data and other data sources or providing adequate audit trails. Adjustments to accounting data that are not properly supported by an audit trail indicate potential problems in DoD financial management systems. The lack of proper research, reconciliations, and audit trails impair management's ability to support the financial data. Proper research, reconciliations, and audit trails are important internal controls addressed in Federal financial system requirements. Auditors identified approximately $1.7 trillion in adjustments that were not supported by proper reconciliations or an adequate audit trail. The adjustments were made to the financial data for the Army General Fund, Army WCF, Navy General Fund, Other Defense Organizations, and the DLA WCF.

## FY 1998 Financial Statements of the Military Department General Funds

Auditors were unable to render opinions on the FY 1998 financial statements of the Military Department general funds. The financial management systems that support the Military Department general funds, representing $321.8 billion of the $591.2 billion in DoD consolidated assets, did not have integrated, double-entry, transaction-driven general ledgers to compile and report reliable and auditable FY 1998 financial data. The reported assets for the Military Department general funds and the Corps represent 54.4 percent of DoD consolidated assets. The financial data were not auditable because of inadequate financial management systems, insufficient audit trails, and untimely preparation of the FY 1998 financial statements. Procedural and compliance problems also contributed to the unreliable amounts on the financial statements. Because of inadequate financial management systems, auditors were unable to obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the financial statements. Until financial management and feeder systems with integrated, double-entry, transaction-driven general ledgers are

developed to compile and report financial data, auditors will be unable to determine whether valid transactions are properly recorded, processed, and summarized. Lack of adequate financial management and feeder systems is a significant long-standing scope limitation that is likely to continue to cause disclaimers of opinion on the Military Department general fund financial statements. The following is a discussion of the reasons for disclaimers on the financial statements of the Army, Navy, and Air Force General Funds and the Army Corps of Engineers.

**Army General Fund.** Auditors were unable to render an opinion on the FY 1998 Army General Fund financial statements, which reported assets of $69.6 billion, for the following reasons.

**Financial Management Systems and Audit Trails.** Because of the persistent problems with inadequate financial management systems, insufficient audit trails, and procedural problems, auditors were unable to apply practical methods to conduct audit work of sufficient scope. For example, inadequate financial management systems required the DFAS Indianapolis Center to force the general ledger to match the status of funds data by making unsupported adjustments of at least $512 billion.

**Financial Statement Preparation.** The FY 1998 Army General Fund financial statements were late and incomplete. The unaudited financial statements, which were to have been provided to auditors by December 24, 1998, were not provided until January 8, 1999. The DFAS Indianapolis Center then made 183 adjustments, valued at $225 billion, to the January 8, 1999, statements, of which only 14 adjustments for $44 billion were auditor-recommended. Auditors did not receive the revised draft version of the financial statements until February 12, 1999. The official revised version of the financial statements was not provided until February 16, 1999, providing insufficient time for the auditors to review the financial statements and meet the March 1, 1999, reporting deadline that the Office of Management and Budget established.

**Fund Balance With Treasury.** Auditors were not able to attest to the reasonableness of the $29.5 billion reported for "Fund Balance With Treasury" in FY 1998. Treasury reports showed a net amount of about $704.3 million of unresolved discrepancies between U.S. Treasury records and disbursing officer statements of accountability for checks issued. The total amount of the discrepancies was about $1.8 billion.

**Statement of Budgetary Resources.** The financial management systems, key accounting procedures, and accounting practices used for preparing the Statement of Budgetary Resources (SBR) did not comply with legal and regulatory requirements. DFAS Indianapolis Center did not use the general ledger to prepare the SBR. Instead, DFAS Indianapolis Center used information from other budgetary reports. Because the systems did not comply with FFMIA, DFAS Indianapolis Center personnel had to rely on fund control data for part of the data reported in the SBR instead of relying on accounting data from a general ledger as required. DFAS Indianapolis Center personnel had to develop crosswalks and complicated formulas to convert the data for the

statement. The lack of financial management systems and the use of alternative procedures for preparing financial statements meant that adequate audit trails were not available to trace summary transactions or balances to source documentation.

**Navy General Fund.** Auditors were unable to render an opinion on the FY 1998 Navy General Fund financial statements, which reported assets of $117 billion, for the following reasons.

**Financial Management Systems.** The Navy did not have transaction-driven standard general ledger financial management systems that could accurately report the value of assets and liabilities, including the status of funds appropriated. As a result, auditors could not determine the reliability of the Navy financial statements.

**Operating Materials and Supplies.** An estimated $23 billion in operating materials and supplies was not included on the FY 1998 Navy consolidated balance sheet. In addition, about $10.6 billion in Government-furnished material was improperly expensed as general PP&E instead of being reported as operating materials and supplies.

**Contingent Liabilities.** The account balance for environmental liabilities did not include data as of September 30, 1998. Instead, the Navy used data as of March 31, 1998, because Navy personnel did not obtain September 1998 data in time to meet reporting deadlines. As a result, the $5.8 billion recorded in the Contingent Liabilities account for environmental cleanup was overstated by at least $668.6 million. In addition, the auditors did not receive supporting data in time to validate the remainder of the $5.8 billion value, and they were therefore unable to determine the reasonableness of the reported value.

**Statement of Net Cost.** The FY 1998 Navy Statement of Net Cost did not meet the intent of the CFO Act and the Government Performance and Results Act of 1993. The statement did not meet the requirements because the Navy did not have a system or controls in place to ensure that all costs were included in the Statement of Net Cost and could be traced to transaction-level detail. Therefore, the auditors could not verify the accuracy of the $73.4 billion reported for the Net Cost of Operations line, $486.8 million in additional costs could not be assigned to an appropriation, and the cost data in the FY 1998 Navy Statement of Net Cost were unreliable and incomplete.

**Unliquidated Obligations.** The auditors identified $101.2 million in unliquidated obligations associated primarily with indefinite-delivery contracts and basic ordering agreements that were invalid. The unliquidated obligations were invalid because contract prices in the Mechanization of Contract Administration Services system were never recorded in the Standard Accounting and Reporting System and because adjustments for closed contracts with residual unliquidated amounts were not properly recorded in the Standard Accounting and Reporting System.

**Disbursements.** Footnote 23 of the FY 1998 Navy financial statements identified about $7.4 billion of disbursements that were not correctly matched to obligations in the accounting records. Matching problems occurred because the functions of disbursing and accounting were separated, which allowed payments to be made without determining whether corresponding obligations existed.

**Financial Statement Preparation.** The financial management systems and processes that DFAS Cleveland Center implemented for compiling the FY 1998 Navy financial statements could not adequately produce auditable financial statements. The DFAS Cleveland Center performed the following actions:

- made adjustments to move data from budgetary accounts into proprietary accounts to balance the general ledger,
- made monthly adjustments to budgetary general ledger accounts to "balance" budgetary reports, and
- posted one-sided entries.

**Air Force General Fund.** Auditors were unable to render an opinion on the FY 1998 Air Force General Fund financial statements, which reported assets of $96.3 billion, for the following reasons.

**Operating Materials and Supplies.** Operating materials and supplies, valued at $28.4 billion, were valued on the balance sheet at latest acquisition costs, which were generally higher than the historical costs required by accounting standards. Also, the Air Force used the latest acquisition cost method without computing unrealized gains or losses because of price changes since acquisition.

**Closed Year Appropriations.** Closed year appropriation balances for accounts receivable and accounts payable were not reliable. In addition, accounts payable were understated by approximately $387.6 million for payables held at DFAS Columbus Center because the payables had not been prevalidated with the accountable station.

**Valuations for Equipment.** Valuations for equipment, other than vehicles and computer equipment, were based on latest acquisition cost, and no gains or losses were recognized for changes in the latest acquisition cost.

**Computer Equipment.** The system used to account for computer equipment could not distinguish between equipment owned by the general fund and equipment owned by the WCF.

**Audit Trails.** DFAS Denver Center personnel did not maintain a clear audit trail from obligation and disbursement amounts reported on the financial statements to related transactions recorded at the DFAS operating locations. In addition, both the DFAS Denver Center and operating locations initiated adjustments to the data, which further obscured the audit trail.

**Matching Disbursements to Obligations.** DFAS internal controls did not ensure proper matching of disbursements and related obligations, resulting in $388 million of negative unliquidated obligations in the financial management system.

**End of Period Cutoffs.** The Air Force and DFAS did not satisfy the assertion of completeness and ensure that only FY 1998 transactions were recorded in the FY 1998 records. For example, DFAS posted some FY 1997 transactions to FY 1998 records and some FY 1998 transactions to FY 1999 records. The erroneous postings involved aviation fuel purchases, contract modifications, and accounts payable transactions. For example, DFAS personnel recorded FY 1997 and earlier aviation fuel purchases of $210.9 million in FY 1998 and did not adjust the reported purchases when they processed the excluded transactions in FY 1998. The same cutoff procedures caused late FY 1998 transactions to be incorrectly recorded in FY 1999 data.

**Gains and Losses.** The Air Force could not accurately identify and report uninstalled aircraft engine gains and losses for FY 1998 because the Comprehensive Engine Management System computer system could not differentiate between true gains and losses to the Air Force and to other transactions. The Air Force included the other transactions in the gain and loss data reported to the DFAS Denver Center. Further, the auditors could not find supporting documentation for 98 of 178 gain transactions reviewed.

**Army Corps of Engineers, Civil Works Program.** Auditors were unable to render an opinion on the FY 1998 financial statements of the Corps, which reported assets of $38.8 billion, for the following reasons.

**Fund Balance With Treasury.** The Corps Fund Balance With Treasury account balance in its financial management system did not agree with the account balance that the U.S. Treasury reported. On September 30, 1998, the difference between the Corps and the U.S. Treasury account balances was about $500 million. The Corps accounting records had a balance of about $3 billion before adjustments and $2.7 billion after adjustments. The U.S. Treasury reported a balance of about $2.5 billion. The Corps reported the U.S. Treasury balance on its FY 1998 financial statements.

**Accounts Receivable.** Accounts receivable were materially incomplete and lacked an allowance for estimated uncollectible amounts. The Corps needed to make changes to its financial management system to help it consistently apply generally accepted accounting principles for accounts receivable. Specifically, districts and other organizations needed to do the following:

- record long-term accounts receivable and long-term accounts payable and
- estimate and record an allowance for loss on accounts receivable and the corresponding bad debt expense.

**Real Property.** The real property values in the Corps' general and subsidiary ledgers did not agree. The net difference between the general and subsidiary ledger for real property assets was about $4 billion, with an absolute value of $6 billion. In addition, about 29,000 real property assets were in the financial management system with no recorded book value.

**Statement of Net Cost.** The Corps did not fully implement the Federal Accounting Standards Advisory Board requirements for its FY 1998 Statement of Net Cost. The Federal Accounting Standards Advisory Board standards require the Corps to present the statement by business program, but the Corps presented the statement by appropriation. The inappropriate presentation occurred because the Corps had not completed system programming to identify the appropriate business program for revenue and expense transactions. However, the Corps complied with the requirements of the FY 1998 DoD Financial Management Regulation, which delayed presentation by business program until FY 1999.

**Statement of Budgetary Resources.** The Corps needed to improve how it reports revolving fund transactions when it produces the SBR. The Corps performed the following actions in regard to the SBR:

- reported $2.3 billion on line 1 (Budget Authority), instead of line 4 (Spending Authority From Offsetting Collections), of the statement;
- made adjustments totaling about $388.8 million on the Standard Form 133 report that were improperly recorded on the SBR; and
- prepared the Standard Form 133 report annually instead of quarterly.

Additionally, the Corps did not present the supplementary information on individual budget accounts related to the SBR that the Office of Management and Budget determined was necessary to supplement, although not required to be a part of, the basic financial statements. The Corps did not prepare the related supplementary information by individual budget account required by Federal accounting standards. The departure was caused by improper DoD implementation of Federal accounting standards.

**Summary for Military Department General Funds.** The financial management systems that support the Military Department general funds account for more than half of DoD consolidated assets. Therefore, DoD should continue to focus its efforts on the development and implementation of compliant financial management and feeder systems that support the Army, Navy, Air Force, and Corps General Funds. During FY 1998, the Corps completed implementation of a financial management system with a standard, transaction-driven general ledger. Developing and implementing compliant financial management and feeder systems should allow the production of useful financial information that DoD financial managers need to effectively and efficiently manage about half of DoD financial resources. In addition, the by-product of

compliant financial management systems, accessible audit trails, would eliminate the major scope limitation that prevents auditors from performing sufficient audit work and prevents favorable audit opinions on the financial statements of the Military Department general funds.

## FY 1998 Financial Statements of the Military Department Working Capital Funds

Auditors were unable to render opinions on the FY 1998 financial statements of the Military Department WCFs, which represent $64.3 billion of DoD consolidated assets, because of deficient financial management systems, insufficient audit trails, and unreliable amounts for several material line items. The reported assets for the financial statements represented 10.9 percent of DoD consolidated assets. Procedural and compliance problems also contributed to the unreliable amounts on the financial statements. Consequently, auditors could not obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the FY 1998 financial statements of the Military Department WCFs.

**Army Working Capital Fund.** Auditors were unable to render an opinion on the FY 1998 Army WCF financial statements, which reported assets of $14.2 billion, for the following reasons.

**Financial Management Systems.** The financial management systems used to account for the Army WCF did not have complete general ledger control and, in some instances, lacked adequate audit trails. Instead, the Army and DFAS used supply, logistics, or budgetary systems to prepare portions of the statements. Those operational systems also had deficiencies.

**Balance Sheet.** Because of financial management system deficiencies, the auditors could not determine whether amounts reported in the balance sheet were reasonable and fairly presented.

**Inventory and Related Property, Net.** The Army adjusted, without reconciling, its accounting records by about $3.1 billion, so that they agreed with the logistical records. The Army believed that its logistical records were a better source for determining the value of Inventory and Related Property, Net. However, the logistical records were not always accurate. Therefore, the Army could not be sure that the inventory balances shown in the accounting records were accurate. Also, the Army financial management systems did not account for inventory held for repair as required by SFFAS No. 3, "Accounting for Inventory and Related Property."

**Inventory In-Transit From Procurement.** The auditors could not satisfy themselves as to the reasonableness of the $595 million reported for inventory in-transit from procurement. The Army did not account for inventory in-transit from procurement using acceptance and receipt

transactions. The Army computed the value by comparing inventory receipts and disbursements made for inventory purchased. The auditors could not reasonably use any other auditing procedures to satisfy themselves as to the reasonableness of the reported amount. The auditors also identified actions that caused the value to be recorded as both inventory in-transit and on-hand.

**Government-Furnished Material.** The auditors could not determine the reasonableness of the $630 million reported for Government-furnished material because of a scope limitation on the ability of logistical or financial management systems to accurately identify material in the possession of contractors.

**PP&E, Net.** The auditors could not satisfy themselves as to the reported value of PP&E, Net, because the Army did not have documentation supporting historical cost, as required by SFFAS No. 6. In addition, the Army depot maintenance organizations did not have a financial management system in place that provided data needed for accurate financial accounting of real property.

**Statement of Net Cost and Statement of Changes in Net Position.** The financial management systems used to account for transactions that affected the Statement of Net Cost and the Statement of Changes in Net Position did not maintain sufficient data to trace transactions to the general ledger. For example, the auditors could not determine whether the $9 billion reported as revenue for the supply business area was reasonable and fairly stated because the general ledger did not agree with the Financial Transaction Register.

**SBR.** The auditors could not determine whether the reported amounts in the SBR were reasonable and fairly stated because much of the information included in the statement came from sources other than the general ledger system. The DFAS Indianapolis Center used other sources because general ledgers that the financial management systems produced at the fiscal stations did not contain necessary data in sufficient detail.

**Statement of Financing.** Because the Statement of Financing was prepared from the same systems used to prepare the Statement of Net Cost and the SBR, the scope limitation encountered during the auditors' review of the Statement of Net Cost and the SBR also prevented auditors from determining whether the information included in the Statement of Financing was fairly presented.

**Navy Working Capital Fund.** Auditors were unable to render an opinion on the FY 1998 Navy WCF financial statements, which reported assets of $24.5 billion, for the following reasons.

**Financial Management Systems.** Navy WCF financial management systems could not adequately control, distribute, or transfer collections and disbursements because audit trails were lacking. Other issues include the following.

- The Navy relied on nonstandard systems because it did not have a plan for the establishment and maintenance of a single integrated financial management system.
- The U.S. Government Standard General Ledger was not being used at the transaction level because DFAS used existing financial management systems for the Navy WCF organizations, which required the use of crosswalks to satisfy the requirement.
- Local commands were using nonstandard budgetary systems because standard financial management systems did not include budgetary charts of accounts.

**Accounts Receivable, Net, Federal and Non-Federal.** Transactions could not always be segregated at selected organizations because they did not establish appropriate general ledger accounts. Also, subsidiary accounts were not reconciled to the general ledger because of a lack of management policy and procedures in performing and posting adjustments to the general ledger.

**Inventory and Related Property, Net.** Records for Inventory and Related Property, Net, valued at $16.4 billion, were inaccurate because of errors in inventory transaction processing and reporting, commercial repair transaction program recognition inadequacies, and the lack of or questionable reporting by some contractors. Values were not accurately reported because of the following conditions.

- In the "Inventory Held for Repair" category, valued at $6.5 billion, the Navy reported items inaccurately because all condition codes were used instead of just the assets needing repairs.
- In the "War Reserve Material" category, valued at $0.2 billion, the Navy reported inventories inaccurately because current information was not requested in a timely fashion for reporting purposes.
- The Navy reported property clearing as a revenue instead of a reduction to purchases, causing inventory to be misstated.
- The inventory valuation model contained material misstatements because of weaknesses in the standard operating procedures and allowance treatment of accounts that were period gains and losses.

**Management Representation Letter.** The Navy WCF provided a management representation letter too late for auditor review or inclusion in the audit report.

**Operating Materials and Supplies.** Operating materials and supplies held for use at industrial organizations had not been revalued to historical cost because of a lack of policies and procedures.

**Air Force Working Capital Fund.** Auditors were unable to render an opinion on the FY 1998 Air Force WCF financial statements, which reported assets of $25.6 billion, for the following reasons.

**Financial Management Systems.** Because of significant financial management system internal control weaknesses, neither DFAS nor the Air Force could ensure that they properly recorded, processed, and summarized only valid transactions and provided accurate financial information. DFAS and the Air Force did not have a transaction-driven general ledger to provide a single source for compiling and reporting financial information for use in preparing the Air Force WCF financial statements.

**Account Balances.** Material uncertainties existed regarding the reasonableness of amounts reported in the FY 1998 Air Force WCF financial statements. Amounts reported on the statements were unauditable, such as $18 billion in inventory, $2.8 billion of PP&E, and $18.8 billion of obligations incurred on the SBR. Uncertainties existed because of the following:

- Air Force supply systems were unable to properly account for and value inventory,
- Air Force depot maintenance and Transportation Command systems did not account for or properly value all PP&E,
- supply and contract depot maintenance systems did not account for cost of goods sold at cost, and
- DFAS and Air Force current budget and financial management systems did not retain subsidiary ledgers and special journals.

**Management Assertions.** Significant conditions adversely impacted the five management assertions. Specifically, the auditors found significant conditions concerning management assertions related to existence or occurrence, completeness, valuation or allocation, rights and obligations, and presentation and disclosure. Examples for each management assertion follow.

**Existence or Occurrence.** Unliquidated obligations totaling $244.6 million recorded in the SBR were either not supported, invalid, or no longer needed.

**Completeness.** The auditors identified 155 equipment items, costing about $108.1 million, furnished to contractors, and the Depot Maintenance Activity Group (Depot Maintenance Group) did not capitalize the items on the balance sheet.

**Valuation or Allocation.** Air Force Materiel Command (the Materiel Command) organizations did not recognize contract depot maintenance revenue based on the percentage-of-completion method of accounting. As a result, the Materiel Command overstated the Depot Maintenance Group revenues reported in the FY 1998 Statement of Net Cost by about $359.3 million.

**Rights and Obligations.** DFAS and Air Logistics Center accounting personnel overstated Depot Maintenance Group unliquidated obligation balances reported in the SBR and understated available budgetary resources by $510 million.

**Presentation and Disclosure.** Within the Depot Maintenance Group, the Materiel Command categorized and reported all contract depot maintenance materials on-hand at contractor facilities ($182.4 million) as operating materials and supplies "held for current use." However, based on analysis of on-hand inventory balances, historical usage data, and excess Government-furnished material reports, the statement should have presented operating materials and supplies as follows: $14.8 million "held for current use"; $74.6 million "held in reserve for future use"; and $93 million as "excess, obsolete, and unserviceable."

**Summary for Military Department Working Capital Funds.** Problems with recording and reporting accurate and reliable financial data found during the audits of the Military Department WCF financial statements were also reflected in the audits of the Military Department general funds. In summary, the problems were financial management system deficiencies, not using a standard transaction-driven general ledger, insufficient audit trails, and unreliable amounts for several material line items on the financial statements. Unless Military Departments resolve the major deficiencies, we will remain unable to perform sufficient audit work to render audit opinions on the Military Department WCF financial statements, which account for 10.9 percent of DoD Agency-Wide assets.

## Financial Statements of Other DoD Working Capital Funds

Auditors were unable to render favorable audit opinions on the financial statements of the other DoD WCFs. The other DoD WCF financial statements represent $15.9 billion, or 2.7 percent, of DoD consolidated assets. Only two other DoD WCFs were subject to audit in FY 1998: the Defense Logistics Agency (DLA) WCF and the DFAS WCF. The main reasons for disclaimer on the other DoD WCF financial statements were previously reported material

deficiencies in the financial management systems and internal controls on which both DLA and DFAS had initiated corrective actions but for which they had not completed the actions during FY 1998.

**DLA Working Capital Fund.** Auditors were unable to render an opinion on the FY 1998 DLA WCF financial statements, which reported assets of $12.7 billion, for the following reasons.

**Financial Management Systems.** Critical automated systems did not comply with the requirements outlined in the FFMIA. Specifically, the automated systems did not comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, other critical systems were not evaluated for compliance with the requirements. The automated systems were often inadequately documented, kept inadequate audit trails, and did not have the capability to provide timely access to the information kept in them.

**Inventory Record Accuracy.** Despite increased efforts during FY 1998 to improve its sampling techniques for measuring record accuracy, DLA did not implement a sound statistical sampling plan to measure the dollar accuracy of its distribution depot inventory records.

**Inventory Valuation.** The methodology used to estimate the historic cost of ending inventories and cost of goods sold during the year was not adequate. In an attempt to comply with SFFAS No. 3, which requires that inventories be valued at historic cost, the Under Secretary of Defense (Comptroller) developed a methodology to convert inventories at latest acquisition cost to estimated historic cost. The methodology was established in the DoD Financial Management Regulation. DLA was required to use the DoD methodology to estimate the historic cost of its ending inventory and cost of goods sold. However, the DoD methodology did not comply with Federal accounting standards regarding the treatment of inventory gains and losses, did not contain adequate guidance to properly account for established inventory transaction codes, and was not adequately documented. In addition, the methodology was dependent on unreliable information produced by the DLA automated systems and the ability of DFAS to translate the DLA inventory records into the six inventory accounts in the U.S. Government Standard General Ledger.

**PP&E.** DLA did not have centralized control to inventory and reconcile its PP&E records to on-hand assets. As a result, the auditors could not verify that the $2.2 billion acquisition value of PP&E or the $1.45 billion of accumulated depreciation expenses reported on the FY 1998 financial statements were complete and accurate.

**Cash Reconciliations.** The DFAS Columbus Center did not reconcile cumulative DLA cash counts to the amounts reported to the Department of the Treasury. As a result, the DFAS Columbus Center made more than $1 billion in unsupported adjustments to FY 1998 accounts receivable

and accounts payable. In addition, auditors could not verify the DLA FY 1998 year-end obligated balance of $4.6 billion and Fund Balance With Treasury of $572.8 million.

**DFAS Working Capital Fund.** Auditors were unable to render an opinion on the FY 1998 financial statements of the DFAS WCF, which reported assets of $0.7 billion, because of continued deficiencies in systems and control procedures. The DFAS financial management systems did not substantially comply with the requirements of FFMIA. Specifically, the Defense Business Management System, which is one of the sources used to compile the DFAS WCF financial statements, did not substantially comply with Federal financial management system requirements. The Defense Business Management System general ledger did not support Fund Balance With Treasury and used a chart of accounts that did not comply with the U.S. Government Standard General Ledger at the transaction level. Auditors could not trace amounts recorded in budgetary and proprietary accounts to supporting transactions because DFAS deleted transactions that had been disbursed and finalized from the Defense Business Management System on a quarterly basis. Internal controls were not adequate to ensure the accurate reporting of fixed assets on the FY 1998 DFAS WCF financial statements. As a result, fixed assets, valued at $705.3 million, were not properly valued, classified, and presented on the financial statements.

**Other Defense Organizations Working Capital Funds.** Six Other Defense Organizations WCFs were not subject to audit in FY 1998. The Other Defense Organizations WCFs not subject to audit were the Defense Commissary Agency, the Defense Information Systems Agency, the Defense Technical Information Services Center, the Joint Logistics Systems Center, the Office of the Secretary of Defense Corporate Account, and the Headquarters Account. The Other Defense Organizations WCF financial statements represent $2.5 billion, or 0.4 percent, of DoD consolidated assets.

## Other Defense Organizations Financial Data

DoD auditors reviewed Other Defense Organizations' financial data for the FY 1998 DoD consolidating financial statements. The Other Defense Organizations accounted for $45.2 billion, or 7.6 percent, of DoD consolidated assets. The DFAS Indianapolis Center did not have effective internal controls in place to compile the FY 1998 financial statements for the Other Defense Organizations in a reliable and timely manner. Internal controls did not provide reasonable assurance that disbursements, collections, accounts payable, accounts receivable, and net obligations were accurately shown on the Report on Budget Execution. The DFAS Indianapolis Center made unsupported budgetary adjustments of $17.7 billion, an amount material to the FY 1998 DoD Agency-Wide financial statements. The $17.7 billion consisted of adjustments of $4.6 billion to collections, $1.5 billion to disbursements, $7.8 billion to accounts payable, and $3.8 billion to accounts receivable. The lack of transaction-driven general ledger financial management systems for Other

Defense Organizations; the inability to implement prior Inspector General, DoD, recommendations; and the lack of reconciliation procedures contributed to the ineffective internal controls.

## DoD-Wide Improvements Taken or Planned

DoD financial managers have acknowledged significant long-standing problems that prevent favorable audit opinions on the DoD financial statements and made financial management a top priority within DoD. In response to financial statement audits and congressional and public concerns, DoD managers began numerous actions to address reported problems that are both DoD-wide and agency-unique. DoD continued to evaluate its options for achieving adequate and compliant financial management systems, but progress in correcting deficiencies in financial management systems has been slow. Initiatives to correct system deficiencies began in August 1991, when DFAS developed a plan to decrease the number of DoD financial management systems and correct system deficiencies. However, the 1998 DoD Biennial Financial Management Improvement Plan states that compliant financial management systems were not expected to be in place until FY 2003. In addition, the Plan identified feeder systems for which intermediate target dates extended beyond the FY 2003 milestone. Until DoD deploys financial management systems and feeder systems that comply with the CFO Act and FFMIA, auditors would not be able to perform sufficient audit work on material financial statement line items to warrant favorable audit opinions on the DoD financial statements.

DoD could learn from its experience in bringing mission-critical systems into year 2000 (Y2K) compliance in a relatively short period of time. A similar management approach with a viable status reporting process would provide for more visible, accountable, and effective management of the financial management systems improvement effort. Following are actions that have been taken or planned to correct DoD-wide deficiencies.

**DoD Biennial Financial Management Improvement Plan.** As directed by the National Defense Authorization Act of 1998, DoD created the DoD Biennial Financial Management Improvement Plan (the Biennial Plan) to address both the financial management systems within DoD and the feeder systems owned by others than the financial community that provide data to the DoD financial management systems. The Biennial Plan provides the guidance needed to ensure that organizations conform to the requirements necessary to achieve compliant, auditable financial data, while allowing the flexibility to implement processes and systems essential for their individual operations. However, the Inspector General, DoD, reported that the Biennial Plan could be improved if it better identified the deficiencies for each financial management system and discussed the remedies, resources, and intermediate target dates necessary to bring DoD financial management systems into substantial compliance with the CFO Act. The following section provides details on DoD initiatives to improve financial management systems.

**DoD Financial Management Systems.** Efforts were taken and planned within DoD to address the Y2K problem, reduce the number of DoD financial management systems, standardize DoD payroll systems, standardize data elements, and improve compliance with Federal financial management system requirements. In the Biennial Plan, DoD identified more than 160 program and core initiatives meant to improve financial management systems and related business practices and processes. Some of the more significant initiatives are discussed as follows.

**Y2K.** The Y2K problem is the term used to describe the potential failure of information technology systems to process or perform date-related functions before, on, or after the turn of the century. The actions taken within DoD to accelerate the Department's work resulted in commendable progress in its efforts to address the Y2K problem. On August 7, 1998, the Secretary of Defense issued a memorandum to improve accountability for actions taken or planned to solve the Department's Y2K computer problem. In December 1998, the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) issued a DoD Y2K Management Plan, which outlined the following five-phased management process to achieving Y2K compliance for DoD systems: awareness, assessment, renovation, validation, and implementation. The DoD Y2K Management Plan also outlines Y2K reporting requirements and resulted in the development of a DoD Y2K database to track compliance of DoD systems. As a result of the high-level visibility and continuous monitoring of Y2K status, as of March 31, 1999, 88 percent of DoD mission-critical systems were Y2K compliant, an increase from 53 percent compliance in November 1998. The Navy was using the Y2K model to monitor the status of bringing the Navy nonfinancial feeder systems into compliance with the CFO Act.

**Consolidation of Finance and Accounting Systems.** DoD had been reducing the number of its financial management systems, which include finance and accounting systems. The number of DoD finance systems was reduced from 127 in FY 1991 to 18 in September 1998, with annual avoided costs of $77 million. DoD intended to reduce the number of DoD finance systems to nine. DoD reduced the number of accounting systems from 197 in FY 1991 to 91 in September 1998. DoD planned to reduce the number of accounting systems to no more than 23 by FY 2003.

**Departmental Corporate Database.** The corporate database initiative was to implement a logically defined database using standard processes and data elements that support financial reporting, financial management analysis, prevalidation of disbursements with related obligations, cash accountability, and a global edit capability. The initiative was to correct weaknesses that have a critical impact on improving data accuracy and systems compatibility. The initiative was to be achieved through the use of the following:

- a detail-driven standard general ledger,
- precise reporting,

- accurate cash accountability,
- near instantaneous interaction between systems,
- increased internal controls and an end-to-end audit trail that spans the life of a transaction and all systems used in processing,
- near real-time delivery of program management information, and
- accurate trend analysis and strategic and tactical management information.

**DoD-Level Financial Management System Initiatives.** DoD had financial management systems and system initiatives in place to address and improve financial reporting by DoD Components. Some of the more significant initiatives related to the following systems, and details of those initiatives are in Appendix E:

- the Defense Civilian Pay System,
- the Defense Joint Military Pay System,
- the Defense Procurement Payment System,
- the Defense Property Accountability System,
- the Defense Retiree and Annuitant Pay System,
- the Defense Standard Disbursing System,
- the Defense Transportation Payment System,
- the Defense Travel System, and
- the Mechanization of Contract Administration Services.

**Military Department General Fund Financial Management Systems Initiatives.** DoD and DFAS put several initiatives in place to improve financial management systems that the Military Department general funds use. Some of the more significant initiatives related to the following systems, and details of those initiatives are in Appendix E:

- the Defense Joint Accounting System;
- the Standard Accounting and Reporting System;
- the General Accounting and Finance System;

- the Standard Accounting, Budgeting, and Reporting System; and
- the Corps of Engineers Financial Management System.

**DoD Working Capital Fund Financial Management System Initiatives.** DoD and DFAS put several initiatives in place to improve financial management systems that the DoD WCFs use. Some of the more significant initiatives related to the following systems, and details of those initiatives are in Appendix E:

- the Commodity Command Standard System,
- the Defense Working Capital Accounting System,
- the Material Financial Control System,
- the Defense Industrial Financial Management System,
- the Integrated Logistics System-Supply,
- the Standard Material Accounting System,
- the Defense Business Management System, and
- the Standard Automated Material Management System.

**Feeder Systems.** DoD and DFAS were working closely with the Military Departments and the Defense agencies in identifying critical feeder systems, defining roles and responsibilities concerning changes to systems that record financial data, and integrating feeder systems with financial management systems. Details of the initiatives are in Appendix E.

**DoD Implementation Strategy for Auditable Financial Statements.** In May 1998, the DoD CFO began developing the DoD Implementation Strategy for Auditable Financial Statements (the Implementation Strategy), which would allow for achieving favorable audit opinions on the FY 1999 DoD Agency-Wide financial statements. The Implementation Strategy was developed for 13 areas that the CFO determined to need improvement. As of November 1998, the CFO had approved 10 areas, 2 were pending approval (National Defense PP&E and operating materials and supplies), and 1 had been disapproved (finance payments). Details on the Implementation Strategy are in Appendix F. The 13 areas for improvement follow:

- existence and completeness of general PP&E,
- valuation of general PP&E,
- PP&E (Government property in the hands of contractors),
- National Defense PP&E,

- deferred maintenance,
- inventory,
- operating materials and supplies,
- environmental restoration and hazardous waste liabilities,
- disposal liabilities,
- postretirement healthcare liabilities,
- Fund Balance With Treasury,
- intragovernmental eliminations, and
- finance payments.

**Government Property in the Possession of Contractors Integrated Process Team.** In FY 1997, the Under Secretary of Defense for Acquisition and Technology (USD[A&T]) formed the Government Property in the Possession of Contractors Integrated Process Team (the Process Team) to review problems in the administration of Government property. The Process Team presented its conclusions and recommendations to a DoD Executive Review Group. The Process Team acknowledged that the Contract Property Management System did not provide adequate information for a DoD financial statement and did not recommend using the Contract Property Management System as a long-term solution to the financial reporting problem. However, the Process Team did not find an acceptable solution to the financial reporting problem. The Navy and the Air Force initiated reviews of their systems to determine where Government property data were being captured and reported. In addition, DoD developed an approach to annually obtain from contractors sufficient information to report the cost and to calculate depreciation on general PP&E in the possession of contractors. Specifically, DoD developed a supplement to Standard Form 1450 to require DoD contractors to report annually on improvements to DoD-owned real property in the possession of contractors and on equipment acquired (purchase or transfer in from another contractor or contract) and fabricated by the contractor.

**Problem Disbursement and In-Transit Disbursement Initiatives.** DoD had taken or planned several initiatives to improve its management of problem disbursements and in-transit disbursements.

**Problem Disbursements - Unmatched Disbursements and Negative Unliquidated Obligations.** The Unmatched Disbursements and Negative Unliquidated Obligations initiative is a program that identifies the types of transactions resulting in unmatched disbursements and negative unliquidated obligations. It also analyzes unmatched disbursements and negative unliquidated obligations to identify underlying causes or reasons and the organizations responsible for resolution. The initiative provides oversight and assesses the effectiveness of the DoD-wide efforts to reduce unmatched

disbursements and negative unliquidated obligations. It proposes alternatives to eliminate procedural and systems-related shortcomings causing recurrences of unmatched disbursements and negative unliquidated obligations. An initiative milestone is to reduce unmatched disbursements and negative unliquidated obligation amounts by 10 percent each year from FYs 1999 through 2005. DoD and DFAS should also benefit through marginal increases in the accuracy of appropriation-level financial reports, significant increases in the accuracy of funds holders' and program managers' financial status reports, and lower operational processing costs.

**Problem Disbursements and In-Transit Disbursements.** DoD problem disbursements, once totaling $34.3 billion, were reduced to $8.1 billion as of August 1998. As of June 1998, aged in-transit disbursements had decreased in the previous 12 months from $22.9 billion to $9.6 billion. However, for the Army and some Defense agencies, aged in-transit disbursements increased $0.6 billion from June 1997 through June 1998, and problem disbursements increased $2.2 billion from June 1996 through June 1998.

**In-Transit Reduction Initiative.** The in-transit reduction initiative designs, develops, implements, and monitors a program to eliminate operational and systems problems that cause in-transits. The objectives are to reduce and eliminate in-transits and improve timely posting of disbursements and collections to accounting systems. In a 1-month period (February through March 1998), the initiative reduced the absolute value of in-transits from $12.2 billion to $11 billion.

**Prevalidation.** The prevalidation accountability initiative allows DoD to prevalidate obligations before disbursing payment by implementing an accounting and payment system to match obligations and disbursements before payment. Unmatched disbursements total in the billions. Without implementation of a prevalidation process, the cost to reconcile unmatched disbursements would continue to rise. The initiative objective was to reduce unmatched disbursements and negative unliquidated obligations. The initiative would also benefit DoD through costs avoided by reduction in personnel dedicated to resolving unmatched disbursements, elimination of duplicate payments, and ensuring that valid payments are made. However, the lowering of prevalidation dollar thresholds resulted in delays to paying some DoD contractors in a timely manner. The delays are mainly from increased volume of payments to be prevalidated while still operating with outdated payment systems and technology.

**DoD Joint Working Groups.** DoD established several joint working groups to allow the DoD financial and audit communities to coordinate their efforts to correct major deficiencies.

**DoD Federal Financial Management Act Executive Committee.** This group enables resolution of issues that would hamper the compilation and auditing of financial statements. It consists of the Deputy Chief Financial Officer, Assistant Inspector General for Auditing, senior DFAS managers and other staff.

**Executive Steering Committee.** The Executive Steering Committee provides audit direction for CFO and supporting financial statement audits performed by the General Accounting Office; the Inspector General, DoD; and the Military Department audit agencies.

**DoD Financial Management Steering Committee.** This group oversees the development of functional requirements, facilitates the implementation of policy recommendations, and addresses financial management systems and practices, other than those involving the WCFs. The Steering Committee is also intended to serve as a forum for monitoring the status of DoD Implementation Strategy efforts. The Steering Committee consists of the Under Secretary of Defense (Comptroller), the DFAS Director, the Assistant Secretaries (Financial Management and Comptroller) of the three Military Departments, the DLA Comptroller, and a senior official from the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence).

## Army General Fund Improvements

Auditors verified some positive conditions and determined that the Army General Fund made some progress in resolving some previously reported problems.

**CFO Strategic Plan**. The Army recognized that until recently, it did not have a comprehensive document designed to synchronize efforts across the Army toward the goal of achieving an unqualified audit opinion on the Army General Fund financial statements. Therefore, the Deputy Assistant Secretary of the Army for Financial Operations developed the Army CFO Strategic Plan (the Strategic Plan), in conjunction with Army functional experts, consulting firms familiar with the Army efforts to become CFO-compliant, and the Army Audit Agency.

The Strategic Plan is an Army-wide management plan with a purpose of improving accuracy, timeliness, and usefulness of financial information by improving the processes that create the information. It has the following goals and objectives:

- ensure that all feeder systems provide accurate and verifiable data to the financial management system;
- improve internal controls and compliance with laws and regulations;
- improve accountability and oversight of budgetary resources; and
- improve accountability for Army assets and liabilities; net costs; net position; financing sources; and stewardship property, equipment, and land.

Implementing the Strategic Plan would involve more than 25 organizational elements within the Army, as well as DFAS. The Army expected that successful implementation of the Strategic Plan would enable it not only to produce auditable financial statements by FY 2003, but also to improve stewardship over scarce resources.

**Other System Improvements.** System modifications were being implemented across Army organizations, which include elimination or incorporation of systems. The Army had major system improvement initiatives ongoing. System modifications were to address improvements to meet CFO requirements and to improve data reliability. The Army is also doing some of the improvement activities in conjunction with DFAS.

**Senior-Level Steering Group.** The Senior-Level Steering Group was established in FY 1993 as a direct result of the initial audits of the Army financial statements prepared under the CFO Act. It is composed of the principal deputies of the Army staff and Secretariat. The mission is to address issues raised by the auditors and develop approaches to meet the requirements of the CFO Act.

**Army General and Mission Equipment Working Group.** The Army General and Mission Equipment Working Group is a joint working group that includes representatives from the Army and DFAS. The working group was to focus on overall issues of accounting and reporting on the Army investment in general and mission equipment. That initiative would produce results in determining key elements, possible approaches, and solutions for meeting existing and future reporting requirements for Army equipment.

**Real Property Integrated Process Team.** The Real Property Integrated Process Team is a joint working group that includes representatives from the Army and DFAS. The Process Team was to focus on overall issues of accounting for and reporting of the Army investment in land and structures. That initiative would determine key elements, possible approaches, and solutions for meeting existing and future reporting requirements for Army real property.

**Reporting for Environmental Restoration Liabilities.** During FY 1998, the Army Environmental Center ensured that installation action plans contained the required information and generally were approved. The approval process ensured that environmental cleanup projects were identified, reported, and approved. The process also provided additional assurance about the existence of reported environmental liabilities.

**Military Personnel and Payroll.** The Army and DFAS had been continuing their efforts to integrate the personnel and pay systems to ensure that only personnel entitled to be paid are actually paid. The primary focus of the integration process is for various pay events to be transmitted from personnel systems to finance. The fielding of software upgrades to enhance the interface between personnel and pay systems was to be completed in four increments. The first increment would consist of 10 pay events and was projected for fielding during the second quarter of FY 2000. The remaining releases of pay events would be fielded at a rate of one grouping per fiscal year, through FY 2003. The end result would be an integrated system that provides more accurate and timely information, reduces fraud and potential overpayments, and improves database integrity between the personnel and pay systems.

**Out-of-Service Debt.** During FY 1998, the Army established a debt management task force to identify causes of valid and invalid out-of-service debt. The task force successfully completed its mission and suggested improvements. The efforts resulted in recommendations to improve the policies and procedures of the Army to decrease out-of-service debt. The efforts reduced the out-of-service debt from about $43 million during FY 1997 to about $26 million during FY 1998.

**Capital Leases.** As a result of revised DoD guidance, the Army reclassified about $5.6 million (acquisition value) of overseas real property assets from assets under capital lease to real property accounts. The Army correctly adjusted and reported its Section 801 family housing leases in its FY 1998 financial statements and related footnotes.

## Navy General Fund Improvements

The Navy and DFAS were working together to attempt to prepare auditable financial statements. Their initiatives lay the ground work for improving financial management and reporting within the Navy.

**Nonfinancial Feeder System Working Groups.** During FY 1998, the Navy began a comprehensive effort to identify and evaluate nonfinancial feeder systems used in producing principal statements. That effort included the

establishment of 12 working groups responsible for identifying and evaluating nonfinancial systems used to feed data to the financial statement line accounts. The working groups were tasked to do the following:

- identify the organizations responsible for the nonfinancial systems;
- evaluate nonfinancial systems for compliance with the DFAS Manual, "A Guide to Federal Requirements for Financial Management Systems," April 14, 1998 (the Blue Book);
- establish an action plan to bring noncompliant systems into compliance with the Blue Book;
- certify and document that the reporting processes for nonfinancial systems are compliant; and
- provide an update of the progress to the Office of the Secretary of Defense.

In addition, the Navy was using a variation of the Y2K model to monitor the status of bringing the nonfinancial feeder systems of the Navy into compliance with the CFO Act. The Y2K model, as defined in the DoD Y2K Management Plan, integrates a five-phased management process to achieving Y2K compliance for DoD systems. The phases are awareness, assessment, renovation, validation, and implementation. The Navy was using a similar approach to try to achieve compliant systems, except the Navy added a sixth phase for a favorable audit opinion, and, instead of applying the model to individual systems, the Navy applied the model to material lines on the Navy financial statements. That approach should result in increased visibility and should provide useful information for upper managers to monitor the status of Navy nonfinancial feeder systems.

**Other System Improvements.** The Navy was further refining its strategy to eliminate and consolidate nonfinancial feeder systems within each functional area. For example, for general PP&E and time and attendance source data automation, the Navy would be consolidating and eliminating systems performing similar functions.

**Enhancement of Organizational Internal Control Structures.** The Navy "enhancement of organizational internal control structures for financial statement audits" initiative provided an assessment of the existing internal control structure of various Navy commands and organizations. The need for the project was an outcome of the audit of the Navy financial statements that discussed the need to improve administrative and accounting controls. The initiative intended to enhance the organizational internal control structure, which affects timeliness and reliability of accounting organizations, resulting in auditable financial statements.

**Problem Disbursement Improvement Project.** The Navy Problem Disbursement Improvement Project was to coordinate and monitor improvement efforts between the Navy and DFAS to identify systemic causes and to

implement business process changes and system enhancements to reduce problem disbursements to an acceptable level for CFO compliance. The FY 1999 goal was a $1.5 million net problem disbursement balance. The project was intended to do the following:

- improve data accuracy and the timeliness of the Navy financial position,
- implement single-source data entry and rejection of errors back to the source, and
- improve the integrity of disbursement and collection processes.

## Air Force General Fund Improvements

The Air Force and DFAS were working to improve the accuracy of data and reporting for the Air Force General Fund financial statements.

**Feeder System Improvements.** In an effort to monitor and facilitate feeder system improvement, Air Force financial management requested Air Force Audit Agency (AFAA) assistance with improving feeder systems. AFAA was reviewing the feeder systems, identifying deficiencies, and making recommendations for improvements. Of 41 critical feeder systems, work was completed on 20 systems, with 9 more in process. AFAA was also providing management advisory services for new systems under development. In the fall of 1995, the Air Force established an office to foster financial reform. A key accomplishment of the office was the identification of 60 critical systems responsible for providing the majority of financial statement data. The identification of those systems would aid the Air Force in its feeder system consolidation and elimination efforts. In addition, the Air Force contracted with a major accounting firm to improve reporting of capital leases, computer hardware, contingent liabilities, and national Defense equipment. The Air Force was also developing systems to replace 7 of the 18 critical feeder systems.

**Producing Financial Statements**. The Air Force initiated a high priority effort to build a "Road Map to Auditable Financial Statements." When complete, the road map would identify all critical areas that the Air Force had to address before the Air Force could expect to have auditable financial statements. The effort would focus first on general funds and then on the working capital funds. Within each of the fund categories, the road map would address financial systems and related feeder systems and would address the policies and procedures that guide DoD and Air Force financial management. The project was to involve Air Force financial and other functional areas, the Under Secretary of Defense (Comptroller), DFAS, and AFAA.

**SBR.** The Air Force, working in concert with the DFAS Denver Center, other DFAS centers, and AFAA, made a significant effort to produce an auditable

SBR for FY 1998. Although AFAA was unable to express an opinion on the FY 1998 SBR, it did find substantial improvement in several areas. For example, Air Force commands responded to 100 percent of the AFAA requests for confirmation of obligated balances. Similarly, DFAS accounting offices were able to provide complete supporting documentation for more than 90 percent of obligations and 92 percent of disbursements sampled.

## Army Corps of Engineers, Civil Works Program, Improvements

The Army Corps of Engineers was working on efforts to improve the accuracy of its financial information and making significant progress.

**Corps of Engineers Financial Management System.** The Corps completed implementation of the Corps of Engineers Financial Management System in FY 1998. The Corps also changed system programming and implemented procedures to ensure that improper time charges were reported on the labor dispute report and were properly corrected.

**Fund Balance With Treasury.** The Corps implemented policies and procedures to reconcile current monthly discrepancies and aged discrepancies. The Corps expected to complete the reconciliations of aged discrepancies during the FY 1999 CFO cycle.

**Real Property.** The Corps was in the process of reconciling its subsidiary and general ledgers and ensuring that all real property assets were valued. The Corps planned to complete the actions during the FY 1999 CFO cycle.

**Statement of Net Cost.** The Corps was programming its financial management system to identify the appropriate business program for revenue and expense transactions. The system would automatically link transactions to business programs. In addition, the Corps planned to meet the SFFAS No. 7 requirement to present the statement by business program, by completing system programming.

## DoD Working Capital Funds Improvements

Many of the improvements from DoD general funds also apply to the DoD WCFs. The following are some additional initiatives ongoing by the Under Secretary of Defense (Comptroller), DFAS, DLA, and the Military Departments to improve the DoD WCF financial statements.

**DFAS Contract to Replace Working Capital Fund Financial Systems**. In FY 1997, DFAS contracted for an analysis-of-alternatives study to identify a migratory system strategy to replace existing WCF financial systems, including

the Defense Business Management System. The contractor recommended Oracle Government Financials, a commercial off-the-shelf system, to replace the Defense Business Management System and three other migratory accounting systems. DFAS issued a request for proposal in FY 1998; however, contract action was delayed because of a bid protest. DFAS could not provide an estimated date for deployment of the replacement system until the bid protest was resolved and a contract awarded.

**Inventory Accounting.** Inventories comprise approximately 75 percent of total assets of DoD WCFs. Because of the high proportion of inventory to overall assets, material weaknesses in inventory impacted the fair presentation of the financial statements for the DoD WCFs. As a result, DoD was taking action to remedy procedural, systemic, and knowledge deficiencies. Auditors were working with the Under Secretary of Defense (Comptroller) to review the financial information provided by the Military Departments' logistics systems to determine the ability to generate data needed to properly account for inventory in accordance with SFFAS No. 3, "Accounting for Inventory and Related Property."

**Inventory Management.** DoD inventory accounting systems would be designed and reengineered to maintain detailed accounting information. DoD was focusing on streamlining through systems consolidation and improving data transmission quality by standardizing data elements.

**DFAS After-Action Report.** To improve future CFO reporting, DFAS established a CFO after-action report. The report was to identify the lessons learned, the planned and actual completion dates of required CFO actions, and policy issues that required resolution before the next CFO reporting process.

**Navy Working Capital Fund Nonfinancial Feeder Systems.** The Navy WCF Nonfinancial Feeder Systems initiative was to identify all nonfinancial feeder modules to ensure that required information was being passed to the financial accounting module that DFAS owned. The initiative would also identify opportunities for nonfinancial feeder system consolidation or standardization within the Navy WCF, which would eliminate duplicative systems.

**DLA Single Distribution System.** DLA developed and implemented a single distribution system, the Distribution Standard System, at all DoD distribution depots. Previously, DLA and each of the Military Departments operated supply depots using different systems, which made changes and improvements to depot operations difficult and expensive. DLA reviewed existing DoD systems and selected one that could be modified and enhanced to best meet DoD needs at the lowest cost. The Distribution Standard System brought many business process improvements, such as inventory accuracy and workload planning.

## Management Plan for Compliant DoD Financial Management Systems

The overarching deficiency preventing favorable audit opinions on FY 1998 DoD financial statements continues to be the lack of adequate financial management and feeder systems for compiling accurate and reliable financial data. DoD financial management system correction efforts involve many systems, are complex, and should be focused on obtaining better financial data. A favorable audit opinion should also result from those efforts. To address the Y2K challenge in a manageable way, DoD developed an overall plan and five-phased approach to identify, assess, renovate, validate, and implement Y2K-compliant systems. A similar approach, applied to DoD financial management systems, would improve DoD efforts to become compliant with the CFO Act and FFMIA.

**Overall Plan and Focus.** The Under Secretary of Defense (Comptroller) should develop and implement a management plan to allow senior managers and Congress to track the status of DoD progress toward achieving financial management systems that are compliant with the CFO Act and FFMIA. At a minimum, the management plan should focus on the following areas:

- defining the problem,
- defining applicability and scope,
- defining specific goals and objectives,
- developing a management strategy,
- defining roles and responsibilities, and
- developing a system tracking database.

**Problem Definition.** DoD financial management systems are not capable of producing reliable and auditable financial data to be used for decisionmaking and financial reporting purposes. The lack of reliable and auditable financial data precludes DoD from complying with the CFO Act and FFMIA.

**Applicability and Scope.** Achieving system compliance depends on all DoD communities, including the financial, acquisition, logistics and personnel communities. Therefore, all DoD communities must do the following.

- They must agree on the approach to remedy the problem. For the Y2K effort, it took a tasking memorandum, which the Secretary of Defense signed, to achieve high priority status with all DoD communities. A DoD-wide management plan was crucial for the Y2K effort, but the current Biennial Financial Management Improvement Plan would require some

adaptation to serve as a management tool in the same fashion as the DoD Y2K management plan.

- They must identify all systems that affect DoD financial management.
- They must agree on common terminology. For example, all must agree on the definition of "CFO compliance" and "FFMIA compliance."
- They must agree on what makes a system "critical" and which systems are "critical." For example, starting with a material line-item on the DoD Agency-Wide financial statements, they must identify all systems that feed that line-item. The systems must be compliant with the CFO Act and FFMIA. Perhaps they could use three levels of criticality: critical to DoD Agency-Wide (most critical), critical to DoD Component (medium criticality), and noncritical. Any system critical to DoD Agency-Wide is critical to DoD Components by default.

**Goals and Objectives.** The overall goal and objective is to bring all financial management systems into compliance with the CFO Act and FFMIA so that DoD has reliable and auditable financial data for decisionmaking and financial reporting purposes. Compliance with FFMIA includes compliance with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Specific goals and objectives for each system will vary depending on the specific problems that a system has.

**Management Strategy.** The Under Secretary of Defense (Comptroller) should develop a management strategy to allow senior managers and Congress to track the status of DoD progress toward achieving compliant financial management systems. The Under Secretary of Defense (Comptroller) should direct each DoD Component to do the following:

- Develop an implementation strategy to address each system for which they are responsible within the context of the overall DoD plan. DoD Components may have subordinate plans that are specific to each system for which they are responsible.
- Report on system improvement progress on an individual system basis.

DoD needs to establish a common methodology to assess the status of system compliance and provide periodic updates on the status of DoD financial management system compliance to Congress. In addition, DoD Components should provide quarterly status updates to the Deputy Secretary of Defense, the DoD Chief Financial Officer, the DoD Chief Information Officer, and senior managers responsible for feeder systems. The Under Secretary of Defense

(Comptroller) should consolidate reports and provide them to the Inspector General, DoD, for analysis and inclusion in the semi-annual report to Congress, as required by the FFMIA.

**Roles and Responsibilities.** For a management plan to be successful, leadership is essential, and buy-in and prioritization may be necessary. A successful plan would also require cooperation between DoD communities and the establishment of memorandums of agreement. Those deemed responsible for a system should fund system improvements according to agreed-upon plans, or else they should immediately report funding shortfalls.

**Tracking.** To facilitate tracking and reporting of financial management improvement progress, the Under Secretary of Defense (Comptroller) needs to develop a database to track progress on all DoD financial management systems. The database should employ common data fields based on common compliance criteria and should be updated by an independent source in a timely manner.

**Five-Phased Approach.** The Under Secretary of Defense (Comptroller) should develop and implement a five-phased approach, similar to the one used to attain Y2K compliance, to track the status of DoD progress toward achieving compliant financial management systems. The approach should have defined and agreed-upon exit criteria for each of the following five phases:

- the awareness phase,
- the assessment phase,
- the renovation phase,
- the validation phase, and
- the implementation phase.

**Awareness.** Each DoD Component head must know that the general problem of noncompliant financial management systems exists and must understand the impact of the problem. For example, without reliable PP&E data, DoD would not have visibility over all of its assets. Without reliable cost data, DoD would be unable to properly plan for weapon system acquisitions. Without reliable disbursements data, DoD would be unable to monitor contract payments and deter fraud. Further, the DoD credibility with the public could be adversely affected by unfavorable audit opinions. Before a system can progress past the awareness phase, the system owners, comptroller and chief information officer of the component must acknowledge the need to achieve compliance by that system or replace it.

**Assessment.** The DoD Components must determine interrelationships between the systems feeding data to the DoD Component and DoD Agency-Wide financial statements. For example, they must identify all Military Department and DFAS systems that feed PP&E data. They must determine the systems that are most critical. For example, any systems that support a material line-item on the DoD Agency-Wide financial statements would be designated as

critical. Next, the DoD Component must identify specific internal control weaknesses and noncompliance with accounting standards for each system. They might have to develop memorandums of agreement between DoD communities that share interest in a given system or between interfacing system program offices. Those deemed responsible for a system should reserve funds for system improvements during the assessment phase. DoD Components should not permit a system to leave the assessment phase until specific problems have been identified, all memorandums of agreement are completed and signed, or all agree that the system is noncritical.

**Renovation.** The renovation phase would be different for each system depending on the scope of system problems identified in the assessment phase. The goal of the phase is to fix all problems identified in the assessment phase. DoD management must agree that all problems are remedied for the system to pass beyond the renovation phase.

**Validation.** Auditors or other independent parties should validate that all system problems have been remedied and determine that the financial management system is compliant with the CFO Act and FFMIA. If experts other than DoD auditors perform the system validation, DoD auditors must be provided the opportunity to participate in oversight of the effort and to review the support for the validation.

**Implementation.** As each system passes the validation phase, it would be implemented into the operating environment.

Because of the slow progress in correcting existing financial management system deficiencies, and the size, complexity, and importance of the task, DoD needs to improve internal controls and visibility over initiatives to improve financial management systems. The management approach outlined in this section of the finding would provide for more visible, accountable, and effective management of the financial management systems improvement effort. The IG, DoD, would be pleased to establish the same type of partnership with the DoD CFO in this area as was successfully implemented with the DoD Chief Information Officer to attain Y2K compliance.

# Conclusion

Until DoD deploys financial management systems that comply with the CFO Act and the FFMIA, auditors will not be able to perform sufficient audit work on material financial statement line items to warrant favorable audit opinions on the DoD financial statements. DoD could learn from its experience in bringing mission-critical systems into Y2K compliance in a relatively short period of time. DoD needs to develop and implement a management control plan to allow senior managers and Congress to closely monitor improvements to DoD financial management systems.

## Recommendations, Management Comments, and Audit Response

**1. We recommend that the Under Secretary of Defense (Comptroller), in coordination with the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Under Secretary of Defense for Personnel and Readiness; and the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), develop and implement a management plan, based on the year 2000 approach, to allow senior managers and Congress to track the status of DoD progress toward achieving financial management systems compliant with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996. At a minimum, the management plan should:**

**a. Define the financial management and accountability problems.**

**b. Define the applicability and scope of the problems and the approach to remedy the problems. The approach should include agreeing on terminology, establishing levels of system criticality, and categorizing all DoD financial management systems.**

**c. Define specific goals and objectives to bring all DoD financial management systems into compliance with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996.**

**d. Define an overall management strategy to fixing the problems that:**

**(1) Directs each DoD Component to develop management strategies addressing each system for which it is responsible.**

**(2) Establishes a common methodology to assess the status of system compliance.**

**(3) Requires DoD Components to provide quarterly status updates to the Defense Management Council, other oversight groups, the DoD Chief Financial Officer, the DoD Chief Information Officer, and senior managers responsible for feeder systems.**

e. **Establish accountability by defining roles and responsibilities for those responsible for financial management system compliance.**

f. **Develop a database to track progress on all DoD financial management systems.**

2. **We recommend that the Under Secretary of Defense (Comptroller) provide periodic updates to Congress on the status of DoD financial management systems.**

3. **We recommend that the Under Secretary of Defense (Comptroller) consolidate the results of the quarterly status reports from the DoD Components and provide them to the Inspector General, DoD, for inclusion in its semi-annual report to Congress.**

**Management Comments.** The Under Secretary of Defense (Comptroller) concurred with the intent of the recommendations. The Department recognized the benefits of a management plan, consisting of elements similar in nature to those followed in the DoD year 2000 approach, that allows senior managers within the DoD to monitor the status of the DoD progress toward achieving systems compliant with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996.

**Audit Response.** The comments from the Under Secretary of Defense (Comptroller) were generally responsive to our recommendations, but did not outline specific corrective actions to be taken to improve the Financial Management Improvement Plan. In addition, the comments did not provide completion dates to implement a year 2000 based plan or a process to monitor progress. As part of our yearly review of the Financial Management Improvement Plan, we will conduct followup work to what actions were initiated and completed. Because of our considerable experience in the Y2K conversion, we are also available to provide advice on adapting its lessons to the CFO Act/FFMIA compliance challenge.

# Appendix A. Audit Process

## Scope

**Audit Results Reviewed.** The FY 1998 DoD Agency-Wide financial statements had total assets of $591.2 billion and total liabilities of $948.5 billion. See Appendix C for total DoD assets listed by reporting entity. We reviewed audit results for the FY 1998 DoD financial statements.

| DoD Financial Statement | Auditor |
|---|---|
| DoD Consolidated | Inspector General, DoD |
| Army General Fund | Army Audit Agency |
| Navy General Fund | Naval Audit Service |
| Air Force General Fund | Air Force Audit Agency |
| Army Corps of Engineers, Civil Works Program | Army Audit Agency |
| Army Working Capital Fund | Army Audit Agency |
| Navy Working Capital Fund | Naval Audit Service |
| Air Force Working Capital Fund | Air Force Audit Agency |
| DLA Working Capital Fund | Inspector General, DoD |
| DFAS Working Capital Fund | Inspector General, DoD |
| DoD Military Retirement Trust Fund | Inspector General, DoD |

See the table on page 3, "Audit Opinions on the FY 1998 DoD Financial Statements," for a list of the FY 1998 audit reports that we reviewed. The audit was limited to identifying and summarizing the major deficiencies that prevented favorable audit opinions on the FY 1998 DoD financial statements. We defined "major deficiency" as a reason that auditors could not render an audit opinion, as reported in their FY 1998 audit reports. We further limited the audit to identifying the actions taken or planned to correct or remove the deficiencies preventing favorable audit opinions on the FY 1998 DoD financial statements. The Inspector General, DoD; the Army Audit Agency; the Naval Audit Service; and the Air Force Audit Agency reported improvements in FY 1998 audit reports such as the opinions on the financial statements, reports on internal controls and compliance, and supporting reports on functional audit areas. DoD also identified corrective actions in published planning documents.

**DoD-Wide Corporate-Level Government Performance and Results Act Goals.** In response to the Government Performance and Results Act, the Department of Defense established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting the objectives. This report pertains to the achievement of the following objective and goal.

- **Objective:** Fundamentally reengineer the Department and achieve a 21st century infrastructure. **Goal:** 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 objective and goal.

- **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 identified several high-risk areas in DoD. This report primarily provides coverage of the Defense Financial Management high risk area, but also pertains to the Information Technology Management high risk area.

# Methodology

**Audit Period and Standards.** We performed this financial-related audit from February through May 1999 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit. We did not review the internal control programs of the DoD entities and funds because internal controls were reviewed by the auditors performing the financial statement audits and reported in the reports on internal controls and compliance with laws and regulations.

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

# Appendix B. Summary of Prior Coverage

The General Accounting Office; the Inspector General, DoD; and the Military Department Audit Agencies have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at http://www.gao.gov. Inspector General, DoD, reports can be accessed on the Internet at http://www.dodig.osd.mil. Army Audit Agency reports can be obtained by contacting Ms. Pam Evans at (703) 681-9863. Naval Audit Service reports can be obtained by contacting Ms. Nancy Embrey at (703) 681-9126 (e-mail: nembrey@audit.navy.mil). Air Force Audit Agency reports can be accessed on the Internet at http://www.afaa.hq.af.mil.

Inspector General, DoD, reports covering major deficiencies in DoD financial statements follow.

Inspector General, DoD, Report No. 98-208, "Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements," September 23, 1998.

Inspector General, DoD, Report No. 98-002, "A Status Report on the Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund for FY 1996," October 3, 1997.

Inspector General, DoD, Report No. 97-225, "Major Deficiencies Preventing Favorable Audit Opinions on FY 1996 DoD General Fund Financial Statements," September 30, 1997.

Inspector General, DoD, Report No. 97-026, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on FY 1995 DoD General Fund Financial Statements," November 19, 1996.

Inspector General, DoD, Report No. 97-006, "Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995," October 15, 1996.

Inspector General, DoD, Report No. 95-301, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995.

Inspector General, DoD, Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," August 18, 1995.

# Appendix C. Total DoD Assets by Reporting Entity

| DoD Reporting Entity | Total Assets (billions)[1] | Percentage of Total DoD Assets |
|---|---|---|
| Army General Fund | $ 69.6 | 11.8 |
| Navy General Fund | 117.0 | 19.8 |
| Air Force General Fund | 96.3 | 16.3 |
| Army Corps of Engineers, Civil Works Program | 38.8 | 6.5 |
| Army Working Capital Fund | 14.2 | 2.4 |
| Navy Working Capital Fund | 24.5 | 4.2 |
| Air Force Working Capital Fund | 25.6 | 4.3 |
| Defense Logistics Agency Working Capital Fund | 12.7 | 2.2 |
| Defense Finance and Accounting Service Working Capital Fund | 0.7 | 0.1 |
| DoD Military Retirement Trust Fund | 149.9 | 25.4 |
| Other Defense Organizations[2] | 45.2 | 7.6 |
| Other Defense Organizations Working Capital Funds | 2.5 | 0.4 |
| Eliminating entries | (5.9) | (1.0) |
| **DoD Consolidated Totals** | $591.2 | 100.0 |

[1] Total subject to rounding of the DoD reporting entity totals.
[2] No official financial statements were produced, but data are included on the FY 1998 DoD Agency-Wide financial statements.

# Appendix D. Statements of Federal Financial Accounting Standards and Concepts

| | Publication | Publication Date | Effective Date |
|---|---|---|---|
| Concept No. 1 | Objectives of Federal Financial Reporting | September 2, 1993 | - |
| Concept No. 2 | Entity and Display | June 6, 1995 | - |
| Standard No. 1 | Accounting for Selected Assets and Liabilities | March 30, 1993 | FY 1994 |
| Standard No 2 | Accounting for Direct Loans and Loan Guarantees | August 23, 1993 | FY 1994 |
| Standard No. 3 | Accounting for Inventory and Related Property | October 27, 1993 | FY 1994 |
| Standard No. 4 | Managerial Cost Accounting Standards for the Federal Government | July 31, 1995 | FY 1997 |
| Standard No. 5 | Accounting for Liabilities of the Federal Government | December 20, 1995 | FY 1997 |
| Standard No. 6 | Accounting for Property, Plant, and Equipment | November 30, 1995 | FY 1998 |
| Standard No. 7 | Accounting for Revenue and Other Financing Sources | May 10, 1996 | FY 1998 |
| Standard No. 8 | Supplementary Stewardship Reporting | June 11, 1996 | FY 1998 |
| Recommended Standard No. 9 | Recommended: Deferral of Required Implementation Date for Statement of Federal Financial Accounting Standards No. 4 | October 1997 | - |
| Standard No. 10 | Accounting for Internal Use Software | June 1998 | FY 2001 |
| Standard No. 11 | Amendments to Accounting for Property, Plant, and Equipment – Definitional Changes | December 15, 1998 | FY 1999 |
| Standard No. 12 | Recognition of Contingent Liabilities Arising From Litigation: An Amendment of Standard No. 5, Accounting for Liabilities of the Federal Government | December 1998 | FY 1998 |
| Standard No. 13 | Deferral of Paragraph 65.2-Material Revenue-Related Transactions Disclosures | January 1999 | FY 2001 |
| Interpretation 1 | Reporting on Indian Trust Funds | March 12, 1997 | - |
| Interpretation 2 | Accounting for Treasury Judgment Fund Transactions | March 12, 1997 | - |
| Interpretation 3 | Measurement Date for Pension and Retirement Health Care Liabilities | August 29, 1997 | - |
| Report 1 | Overview of Federal Financial Accounting Concepts and Standards | December 31, 1996 | - |
| Volume 1 | Federal Accounting Standards Advisory Board Volume 1, Original Statements | March 1997 | - |
| Exposure Draft | Management's Discussion and Analysis | February 1997 | - |
| Exposure Draft | Governmentwide Supplementary Stewardship Reporting | June 1997 | - |
| Exposure Draft | Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS 2 | March 1999 | - |
| Invitation for Views | Accounting for the Cost of Capital by Federal Entities | July 1996 | - |

# Appendix E. DoD Financial Management System Initiatives

## DoD-Level Financial Management System Initiatives

DoD had financial management systems and system initiatives in place to address and improve financial reporting by DoD Components.

**Defense Civilian Pay System.** The Defense Civilian Pay System processes all DoD civilian pay accounts. DFAS implemented automated interfaces between the Defense Civilian Pay System and the personnel and accounting systems. Other benefits include the following:

- uniform interpretation of regulations and payroll calculations;
- standard operating procedures, forms, and training;
- reductions of overall documentation including regulations and manuals; and
- support for the standardization and integration with other areas such as personnel, accounting, and labor cost accounting.

In June 1998, DFAS completed the implementation of all civilian payroll accounts to the system, closing 349 civilian payroll offices and eliminating 26 legacy civilian pay systems. In addition, modifications were made during FY 1998 to support civilian pay processing in the year 2000.

**Defense Joint Military Pay System.** The Defense Joint Military Pay System standardization and consolidation initiative was to standardize and consolidate the automated systems that support military pay under two systems, the Defense Joint Military Pay System and the Marine Corps Total Force System. All Army, Navy, and Air Force military pay functions would be under the Defense Joint Military Pay System. An objective of the initiative is the processing of timely and accurate payments and leave and earnings statements. In addition, the initiative was to result in financial data that fairly present the results of operations and that are in compliance with laws, regulations, and policies for those events and transactions that have a material effect on the pay and leave of military members. Another objective was to replace 22 military pay systems. Expected benefits include being a standard military pay system for DoD and the elimination of legacy military pay systems.

**Defense Procurement Payment System.** The Defense Procurement Payment System consolidation and migration initiative was to become the standard DoD procurement payment system. A series of interim consolidation efforts would reduce 16 existing contract and vendor payment systems to 8 systems. The eight systems would then be migrated into the system. The system was expected

to be fully implemented in December 2000. The initiative would focus on modernizing business processes, resolving known system deficiencies, and defining standard and shareable financial data for contract and vendor payments. The objectives were to do the following:

- replace the current contract and vendor payment systems with a modern standard payment system,
- integrate both the contract and vendor payment business areas into a standardized on-line computer processing environment, and
- merge both functional areas to operate from common data rather than duplicate unmatched data records residing in various databases and in hard copy format.

**Defense Property Accountability System.** The Defense Property Accountability System is an integrated system for achieving financial and physical control over real and personal property. The system supports inventory tracking and financial reporting for all real and personal property regardless of the funding authority under which the assets were acquired. The system corrects weaknesses in financial statements and operations that have a critical impact on property accounting and reporting accountability. The Defense Property Accountability System would also improve the timeliness and reliability of financial information on the DoD investment in property and the DoD liability to others for the use of its property. Implementation was scheduled for completion in FY 2000.

**Defense Retiree and Annuitant Pay System.** All military retiree and annuitant pay was consolidated into the Defense Retiree and Annuitant Pay System. The consolidation also standardized policies and procedures across the Military Departments and reduced the costs of maintaining multiple systems. Consolidation was completed in April 1995, effectively replacing eight systems. To accommodate growth in the customer base, DoD continued enhancing technology and operations.

**Defense Standard Disbursing System.** The goal of the Defense Standard Disbursing System was to develop a strategy to modernize business processes as well as define standard data that could be shared. The Defense Standard Disbursing System, currently under development, was to replace existing service and center-specific disbursing systems and modules with a single automated information system. It was to be a standard disbursing system that would be used DFAS-wide to make payments, accept collections, and maintain accountability for public funds. The system, through the DFAS Corporate Data Base, was to operate in concert with interim and migratory DoD entitlement and accounting systems to produce accurate disbursing transactions and reports.

**Defense Transportation Payment System.** The Defense Transportation Payment System consolidation and reengineering initiative was designated as a

migratory system for standardizing and consolidating DoD transportation payment within DoD. The projected impacts for the initiative are as follows:

- consolidation of payments using electronic data interchange technology,
- promotion of electronic data interchange while preparing to consolidate transportation payments by FY 1999,
- elimination of a paper-intensive environment, and
- transition to an environment that takes extensive advantage of transmitting and processing information electronically.

**Defense Travel System.** DoD developed a new concept for temporary duty travel that combines the traditionally separate functions of arranging for travel services and travel reimbursement vouchering. The Defense Travel System reengineering initiative was attempting to create a seamless, paperless, temporary duty travel system that meets the needs of travelers, commanders, and process owners. It was intended to reduce the costs, support mission requirements, and provide superior customer service. Implementation began in FY 1998 and should be operational throughout DoD by the end of FY 2001.

**Mechanization of Contract Administration Services.** The Mechanization of Contract Administration Services initiative was to focus on improving data accuracy and reengineering business practices. The objectives were to become compliant with regulations and to correct data inaccuracy. The corrective actions for accounts receivable are complete, and the accounts payable and system controls initiatives were scheduled for completion in FY 1999. Although the system was no longer the standard DoD contract payment migration system, it remained active and served as the DoD contract payment legacy system. It was to be replaced by the Defense Procurement Payment System, which was under development.

## Military Department General Fund Financial Management System Initiatives

DoD and DFAS began several initiatives to improve financial management systems that the Military Department general funds use. Some of the more significant initiatives are discussed as follows.

**Defense Joint Accounting System.** The Defense Joint Accounting System implementation initiative was to provide general fund accounting for all customers supported by DFAS Indianapolis Center. The initiative was intended to correct weaknesses that impact financial operations or data that involve violations of statutory requirements, fraud, or other criminal activities that go

undetected in the areas of data accuracy, internal controls, compliance with regulations, and the ability to integrate with other communities. The objectives were to do the following:

- implement a Y2K-compliant system,
- become compliant with regulations,
- eliminate duplication of systems,
- correct data inaccuracy,
- integrate feeder systems, and
- improve internal controls.

**Standard Accounting and Reporting System.** The Standard Accounting and Reporting System was established as the migratory financial management system on which to consolidate all Navy General Fund accounting, commercial, and reporting operations. The system was intended to satisfy regulatory and statutory requirements. The initiative focused on system enhancement and upgrades. Projected benefits include the following:

- scheduled incorporation of all Navy General Fund accounting systems;
- reduced operational, training, and support costs;
- reduced run time for labor programs;
- improved productivity and design efficiency;
- reduced equipment and communication costs;
- functional and productivity enhancements (paper reduction);
- improved discipline of accounting functions and operations; and
- business process improvement through ongoing standardization efforts.

**General Accounting and Finance System.** The General Accounting and Finance System provides general fund accounting support to the Air Force and selected Defense agencies. The reengineering initiative was intended to correct weaknesses that have a critical impact on financial operations or data that impact violations of statutory requirements, fraud, or other criminal activities that go undetected in the following areas:

- data accuracy,

- internal controls,
- compliance with regulations, and
- General Accounting Office identification as a noncompliant system.

The reengineered system was intended to comply with Government accounting standards and was scheduled for implementation in 2002.

**Standard Accounting, Budgeting, and Reporting System.** The Standard Accounting, Budgeting, and Reporting System migrates all the Marine Corps appropriations to a single financial management system and eliminates five legacy systems. Projected benefits of the Standard Accounting, Budgeting, and Reporting System initiative are as follows:

- a transaction-driven general ledger;
- compliance with the U.S. Government Standard General Ledger;
- elimination of five general fund accounting systems;
- compliance with the key accounting requirements; and
- a single, integrated system that supports all Marine Corps financial accounting needs.

**Corps of Engineers Financial Management System.** During FY 1998, the Corps completed implementation of the Corps of Engineers Financial Management System, which has a standard, transaction-driven general ledger. The system was designed to integrate Corps business processes and support the management of all types of work and funds. The system consolidation initiative was expected to produce results in the following areas:

- implement a Y2K-compliant system,
- become compliant with regulations,
- eliminate duplication of systems,
- correct data inaccuracy,
- integrate feeder systems,
- improve internal controls, and
- provide real time management information to managers.

## DoD Working Capital Fund Financial Management System Initiatives

DoD and DFAS began several initiatives to improve financial management systems that the DoD WCFs use. Some of the more significant initiatives are discussed as follows.

**Commodity Command Standard System.** The Commodity Command Standard System accounts for the funds of the Army WCF. The initiative objectives were to maintain the system finance modules and implement the system as the interim migratory financial management system for the Army WCF, Wholesale Supply business area. The objective was also intended to ensure CFO Act compliance related to the key accounting requirements and implementing system requirements to improve the reliability of the financial statements to ensure system capabilities such as the following:

- general ledger control and financial reporting,
- property and inventory accounting,
- accounting for receivables,
- system controls (fund and internal),
- audit trails,
- cash procedures and accounts payable, and
- budgetary accounting classification code.

**Defense Working Capital Accounting System.** The Defense Working Capital Accounting System is the interim migratory financial management system for the Navy WCF Base Support activity group. The first Base Support conversion was anticipated in 1999, with all public works centers implemented by mid FY 2002. Upon completion of the conversions, 2 existing systems were to have been consolidated, and 10 operational databases were to have been replaced by 1 system operational database. DoD began the following improvement initiatives for the system:

- data conversion,
- data standardization,
- budgetary accounting classification code,
- Defense Travel System,
- electronic commerce/electronic data interchange,

- functional enhancements,
- technical enhancements,
- mandatory requirements,
- site-unique interfaces, and
- Y2K compliance.

**Material Financial Control System.** The Material Financial Control System is the interim migratory financial system for the Navy WCF Supply Management activity group, for both the wholesale and retail segments of the inventory. When the system initiative is completed, a total of five systems will have been consolidated into the system, of which two shipboard systems have already been consolidated. DoD began the following initiatives for the system:

- budgetary accounting classification code,
- data conversion,
- corporate database,
- electronic commerce/electronic data interchange,
- key accounting requirements,
- open systems environment, and
- Y2K compliance.

**Defense Industrial Financial Management System.** The Defense Industrial Financial Management System was the financial management system for six Naval aviation depots and was the interim migratory accounting system for Navy Depot Maintenance and Research and Development activity groups. It was scheduled for implementation at Air Force Logistics Centers, Naval Ordnance Centers, and Naval Shipyards. The objectives of the Defense Industrial Financial Management System enhancements initiative were to become compliant with the CFO Act and FFMIA, eliminate duplication of systems, correct data inaccuracy, and integrate feeder systems.

**Integrated Logistics System-Supply.** The Air Force planned to implement the Integrated Logistics System-Supply and the Seamless Supply System by the end of FY 2001 for the supply management area. The Air Force Materiel Command completed requirements for the base-level portion of the Integrated Logistics System-Supply and developed the operational requirements document to integrate the base and depot systems.

**Standard Material Accounting System.** The Standard Material Accounting System is the system supporting the Air Force Retail Supply Management business area. Initiative objectives included both streamlining and compliance requirements. Under the streamlining objective, the system would eliminate three other automated supply accounting systems. The compliance technical initiative was expected to resolve the Y2K issue. The system was expected to provide a single integrated system that supports Air Force Retail and Wholesale Supply Management business functions. Another expected benefit was compliance with the key accounting requirements, the CFO Act, and the Federal Managers' Financial Integrity Act.

**Defense Business Management System.** The Defense Business Management System is the migratory financial management system for DFAS and the Defense Commissary Agency and was the interim migratory DoD WCF financial management system for distribution depots, supply management, information services, commissary operations, financial operations, industrial plant equipment, and reutilization and marketing. The Defense Business Management System improvement initiative was intended to result in timely and accurate data for customers and managers, sound internal controls, data processing improvements and streamlining, and auditable financial statements. The overall objective was to improve the system so that it is compliant with the FFMIA and the CFO Act and to provide support for all DoD WCF accounting requirements. To meet that objective, the Defense Business Management System had to be brought into compliance with several key accounting requirements.

**Standard Automated Material Management System.** The Standard Automated Material Management System was the interim migratory DoD WCF financial management system for the DLA Wholesale Supply business area. The initiative objective was to implement the Defense WCF Corporate Board Directive for the improvement of the system for the DLA Wholesale Supply business area. The initiative also addressed Y2K compliance and incorporated changes identified and required by the CFO Act, as related to the key accounting requirements.

## Feeder Systems

The DoD publication, "A Guide to Federal Requirements for Financial Management Systems," April 14, 1998 (the Blue Book), includes not only requirements for DoD financial management systems but also requirements for the DoD feeder systems, which provide data to the DoD financial management systems. In conjunction with the publication of the Blue Book, DFAS was working closely with the Military Departments and the Defense agencies in identifying their critical feeder systems. DoD was working with the Military Departments and Defense agencies to define roles and responsibilities concerning changes to systems that record financial data. In addition, DoD was

making progress in integrating feeder systems with financial management systems. Some of the significant initiatives taken or planned are discussed as follows:

- DoD created a systems inventory database to record and store information on financial management systems, including all feeder system interfaces; all critical feeder systems were scheduled to be stored in the database.

- The budgetary accounting classification code provided the framework for interrelating planning, programming, budgeting, execution, and workforce control through a standard classification of Military Department and Defense agency organizations and functions into standard lines of accounting; after systems modernization, the data would comply with the budgetary accounting classification code standard.

- Systems consolidation efforts taken or planned would significantly reduce the number of systems with which to interface.

- The creation of a DoD corporate database, a central repository for DoD data, would also contain standard translators from nonstandard legacy and feeder systems; by placing all translators in a common location, the burden of controlling nonstandard interfaces would ease significantly.

In addition, the Military Departments all had initiatives to integrate feeder systems with financial management systems. Some of those efforts were begun in conjunction with DFAS.

# Appendix F. DoD Implementation Strategy

In May 1998, the DoD CFO began developing the DoD Implementation Strategy for Auditable Financial Statements (the Implementation Strategy), which would allow for achieving favorable audit opinions on the FY 1999 DoD Agency-Wide financial statements. The Implementation Strategy was developed for 13 areas that the CFO determined to need improvement. The CFO approved 10 areas, 2 were pending approval (National Defense PP&E and operating materials and supplies), and 1 had been disapproved (finance payments). The 13 areas for improvement follow.

**Existence and Completeness of General PP&E.** The Implementation Strategy addresses the verification of property accountability records and systems by the military units. DoD requires that all PP&E be properly recorded. The Under Secretary of Defense for Acquisition, Technology, and Logistics (USD[AT&L]) is responsible for issuing policy ensuring implementation of improvements. DoD Components are responsible for removing the costs of completed PP&E from construction-in-progress accounts, properly capitalizing and depreciating general PP&E, and properly recording and reporting capital leases per SFFAS No. 6. In response to that strategy, the Inspector General, DoD, and the Military Department auditors performed an audit of the existence and completeness of real property accountability records and systems. Also, the Under Secretary of Defense (Comptroller) (USD[C]) obtained contractor support to test the personal property assets for existence and completeness, and USD(AT&L) issued a policy memorandum requiring the Military Departments, Defense agencies, and DoD field organizations to conduct periodic inventories of PP&E throughout the year.

**Valuation of General PP&E.** In response to the problems regarding the valuation of DoD general PP&E, DoD management began actions to correct the problems.

- USD(AT&L) issued a memorandum to the Military Departments and Defense agencies requiring them to expedite the implementation of CFO-compliant property systems for general PP&E assets, unless they have a property system that meets CFO requirements.

- USD(C) developed statements of work and obtained contractor support to develop an approach to value real and personal property assets.

- USD(C) organized an Oversight Committee with members from the Office of USD(C); Military Departments; the General Accounting Office; and the Inspector General, DoD, by which the contractors would report the status of efforts to the Oversight Committee.

- USD(C) issued guidance on the requirement for capital leases as required in SFFAS No. 6 and on depreciation and cost recognition of PP&E.

**PP&E (Government Property in the Hands of Contractors).** Among the proposed actions to improve the reporting of Government property in the hands of contractors are the following.

- USD(C) and USD(AT&L) were to develop a new contractor reporting format and requirements needed to meet financial statement standards.

- USD(AT&L) was to develop, and share with the Office of Management and Budget and auditors, a plan to validate the adequacy of the contractors' property management systems and the accuracy of the data in those systems and work with contractors to properly implement the plan.

- The Military Departments and Defense agencies were to be directed to work with the Defense Contract Management Command, with support from the Defense Contract Audit Agency; Service auditors; Inspector General, DoD, auditors; and applicable contractors to validate the adequacy of the contractors' systems and accuracy of the information reported.

**National Defense PP&E.** The Office of Management and Budget released SFFAS No. 11, "Amendments to Accounting for PP&E—Definitional Changes," on December 15, 1998. Upon approval of SFFAS No. 11, USD(C) was to issue implementing guidance.

**Deferred Maintenance.** Among the proposed actions to improve the reporting of deferred maintenance are the following.

- DoD was to develop implementing guidance for reporting deferred maintenance amounts.

- DoD proposed to include in its financial statements deferred maintenance amounts developed as part of the DoD budget process, deferred maintenance amounts reported by DoD Components in the budget process for general PP&E real property, and depot-level deferred maintenance amounts reported by the DoD Components in the budget process for National Defense PP&E assets.

- DoD was to review the desirability, feasibility, and benefit of expanding the categories of National Defense PP&E assets included in the deferred maintenance reporting.

**Inventory.** Among the proposed actions to address issues regarding the existence, completeness, and valuation of inventory are the following.

- USD(AT&L) was to direct the Military Departments and DLA to evaluate inventory transaction processing, identify errors, determine the sources and causes of the errors, and develop a remedial plan to correct those errors.

- DoD was to take five steps to improve controls over physical inventories.

- USD(AT&L) and DoD Components were to establish a physical inventory plan that integrates cycle counts and statistical sampling with the full participation of USD(C) and the audit community.

- The Military Departments and DLA were to take steps to improve in-transit inventory accounting.

- The Office of Management and Budget, USD(C), and the audit community were to work toward a consensus on the accounting treatment of inventory gain and loss accounts.

- DoD was to work with the Office of Management and Budget and the audit community to identify the approximate historical cost for the beginning balance of inventory.

**Operating Materials and Supplies.** Proposed DoD actions to address the reporting of operating materials and supplies are as follows.

- DoD proposed to use the purchase method of accounting in the short term, except for those cases in which DoD believed that it was more cost beneficial to use the consumption method of accounting.

- DoD was to take numerous actions to move to the consumption method of accounting in future years. For example, DoD proposed to record operating materials and supplies as an asset until they are issued to the end-user, in accordance with SFFAS No. 3, except when operating materials and supplies are not a significant amount, or they are in the hands of end-users, or it is more cost beneficial to expense when purchased.

**Environmental Restoration and Hazardous Waste Liabilities.** The Deputy Under Secretary of Defense for Environmental Security planned to revise management guidance for the Defense Environmental Restoration Program. The Military Departments and Defense agencies were to be tasked to estimate and report environmental remediation amounts and schedule tasks to estimate and report hazardous waste upon completion of the draft DoD Financial Management Regulation. Also, beginning January 1999, the Military Departments and Defense agencies were to begin reporting progress on estimating and reporting environmental liabilities.

**Disposal Liabilities.** USD(C) was to issue DoD Financial Management Regulation guidance for disposal liabilities requiring the Military Departments and Defense agencies to estimate and report hazardous waste liability amounts.

**Postretirement Healthcare Liabilities.** For FY 1999 and beyond, the Office of the Actuary, working with the Assistant Secretary of Defense (Health Affairs) and a contractor, ensured that FY 1998 data from most of the 105 Military Treatment Facilities were collected. The General Accounting Office and the Inspector General, DoD, are working closely with the Assistant Secretary of Defense (Health Affairs) and the Actuary to develop a sound, auditable estimate. A working group was formed and was exploring alternative sources of information that could be used to support the estimate. The Inspector General, DoD, was working with the Assistant Secretary of Defense (Health Affairs) on inpatient and outpatient workload data used to calculate the liability. The General Accounting Office was also working on cost-related information.

**Fund Balance With Treasury.** DoD reported the fund balance as reflected in the DoD Fund Balance With Treasury general ledger account at the appropriation level. However, DoD promised several other actions to correct identified problems that still needed to be taken.

**Intragovernmental Eliminations.** DFAS was to develop and document intra-DoD elimination procedures and reasonableness checks to improve the accuracy of intra-DoD eliminations. USD(C) was to prepare guidance requiring the reporting of both intra-departmental and inter-agency eliminations based on amounts billed and provide a copy to the Office of Management and Budget; the General Accounting Office; and Office of the Inspector General, DoD, for review and comment.

**Finance Payments.** On May 22, 1998, DoD requested that the Office of Management and Budget endorse the DoD treatment of finance payments (payments on fixed-price contracts that are not based on percentage of completion) as advances. An Office of Management and Budget decision, dated October 2, 1998, sided with the audit community position that finance payments should be reported in a manner identical to other progress payments. USD(C) proposed to reiterate prior guidance directing that finance payments on fixed-price contracts, which are not based on a percentage of completion, are to be reported as advances while progress payments based on the percentage of completion of a contract are to be excluded from advances and prepayments. The Implementation Strategy for finance payments was disapproved.

# Appendix G. Report Distribution

## Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense for Personnel and Readiness
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence)

## Department of the Army

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

## Department of the Navy

Naval Inspector General
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 Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

## Non-Defense Federal Organizations

Inspector General, Department of Education
Office of Management and Budget
General Accounting Office
  National Security and International Affairs Division Technical Information Center

## Congressional Committees and Subcommittees, Chairperson and Ranking Minority Member

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 Relations, Committee on Government Reform

# Under Secretary of Defense (Comptroller) Comments

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

OCT 25 1999

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Major Deficiencies Preventing Favorable Audit Opinions on the FY 1998 Department of Defense (DoD) Financial Statements, Dated July 23, 1999 (Project No. 8FI-2025.02)

This is the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) response to the Office of the Inspector General draft report, "Major Deficiencies Preventing Favorable Audit Opinions on the FY 1998 DoD Financial Statements."

The Department recognizes the benefits of a management plan, consisting of elements similar in nature to those followed in the Department's Year 2000 (Y2K) approach, that allows senior managers within the Department to monitor the status of the Department's progress toward achieving systems compliant with the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996. The Department's Financial Management Improvement Plan encompasses many of the elements that would be expected to be included in such a plan.

Additionally, the Department currently includes the offices of the Under Secretary of Defense (Acquisition and Technology), Under Secretary of Defense (Personnel and Readiness), Assistant Secretary of Defense (Command, Control, Communications and Intelligence) as well as the Military Departments and others in existing processes and/or committees (such as the Financial Management Steering Committee) to improve financial management and resolve system deficiencies. During FY 2000, I expect to revise the process within the Department used to address financial management system issues. This revision will contain the primary features found in Y2K-like processes.

Attached are more detailed comments on each of the specific recommendations contained in the subject audit report.

The point of contact for this matter is Mr. Raymond N. Miller. He may be reached by e-mail: millerr@osd.pentagon.mil or by telephone at (703) 604-6363.

William J. Lynn

Attachment

**DRAFT AUDIT REPORT ON**
**MAJOR DEFICIENCIES PREVENTING FAVORABLE AUDIT OPINIONS**
**ON THE FISCAL YEAR (FY) 1998 DEPARTMENT OF DEFENSE (DoD)**
**FINANCIAL STATEMENTS**
**PROJECT NO. 8FI-2025.02, DATED JULY 23, 1999**

*****

**UNDER SECRETARY OF DEFENSE (COMPTROLLER)**

**COMMENTS ON RECOMMENDATIONS**

**Recommendation 1.** The Office of the Inspector General (OIG), DoD recommends that the Under Secretary of Defense (Comptroller) (USD(C)) in coordination with the Under Secretary of Defense (Acquisition and Technology), the Under Secretary of Defense (Personnel and Readiness), and the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), develop and implement a year-2000-based management plan to allow senior managers and Congress to track the status of DoD progress toward achieving systems that are compliant with the Chief Financial Officers (CFO) Act of 1990 and the Federal Financial Management Improvement Act of 1996. At a minimum, the management plan should:

a. Define the financial management and accountability problems.

b. Define the applicability and scope of the problems and the approach to remedy the problems. The approach should include agreeing on terminology, establishing levels of system criticality, and categorizing all DoD financial management systems.

c. Define specific goals and objectives to bring all DoD financial management systems into compliance with the CFO Act of 1990 and the Federal Financial Management Improvement Act of 1996.

d. Define an overall management strategy to fixing the problems that:

   (1) Directs each DoD Component to develop management strategies addressing each system for which it is responsible.
   (2) Establishes a common methodology to assess the status of system compliance.
   (3) Requires DoD Components to provide quarterly status updates to the Defense Management Council, other oversight groups, the DoD CFO, the DoD Chief Information Officer, and senior managers responsible for feeder systems.

e. Establish accountability by defining roles and responsibilities for those responsible for financial management system compliance.

f. Develop a database to track progress on all DoD financial management systems.

**OUSD(C) Response:** The Office of the USD(C) concurs with the intent of the recommendation to consider the use of a process that would incorporate features similar to those utilized in the Department's Year 2000 (Y2K) process. This office does not, however, necessarily agree that the process must be identical to each of the numerous subparts contained in the recommendation. This office believes that the recommendation, as written, could impose a costly administrative burden.

This office believes that the Department's Financial Management Improvement Plan (FMIP) currently satisfies the intent of subparts a., b., and c. to the recommendation. The FMIP is an integrated plan that incorporates almost all aspects of the Department's financial management operations--to include information on critical feeder systems owned or controlled by the Military Departments and Defense Agencies that provide the majority of data to the Department's finance and accounting systems. The FMIP also will identify the compliance status of the Department's migratory and finance and accounting systems and critical feeder systems. It also links the current status to the target environment by outlining the long-term actions intended to move the Department from its current financial management environment toward an integrated financial management process.

This office expects to revise its management strategy for addressing compliance during FY 2000 as contained in subpart d. of the recommendation. The Department's management approach will build on the current processes that are used to prepare the FMIP. The FMIP currently addresses most of the items in subparts d. and e. of the recommendation; as well as includes details on compliance status, deficiencies, corrective actions, milestones and resources. The Department currently also is in the early stages of looking at databases for collecting and analyzing information, as recommended in subpart e. However, the Department's approach is not likely to follow the recommendation in all details. For example, subpart d. of the recommendation proposes quarterly status reports from Components. Quarterly status reports are not necessary if the information is available in a database that the Components update. Also, the Department may use the Financial Management Steering Committee as an oversight group to monitor progress.

**RECOMMENDATION 2.** The OIG, DoD recommends that the USD(C) provide periodic updates to Congress on the status of DoD financial management systems.

**OUSD(C) Response:** Applicable information will be included in the Department's FMIP. The Department currently provides, and intends to continue to provide, copies of the FMIP to the Congress.

**RECOMMENDATION 3.** The OIG, DoD recommends that the USD(C) consolidate the results of the quarterly status reports from the DoD Components and provide them to the Inspector General (IG), DoD for inclusion in its semi-annual report to Congress.

**OUSD(C) Response:** The preparation, consolidation, and presentation of quarterly reports to the IG, DoD would appear to represent an unnecessary and costly administrative burden especially if information is available in a database that the Components can update. However, this office would make such information available for review by the IG, DoD as requested.



Attachment

# Audit Team Members

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

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