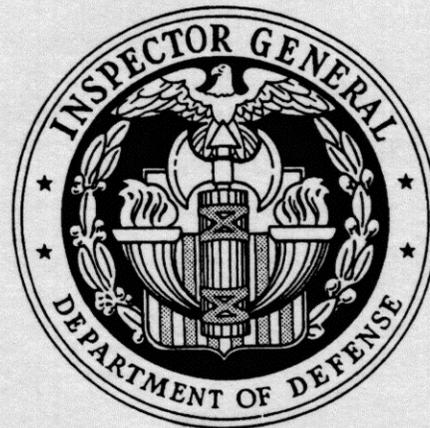


Audit



Report

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE ARMY AUDIT
AGENCY AUDIT OF THE ARMY'S GENERAL FUND PRINCIPAL
FINANCIAL STATEMENTS FOR FISCAL YEAR 1999

Report No. D-2000-087

February 14, 2000

Office of the Inspector General
Department of Defense

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Acronyms

AAA
GAO

Army Audit Agency
General Accounting Office



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

February 14, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND
CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Army Audit
Agency Audit of the Army's General Fund Financial Statements for Fiscal
Year 1999 (Report No. D-2000-087)

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Army Audit Agency (AAA) disclaimer of opinion on the FY 1999 Army General Fund Financial Statements, along with the AAA report, "Army's General Fund Principal Financial Statements for Fiscal Year 1999: Summary Audit Report." An audit of the Army General Fund Financial Statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Because this report contains no findings or recommendations, written comments are not required.

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, e-mail rbird@dodig.osd.mil) or Mr. Jack L. Armstrong at (317) 510-3846 (DSN 699-3846, e-mail jarmstrong@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-087
(Project No. OFI-2116)

February 14, 2000

**Inspector General, DoD, Oversight of the Army Audit Agency
Audit of the Army's General Fund
Principal Financial Statements for Fiscal Year 1999**

Executive Summary

Introduction. An audit of the Army General Fund financial statements is required by Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. We delegated the audit of the FY 1999 Army General Fund financial statements to the Army Audit Agency. This report provides our endorsement of the Army Audit Agency disclaimer of opinion on the FY 1999 Army General Fund financial statements, along with the Army Audit Agency report, "Army's General Fund Principal Financial Statements for Fiscal Year 1999: Summary Audit Report."

Audit Objective. Our objective was to determine the accuracy and completeness of the Army Audit Agency audit of the FY 1999 Army General Fund financial statements. See Appendix A for a discussion of the audit process.

Audit Results. The Army Audit Agency report, "Army's General Fund Principal Financial Statements for Fiscal Year 1999: Summary Audit Report," February 9, 2000, stated that the Army Audit Agency could not express an opinion on the FY 1999 Army General Fund financial statements. We concur with the Army Audit Agency disclaimer of opinion; our endorsement of that disclaimer is Exhibit 1.

Internal Control Structure and Compliance With Laws and Regulations. The Army Audit Agency issued reports on internal controls and compliance with laws and regulations in the Army. The reports are in the Army Audit Agency report at Exhibit 2.

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Exhibit 2.	Army Audit Agency Report, "Army's General Fund Principal Financial Statements for Fiscal Year 1999: Summary Audit Report"

Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” we performed oversight of the independent audit conducted by the Army Audit Agency (AAA) of the FY 1999 Army General Fund financial statements. Our purpose was to determine whether we could rely on the AAA audit. We reviewed the AAA audit approach and planning and monitored audit progress at the key points.

Reviewing the AAA Audit Approach. We used the “Federal Financial Statements Audit Manual,” January 1993, issued by the President’s Council on Integrity and Efficiency, and the “Financial Audit Manual,” December 1997, issued by the General Accounting Office (GAO), as the criteria for reviewing the AAA audit approach. Specifically, we reviewed the engagement letter, participated in the entrance conference, assisted in formulating the audit strategy, and commented on audit plans and programs. We also participated in audit planning and working group meetings coordinated by the GAO; the Inspector General, DoD; and the AAA.

Monitoring Audit Progress. Through the DoD Financial Statement Audit Executive Steering Committee, we provided a forum for a centrally managed exchange of guidance and information leading to a focused DoD-wide audit of the DoD Agency-Wide financial statements, including the supporting financial statements of major DoD Components. We participated in audit working groups on significant topics in financial reporting for the Army General Fund. For example, we participated in the audit working groups for DoD-Wide Real Property, Fund Balance With Treasury, Statement of Budgetary Resources, and Munitions. We also participated in the audit working group for Army Equipment. We reviewed and commented on related draft audit reports issued by the AAA, including the opinion report and the report on the evaluation of internal controls and compliance with laws and regulations. In addition to these oversight procedures, we performed other procedures necessary to determine the fairness and accuracy of the AAA audit approach and conclusions. For example, we co-performed audit work with the AAA on controls over the Fund Balance With Treasury, verification of beginning appropriation fund balances for the Statement of Budgetary Resources, the Army compliance with the Anti-Deficiency Act, and compilation of the Army General Fund financial statements at the DFAS Indianapolis Center, Indianapolis, Indiana. We also used the results of GAO reviews of AAA audit work to increase our understanding and provide meaningful input to the AAA.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense established 2 DoD-wide corporate-level goals, 8 subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and financial systems. **(01-DoD-2.5.1)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

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

- **Financial Management Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

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

Audit Type, Period, and Standards. We performed this financial statement audit from February 2, 1999, to February 14, 2000, 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.

Contacts During the Audit. We visited individuals and organizations in the DoD audit and accounting communities. Further details are available upon request.

Summary of Prior Audit Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to oversight of financial statement audits. 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>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Comptroller (Program/Budget)
Deputy Chief Financial Officer
Director for Accounting Policy
Director, Defense Logistics Studies Information Exchange

Department of the Army

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

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

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

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Forces

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

**Exhibit 1. Inspector General, DoD,
Endorsement Memorandum**



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

FEB 14 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND
CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1999 Army General Fund
Financial Statements (Project No. OFI-2116)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Army Audit Agency (AAA) the audit of the FY 1999 Army General Fund financial statements. Summarized as follows are the AAA disclaimer of opinion on the FY 1999 Army General Fund financial statements and the results of our review of the AAA audit. We endorse the disclaimer of opinion expressed by AAA.

Disclaimer of Opinion. The AAA disclaimer of opinion on the FY 1999 Army General Fund financial statements, February 9, 2000, states that AAA was unable to express an opinion on the financial statements. We concur with the AAA disclaimer of opinion.

The AAA could not express an opinion on the financial statements primarily because of continual problems with inadequate accounting systems, insufficient audit trails, and procedural problems. The problems prevented AAA from using any practical methods to conduct audit work of sufficient scope to enable it to express an opinion on the FY 1999 Army General Fund financial statements. Inadequate accounting systems required the Defense Finance and Accounting Service Indianapolis Center to make unsupported adjustments to force the general ledger to match the status-of-funds data. For FY 1999, the dollar value of unsupported adjustments made to force the general ledger to match the status-of-funds data was \$131 billion.

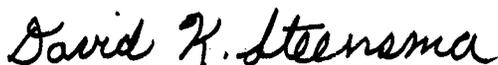
Internal Controls. The AAA determined that internal controls did not provide reasonable assurance that the FY 1999 Army General Fund financial statements contained no material misstatements. Significant internal control weaknesses are associated with the processes, procedures, and accounting systems used to prepare the financial statements. Deficiencies in the accounting and finance systems that account for Army resources remain the major reason the inability of AAA to render a favorable audit opinion on the financial statements. The Army needs to upgrade or replace many of its systems that feed data to the core accounting system. The Defense Finance and Accounting Service Indianapolis Center's use of status and expenditure data is an unacceptable method for compiling the financial statements. The Army and the Defense Finance and Accounting Service recognized many of the financial reporting weaknesses and reported them in their FY 1999 Annual Statements of Assurance. Details on the adequacy of internal controls are discussed in the AAA audit report.

Compliance With Laws and Regulations. The AAA also identified areas of noncompliance with laws and regulations, which are discussed in more detail in the "Compliance With Laws and Regulations" section of the AAA audit report. Under the Federal

Financial Management Improvement Act of 1996, the AAA work disclosed that financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For example, the Headquarters Accounting and Reporting System and its supporting subsystems that DFAS Indianapolis Center used to compile the Army financial statements did not conform to the general ledger method of accounting and could not provide for adequate audit trails to the transaction level. Federal financial management system requirements, "Core Financial System Requirements," and Office of Management and Budget Circular No. A-127, "Financial Management Systems," also require compliance with the U.S. Government Standard General Ledger at the transaction level. Details on the compliance with laws and regulations are discussed in a separate AAA audit report.

Review of Army Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent work that AAA conducted, we reviewed the audit approach and planning and monitored progress at key points. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the AAA work on the FY 1999 Army General Fund financial statements from February 2, 1999, through February 9, 2000, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the AAA disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

**Exhibit 2. AAA Audit Report, “Army’s
General Fund Principal
Financial Statements for Fiscal
Year 1999: Summary Audit
Report”**

Army's General Fund Principal Financial Statements for Fiscal Year 1999

Summary Audit Report

**9 February 2000
Audit Report: AA 00-168**



U.S. Army Audit Agency





DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of The Auditor General
3101 Park Center Drive
Alexandria, VA 22302-1596

9 February 2000

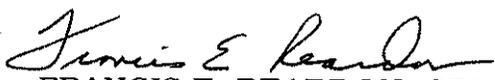
Secretary of the Army

This report summarizes the results of our efforts to audit the Army's General Fund Principal Financial Statements for the fiscal year ended 30 September 1999. We performed our work pursuant to the Chief Financial Officers Act of 1990 as amended by the Government Management Reform Act of 1994.

We could not express an opinion on the financial statements primarily because of inadequate accounting systems and incomplete or unauditible supporting records. We were unable to apply other auditing procedures to satisfy ourselves as to the fairness of the data presented.

This report doesn't contain recommendations, but it does include brief discussions of our results and conclusions. More detailed discussions of our results and conclusions, as well as recommendations, are in various supporting audit reports (see Annex C).

I appreciate the courtesies and cooperation extended to us during the audit.


FRANCIS E. REARDON, CPA
The Auditor General

For more information about this audit, please call the General Fund Audits Division at (703) 681-9766. For extra copies of this report, please call (703) 681-9863.

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BACKGROUND

BACKGROUND

Annual Financial Statements

Federal agencies are required to submit a set of financial statements, overview and notes that were standardized by the Federal Accounting Standards Advisory Board. The Army is required to prepare these general fund financial statements:

- Balance Sheet.
- Statement of Net Cost.
- Statement of Changes in Net Position.
- Statement of Budgetary Resources.
- Statement of Financing.

In addition, the Army must report required supplemental stewardship information. The major component of this is National Defense Property, Plant and Equipment, which is composed of weapon systems plus the support property, plant, and equipment used in the performance of military missions.

Accounting Services

The Defense Finance and Accounting Service has a primary role in the Army's financial operations. It performs much of the Army's accounting services and prepares the Army's annual financial statements. The Accounting Service—subordinate to the Under Secretary of Defense (Comptroller)—owns and operates most of the financial accounting and reporting systems used to account for the Army's resources. The Army owns and operates various feeder systems that provide data to these accounting and reporting systems. Since its establishment in 1991, the Accounting Service has capitalized most of the Army's accounting offices. All offices that account for Army resources report accounting data to the Defense Finance and Accounting Service-Indianapolis Center, which uses the data to prepare summary financial reports. Additional information about the financial systems and the associated reporting structure is in the Overview portion of the Army's Annual Financial Report.

Audit Services

For the Army's FY 99 financial statements, the Inspector General, DOD delegated audit responsibility to the U.S. Army Audit Agency. The Inspector General, DOD assisted us by performing required audit work at the Indianapolis Center. The work consisted of examining the processes that the Indianapolis Center used to compile and summarize accounting data and to prepare the Army's financial statements. In addition, our audit work on real property was a coordinated effort with the Inspector General, DOD and the U.S. General Accounting Office. The financial statements are to be audited in accordance with Generally Accepted Government Auditing Standards and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements).

Federal Accounting Standards

Office of Management and Budget Bulletin 97-01 (Form and Content of Agency Financial Statements), as amended by subsequent memoranda, specifies that Federal agencies are to adhere to the Statements of Federal Financial Accounting Standards. The bulletin also identifies additional sources of accounting principles and incorporates them into the following overall hierarchy:

1. Individual standards agreed to by the Director of the Office of Management and Budget, the Comptroller General and the Secretary of the Treasury and published by the Office of Management and Budget and the General Accounting Office.
2. Interpretations related to the standards issued by the Office of Management and Budget in accordance with procedures outlined in its Circular A-134 (Financial Accounting Principles and Standards).
3. Requirements contained in Office of Management and Budget's Form and Content Bulletin in effect for the period covered by the financial statements.
4. Accounting principles published by other authoritative standard-setting bodies and other authoritative sources (a) in the absence of other guidance in the first three parts of this hierarchy, and (b) if the use of such accounting principles improves the meaningfulness of the financial statements.

The DOD Financial Management Regulation extends this hierarchy downward by specifying three additional sources:

5. United States Government Standard General Ledger, published by the Department of the Treasury, Financial Management Service, through its Treasury Financial Manual.
6. Policies and guidance published in the DOD Financial Management Regulation.
7. Interim policies and guidance issued by the Office of the Under Secretary of Defense (Comptroller) through various memoranda.

Internal Controls

Internal control, as it relates to the Principal Statements and Required Supplementary Stewardship Information, is a process, effected by the organization's management and other personnel, designed to provide reasonable assurance that the following objectives are met:

- Reliability of financial reporting – transactions are properly recorded, processed, and summarized to permit the preparation of the Principal Statements and Required Supplementary Stewardship Information in accordance with Federal accounting standards, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition;
- Compliance with applicable laws and regulations – transactions are executed in accordance with: (a) laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the Principal Statements or Required Supplementary Stewardship Information, and (b) any other laws, regulations, and governmentwide policies identified by the Office of Management and Budget; and
- Reliability of performance reporting – transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

AUDITOR'S REPORT



DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of the Auditor General
3101 Park Center Drive
Alexandria, VA 22302-1596

Secretary of the Army

As required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the U.S. Army prepared the accompanying General Fund financial statements for fiscal year 1999. As delegated by, and in coordination with, the Inspector General, DOD, we were engaged to audit these statements. The financial statements are the responsibility of Army management. Our responsibility is to express an opinion on these statements based on our audit work.

We were unable to express an opinion on these financial statements because inadequate accounting systems, insufficient audit trails, and procedural problems prevented us from using any practical methods to conduct audit work of sufficient scope to support an opinion. Therefore, we caution users that the information presented in the financial statements may not be reliable.

Internal controls weren't fully effective to ensure that the financial statements contained no material misstatements. The Army and the Defense Finance and Accounting Service have recognized many financial reporting weaknesses and included them in their FY 99 annual assurance statements.

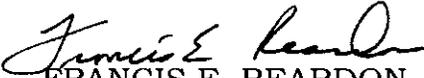
Our limited audit work didn't identify any instances of unreported failures to comply with laws and regulations related to the Army's financial statements. However, the systems that support the Army's financial statements didn't meet the requirements of the Federal Financial Management Improvement Act of 1996. Specifically, these systems didn't substantially comply with established Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

We also performed a limited review of the information in the Overview section of the report and concluded that the financial data in that section may not be reliable since it was derived from the same sources as the financial statements.

As Required Supplementary Stewardship Information, the Stewardship Statement includes national defense property, plant, and equipment; heritage assets; and stewardship land. There was no requirement to audit this information for FY 99. Accordingly, we did not audit it and do not express an opinion on the information presented in the statement.

The supplementary information for deferred maintenance is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. We didn't apply to the information certain procedures prescribed by professional standards because the official accounting guidance regarding the measurement criteria and reporting placement of deferred maintenance on the financial statements was not fully developed.

Except for the limitations described above, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements).


FRANCIS E. REARDON, CPA
The Auditor General

9 February 2000

REPORT ON INTERNAL CONTROLS

REPORT ON INTERNAL CONTROLS

Internal controls didn't provide reasonable assurance that the financial statements didn't contain material misstatements. The Army and Defense Finance and Accounting Service have recognized many material weaknesses and reported them in their FY 99 annual assurance statement on internal management controls. (We discuss this issue in the Report on Compliance with Laws and Regulations beginning on page 33.)

We evaluated and tested relevant financial internal controls related to the reporting of budgetary resources, material asset and liability balances, and the compilation process for financial statements at the Defense Finance and Accounting Service-Indianapolis Center. We also selectively followed up on internal control deficiencies that we previously reported. Because of accounting system deficiencies, we didn't attempt to audit the expenses reported in the Army's statements.

We noted progress in several areas to correct previously identified problems. However, we also identified additional internal control problems. We consider all these problems reportable conditions under standards established by the American Institute of Certified Public Accountants and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements). Reportable conditions represent significant deficiencies in the design or operation of the internal control structure. Material weaknesses are reportable conditions involving deficiencies in the design or operation of internal controls leading to an unacceptable high risk that losses, noncompliance or material misstatements in the financial statements could occur and not be promptly detected.

The Army has recognized that significant problems exist with the processes, procedures, and accounting systems used to prepare its financial statements. To address these problems, the Deputy Assistant Secretary of the Army for Financial Operations, in conjunction with functional experts within and outside the Army, has prepared a detailed plan called, "The Army Chief Financial Officers Strategic Plan." The Army is actively using this plan as a key management tool to improve its financial reporting, and it regularly reviews and updates the plan. As stated in the overview of the Annual Financial Report, the Army completed 115 of the separate tasks identified in the plan, but we haven't verified the completion of these tasks. The Strategic Plan is updated quarterly, and it currently includes more than 200 additional tasks to be completed by the target date of 2003. The goal of the plan is to achieve

an unqualified audit opinion on the Army's financial statements for FY 03.

In this report on internal controls, we summarize the Army's FY 99 financial statement reporting problems in three sections:

- Systems and Procedures.
- Financial Accounts.
- Property Accounts.

Additional information is in our separate supporting reports listed in Annex C.

SYSTEMS AND PROCEDURES

In this section we discuss:

- Accounting systems.
- Other systems.
- Compilation process for financial statements.
- Performance information.

Accounting Systems

Deficiencies in the accounting and finance systems that account for Army resources constitute the major reason for our inability to render an audit opinion on the Army's financial statements. The accounting systems lack a single standard transaction-driven general ledger—an essential element of control for sound, reliable financial reporting. In addition, the accounting systems don't produce account-oriented transaction files (subsidiary ledgers), and data for physical assets is compiled using "work-around" procedures and data from management systems not intended and not suitable for financial reporting. Consequently, the audit trails necessary to verify and reconcile account balances aren't adequate, and the statement balances aren't auditable by any practical means.

Because of system deficiencies, the Army uses a consolidation of accounting data from source documents, budgetary accounting systems, and multiple field-level and department-level entries to produce the financial statements. Army management couldn't provide reasonable assurance that the accounting and non-accounting systems used to record and report Army financial data were reliable. It also acknowledged the possible existence of material transactions that weren't properly recorded in the accounting records and included in the financial statements.

The Defense Finance and Accounting Service, as functional proponent for the Army's accounting and financial management systems, has reported inadequate general ledger control as a material weakness in its annual statement of assurance since FY 91. The FY 99 statement of assurance cites FY 03 as the estimated target date for correction.

The Accounting Service is working on a new accounting system—the Defense Joint Accounting System—that it believes will resolve many of the problems with existing systems. A test of the accounting system's support of financial operations is currently being conducted at the Ballistic Missile Defense Organization. The test began in October 1998 and is scheduled to continue through March 2000. An Operational Test and Evaluation is scheduled for April 2000. Successful completion will result in Milestone Three approval and this will allow deployment to additional DOD agencies. A prototype system originally scheduled to be deployed at Fort Benning in March 2000 has been rescheduled for October 2000. However, even if the tests are successful, the new system will not be fully fielded for several years. In the interim, the Army will continue to depend on inadequate accounting systems.

Other Systems

The Army also needs to upgrade or replace many of its other systems that feed data to the accounting system so that the requirements of financial statement reporting can be met. The Army has recognized this problem. It considers its feeder systems as not adequate to meet the reporting requirements of the Chief Financial Officers Act and has included numerous system improvements in its strategic plan. Including these other system requirements in the strategic plan should enable Army management to coordinate and direct the needed progress in other automated systems. However, some of the expected improvements have not occurred as soon as expected. For example, the Defense Property Accountability System was to be fielded during FY 99 but fielding was not completed. Significant delays of such feeder systems could affect the Army's progress toward auditable financial statements.

Compilation Process for Financial Statements

The Defense Finance and Accounting Service-Indianapolis Center's compilation of financial data from field entities and other sources into the Army's FY 99 General Fund financial statements wasn't in full compliance with applicable laws and regulations. Improved procedures and internal controls were needed in several areas.

The Indianapolis Center's use of status and expenditure data is an unacceptable method for compiling the financial statements. Taken as a whole, the Army's General Fund financial statements won't be auditable until a transaction-driven, integrated accounting system based on general ledger accounting is implemented Armywide.

The Indianapolis Center materially reduced the number and scope of adjustments made to the general ledger while preparing the Army's FY 99 financial statements. The Indianapolis Center made 423 adjustments for about \$993 billion while preparing the FY 98 financial statements. For FY 99 it made 291 adjustments for about \$408 billion. However, controls over the adjustments needed additional improvements:

- Two of the adjustments, valued at about \$131 billion, were used to force the general ledger to match the status of funds data. This is significantly less than the 3 adjustments valued at about \$512 billion used for the same purpose for FY 98. However, these adjustments were not properly supported. Accounting Service regulations require that when the proper authoritative source has determined that there is a discrepancy in data between two or more sources, a correcting journal voucher must be prepared. Evidence to support this type of journal voucher includes source data documentation and related analysis documenting the correct amount. In addition, the journal voucher must document why there was a discrepancy in the source data amounts and how the proper authoritative source determined that the entries included on the journal voucher are correct. The two adjustment vouchers didn't include this evidence.
- Many general ledger adjustments didn't have adequate supporting documentation attached. Of the 291 general ledger adjustments prepared for FY 1999, there were 50 that didn't include the supporting documentation required by Accounting Service regulations. For example, the adjustment for environmental liabilities, about \$27 billion, included a computation of the allocation of the liabilities among several categories but didn't include the original data on which the computation was based.

Performance Information

We conducted only a limited review of information on performance results that was presented in the Overview section. In addition, we obtained a basic understanding of the internal controls related to performance results that were reported in the Overview and Supplemental Financial and Management Information. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such control.

However, last year we noted that in one of our separate audits we had determined that the Army didn't collect accurate data on equipment readiness and therefore the performance results relating to mission capable readiness were misstated. The agreed-to corrective action was to be completed during FY 99. However, this action was rescheduled for FY 00. Therefore, improved controls over this data have not yet been fully implemented. We will conduct additional reviews during FY 00.

FINANCIAL ACCOUNTS

In this section we discuss:

- Reporting of budgetary resources.
- Liabilities.
- Fund balance with Treasury.
- Problem disbursements.
- Progress payments.
- Military payroll issues.

Reporting of Budgetary Resources

Internal controls over the accounting, processing, and reporting of financial transactions that we tested at the local level weren't adequate to ensure the reasonableness of the individual transactions submitted for the Statement of Budgetary Resources. In addition, information in the

statement wasn't based on a standard general ledger as required. Therefore, the accuracy of the statement is unknown.

We reviewed an Armywide sample of transactions for obligations, recoveries, disbursements, collections, and reimbursables to assess the effectiveness of controls. For each type of transaction we found an unacceptable error rate. The problems we found included misclassification of transactions, use of incorrect reimbursement source codes, mismatched disbursements, and the lack of supporting documentation. The results of our sample indicated that there was an unacceptably high level of control risk that amounts reported in the Army's Statement of Budgetary Resources would not be reasonably accurate.

Also, accounting systems, key accounting procedures, and accounting practices used for preparing the Statement of Budgetary Resources didn't comply with legal and regulatory requirements. The Federal Financial Management Improvement Act of 1996 requires each agency to implement and maintain financial management systems that comply with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger.

Because the systems don't comply with the Improvement Act, Defense Finance and Accounting Service-Indianapolis Center personnel had to rely on fund control data for the values reported in the Statement of Budgetary Resources instead of on accounting data from a general ledger as required. Consequently, personnel had to develop crosswalks and complicated formulas to convert the data for the Statement of Budgetary Resources. The lack of financial management systems and the use of alternate procedures for preparing the financial statements meant that adequate audit trails weren't available, and it was labor intensive to trace summary transactions or balances to source documentation.

The following two issues that directly affect the data in the Statement of Budgetary Resources remained unresolved for FY 99:

- Accounting systems lack a standard general ledger and double entry accounting. As a remedy, the Defense Finance and Accounting Service plans to field the Defense Joint Accounting System. However, fielding is not scheduled to be completed until FY 03.
- The effect of intra-Army transactions wasn't eliminated from the statement. Even though guidelines don't require elimination of these transactions until FY 00, the balances reported in the statement will be materially misleading without eliminations.

Liabilities

There were insufficient controls and audit trails for us to evaluate total liabilities of \$35 billion that the Army reported for FY 99. We did find that the Army had not been reporting environmental liabilities that were covered by budgetary resources. DA personnel agreed that these amounts should be reported and included them in the FY 99 financial statements. However, until adequate supporting documentation and reporting guidance is available for all of the Army's material liabilities, the reliability of the reported amounts will be questionable.

Environmental Liabilities

We found inadequate supporting documentation for liabilities related to environmental programs. The Army reported about \$22 billion of environmental liabilities related to the estimated future outlays for these five major programs:

- Chemical Demilitarization Stockpile Program.
- Chemical Demilitarization Non-stockpile Program.
- Restoration of Operating Installations.
- Restoration of Formerly Used Defense Sites.
- Environmental Compliance.

For most of these programs, the Army generally had determined the types and quantities of related projects. For example, there were life-cycle cost estimates for every authorized demilitarization site related to both the stockpile and non-stockpile programs. However, problems with the components of the life-cycle cost estimates made the reported liability of \$8.4 billion for these two programs questionable.

Because of the Army's use of estimating procedures to determine liability values, the supporting documentation for the specific projects within these programs must show not only the dollar amount of each project, but must also clearly show the methodology and computations. We found that such documentation frequently wasn't available or wasn't current.

Additional Liabilities

We also noted problems with other categories of liabilities:

- The Army reported about \$2.4 billion for unexploded ordnance. Guidance for identifying all such ordnance wasn't completed at the time of our review. Until this guidance is issued, the reliability of the reported total will be uncertain. The Army has recognized this problem and reported it as a material weakness in its annual statement of assurance.
- The Army didn't report an amount for base realignment and closure in its financial statements. DOD told the Army not to include it because it would be reported on the DOD statements. We believe this understates the Army's liability.
- The Army didn't report any liabilities for Panama Canal environmental cleanup costs. In our FY 98 report, we reported that this liability was understated by \$138 million. For FY 99, Army managers told us that there was no liability to report, but they didn't have documentation to show that this liability had been cleared.

These three issues further reduced the reliability of the Army's reported liabilities.

Fund Balance with Treasury

We weren't able to attest to the reasonableness of the reported total for Fund Balance with Treasury of about \$32.3 billion as of 30 September 1999. We found material unreconciled differences between the Army's official report on net disbursements and supporting records. Unreconciled check issue, deposit, and Online Payment and Collection differences for balances over 60 days old at fiscal year-end totaled about \$339 million and were material with regards to the Fund Balance With Treasury balance of \$32.3 billion. Taken as a whole, the unreconciled differences represent a material uncertainty with regards to the Fund Balance with Treasury line item balance. In addition, a reconciling difference of about \$25.9 million should have been disclosed in footnote 2.

- Unreconciled Online Payment and Collection differences increased significantly over last fiscal year. Online Payment and Collection differences are intragovernmental transaction amounts reported by an organization but not reported by its trading partner. Differences over 60 days old totaled about \$171 million for FY 99

compared to about \$20 million for FY 98. However, this amount does not include about \$608 million of Online Payment and Collection differences the Indianapolis Center's Directorate for Central Disbursing, the Army's largest disbursing station, had moved to a suspense account by August 1999. Differences moved to a suspense account are not included in the Online Payment and Collection differences reported by the Finance and Accounting Service. Adequate audit trails weren't available for us to determine how much of the \$608 million was resolved by fiscal year end.

- Treasury reports showed a net amount of about \$972 million of unresolved discrepancies as of 30 September 1999 between Treasury records and disbursing officer statements of accountability for checks issued. The total amount of the discrepancies was about \$1.5 billion. As of 30 September 1998, the net discrepancy between Treasury records and disbursing officer statements of accountability for checks issued was about \$704 million, and the total amount of the discrepancies was about \$1.8 billion. Only about \$116.3 million of the unresolved discrepancies of about \$972 million reported as of 30 September 1999 was more than 60 days old. Most differences cleared the following month and management asserted that the major cause of the discrepancies was timing differences between the two sets of records. However, audit work beyond our scope of work for FY 99 would be necessary to confirm this.

Management needed to examine the differences to make sure they weren't indicators of potentially serious problems. For example, a check cashed and not reported as issued could be written on pilfered check stock or indicate other fraudulent payments. In addition, if discrepancies aren't researched and corrected quickly, the research effort becomes progressively more difficult because information needed for the research isn't readily available and the unresolved differences continue to grow. For example, during the year the Finance and Accounting Service determined that \$46.6 million of the old check discrepancies that existed on 30 September 1999 should be written off as losses because they could no longer be researched or corrected. Moreover, the failure to promptly research and resolve these discrepancies creates a weak control environment where fraud could occur and go undetected.

Problem Disbursements

The Army reported significant amounts of problem disbursements at the end of FY 99. Two primary categories of problem disbursements are unmatched disbursements (disbursement transactions that accounting offices have not matched to the correct detail obligations in the

accounting records) and negative unliquidated obligations (disbursement transactions that exceed the value of the matching detail obligations). The Army and the Defense Finance and Accounting Service recognize problem disbursements as a significant issue, but the reported status at yearend indicated that much work remained before this issue would be under control.

As of 30 September 1999, the Army reported unmatched disbursements of about \$1.8 billion (absolute value) and negative unliquidated obligations of about \$782 million (net value). Compared to the end of the prior fiscal year, these amounts represented a decrease in unmatched disbursements but represented an increase in negative unliquidated obligations. The Army's FY 99 goals were to reduce unmatched disbursements 30 percent, to about \$2.1 billion (absolute value), and to reduce negative unliquidated obligations 50 percent, to \$203 million (net value). Therefore, the Army reportedly met its unmatched disbursements goal but didn't meet the negative unliquidated obligations goal. In our report on the Army's FY 98 financial statements we reported similar trends—that the reported amount of unmatched disbursements had decreased but that the amount of negative unliquidated obligations had increased.

The Accounting Service has reported multiple material weaknesses related to problem disbursements in its annual assurance statements. In some cases corrective action is taking longer than expected. One of the weaknesses that we described in our report last year dealt with the contract payment system. In that weakness the primary causes for the problem disbursements were identified as a lack of integration between the entitlement and accounting systems. According to this year's assurance statement the target date for correction has been extended 2 years to FY 03.

The Army and the Accounting Service previously established a Joint Reconciliation Program to increase their combined efforts to solve this issue. These efforts are continuing during FY 00. However, the high amounts of problem disbursements cast doubt on the reliability of the amounts reported in the Army's financial accounts.

Progress Payments

During FY 96, we identified problems with recording holdbacks related to progress payments. The Accounting Service had not implemented changes to correct these problems. In our report on progress payments for the FY 96 financial statements, we recommended that the Accounting Service:

- Modify Army accounting systems to provide for recording of contract holdbacks and use the systems to record holdbacks related to progress payments.
- Make sure actual progress payment rates are used when calculating contract holdback amounts.
- Review trial balances submitted by operating locations and accounting offices to make sure that stations reporting account balances for contract holdbacks also report an account balance for the corresponding asset account.

The Accounting Service agreed to test the recommendation to review trial balances, but didn't agree to modify systems to provide for recording of contract holdbacks or to make sure actual progress payment rates were used when calculating contract holdback amounts.

On 2 October 1998, the Office of Management and Budget made a decision that supported our position. However, DOD has not implemented this decision and has indicated that it intends to challenge it. Since we didn't conduct detailed audit work in this area for FY 99, we estimated the effect on the financial statements. To estimate the value of total unrecorded contract holdbacks, we used balances from general ledger accounts for Progress Payments Made to Others, Work in Process-Contractor, and Contract Holdbacks. We used information from those accounts and an average progress payment percentage that we developed during our prior audit. Using this procedure we estimated the following effect:

- Property, Plant and Equipment (Construction-in-Progress) would be understated by about \$2.4 billion for the amount of progress payments and holdbacks that should have been recorded in general ledger accounting code 1582, Work in Process-Contractor.
- Other Assets would be overstated by about \$2 billion for the progress payments recorded in general ledger accounting code 1453, Progress Payments Made to Others.
- Accounts Payable Non-Federal would be understated by about \$385 million for the unrecorded contract holdbacks.

Because of the limited scope of our assessment, we didn't recommend adjustments to the financial statements. However, we believe the Army should have explained in the notes what the financial statement effect would have been if the Army had implemented the Office of Management and Budget decision.

Military Payroll Issues

The Army and the Accounting Service are 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 (such as base pay, special pay, or other entitlements) to be transmitted from personnel systems to finance. The fielding of software upgrades to enhance the interface between personnel and pay systems was scheduled to begin during FY 98. However, initial fielding has been delayed due to several issues including year 2000 concerns and an effort to improve procedural efficiency rather than merely automating the existing manual procedures. Current projections are to field more than 80 pay events in 4 increments. The first increment will consist of 10 pay events and is projected for fielding during the second quarter FY 02. The second release will consist of 22 pay events and is scheduled for FY 03. The remaining two releases are not yet funded and scheduled.

PROPERTY ACCOUNTS

In this section we discuss:

- Equipment.
- Real property.
- Inventory.

Equipment

The Army achieved some progress during FY 99 but still didn't have adequate procedures and controls to ensure that values reported for general equipment were accurate and complete. This condition was one of the material weaknesses that the Army included in its FY 99 Annual Statement of Assurance on Management Controls. Specifically, the Army couldn't comply with Federal Accounting Standards because its financial and property accountability systems don't capture the data necessary to properly value equipment and compute depreciation.

To bring the Army into compliance with Federal Standards for financial reporting, the Army has initiated two major efforts. The Army, as part of

an Office of the Secretary of Defense initiative, has contracted with a public accounting firm to determine valid costs and depreciation amounts for the Army's general equipment. Also, to ensure that Army systems meet financial reporting requirements for its equipment, the Defense Property Accountability System is being implemented to replace or interface with existing systems that don't meet these requirements.

However, fielding the new system was not completed during FY 99. Therefore, DA used an Armywide data call to generate values for general equipment and related depreciation to be reported in the financial statements. A task force at the U.S. Army Materiel Command's Logistics Support Activity conducted the data call. The task force followed the same routines and procedures as last year and improved its response to the data call from about 80 percent to about 97 percent. However, significant problems related to the reliability and completeness of property book data—plus time constraints resulting from the data call process—prevented us from validating the value of general equipment on the FY 99 financial statements. Nevertheless, during our limited review, we identified three problems that affect the accuracy and completeness of financial statement data.

- The value for general equipment decreased by a large unexplained amount from FY 98 to FY 99. Our review of the preliminary FY 99 value disclosed computation and recording errors that resulted in an understatement of about \$1.3 billion. However, after the Army reprocessed the source data, there was still a large unexplained decrease for the year. The reported net value of equipment for FY 98 was about \$1.6 billion and about \$857 million for FY 99. This situation casts doubt on the reliability of the reported value and prevented the Army from establishing a valid baseline that could be carried forward from one year to the next.
- DA fell short of its original plan for implementing the Defense Property Accountability System in FY 99. As of December 31, 1999, the Defense Property Accountability System had been implemented at 25 sites. A fielding plan is in place to bring targeted sites on line by the 3rd quarter of FY 00. We believe that the Army must continue to expedite the fielding process. Implementing the Defense Property Accountability System directly affects the Army's ability to meet Federal reporting requirements for general equipment. Problems encountered with the data call process makes implementing the new system even more important.
- Even after the planned implementation of the Defense Property Accountability System is completed, the system won't capture or report some of the Army's general equipment. The system is being implemented according to Army policy at Table of Distribution and

Allowance sites. However, unless this implementation policy is modified the system won't capture general equipment in the possession of Modification Table of Organization and Equipment (MTOE) units or information contained in Army Materiel Command depots. Our analysis of property book data provided by the task force showed that about \$438 million, or 22 percent, of general equipment was accounted for by units that won't convert to this system. These are basically tactical units that will remain on the Standard Property Book System - Redesign, or Army Materiel Command depots that account for property using the Commodity Command Supply System. The Army Equipment Working Group will address these issues when it meets in February 2000.

Until improved procedures and controls are in force, the reported values for equipment will not be reliable.

Real Property

Real property values reported in the FY 99 statements are probably misstated, but the amount of the misstatement is unknown. The Army hasn't overcome the long-standing problem of inadequate historical cost data. In addition, the Army hasn't corrected previously reported problems on the timely recording of real property assets, and Army activities didn't consistently record assets when they were placed in service. The Army also wasn't able to implement adequate procedures for reporting real property improvements and reliable depreciation amounts because it didn't field the Integrated Facilities System interface with the Defense Property Accounting System. Inconsistent reporting of construction in progress also contributed to the uncertainty of the reported values.

Validation of Real Property Values

To overcome the lack of historical cost documentation, DOD engaged PricewaterhouseCoopers to evaluate the recorded costs of real property assets as of 30 September 1998. The objective was to determine a valid baseline value of real property. Once this baseline is established, future audit work could focus on real property transactions that occurred after the baseline date. PricewaterhouseCoopers reviewed a DOD-wide sample of real property for this effort. However, at the time we completed the fieldwork on the Army's FY 99 financial statements, the results of PricewaterhouseCoopers analysis were still being evaluated by the audit and financial management community. Therefore, the impact on the reported value of the Army's real property is not yet known.

Accounting for Changes to Real Property Values

In conjunction with the PricewaterhouseCoopers validation effort, we reviewed about \$408 million of FY 99 real property transactions at 23 locations Armywide. We found that transactions valued at about \$113 million, or about 27 percent, were completed in prior periods and should have been reported in the prior periods. We also identified about \$43 million of real property values that were omitted from the FY 99 financial statements because supporting documentation wasn't prepared or wasn't provided to real property offices. Activities also didn't consistently record accurate capitalization dates. Some activities used either the date posted to the automated system or the date they accepted accountability for the real property. Federal accounting standards require the recognition of real property assets when the assets are placed in service. Correct capitalization dates are necessary to accurately report depreciation and real property values in the financial statements.

Document retention wasn't a problem for the transactions that we reviewed. Nearly all activities had supporting documentation for FY 99 transactions that generally supported dollar values recorded in the automated system.

Because it didn't field the interface between the Integrated Facilities System and the Defense Property Accounting System during FY 99, the Army continued to use the business rules it developed for the FY 98 financial statements. These rules included the application of capitalization thresholds and the computation of depreciation. As in FY 98, the Army applied these rules to the Headquarters Executive Information System. However, because the real property information resided at a summary level in this system, the Army was unable to apply the rules to individual capital improvements. Therefore, it was unable to identify accurate years for depreciating these improvements. Until the new system is fielded, this problem will continue to exist.

Construction in Progress

The U.S. Army Corps of Engineers needed to improve internal control procedures to ensure that completed real property projects are promptly transferred to Army installations at the proper amount. Although the Corps had issued guidance on the preparation of transfer documents, the various Corps districts have inconsistently implemented this guidance, and therefore, transfer documents were not always prepared timely. In addition, transfer documents didn't always include the same types of costs for a given phase of completion. As a result, completed

projects could be incorrectly classified in the financial statements or not included in the financial statements.

Inventory

Internal controls were not fully effective over the reporting of munitions as inventory and the related impact on stewardship reporting. Also, DOD and the Army were still evaluating the criteria for classifying certain items as operating materials and supplies.

Wholesale Munitions

We reviewed two commands and found a control weakness at one of them. Aviation and Missile Command didn't research and adjust many of the discrepancies found during monthly reconciliations. Gross discrepancies between the accountable and custodial records were about \$385 million in August 1999 and the command's record accuracy rate was only about 80 percent compared to the existing standard of 95 percent. As a result, the accuracy of the commodity system's wholesale missile balances was questionable. We did a followup review in October and found that the discrepancies still weren't being resolved. In addition, the command didn't have controls to ensure that the value of missiles reported on the stewardship report was subtracted from the value of munitions reported in the balance sheet. We identified \$2.4 billion of missile-related equipment that should be subtracted from the Army's FY 99 balance sheet. After being informed of this, command processed an appropriate journal voucher.

Operating Materials and Supplies

The Army and DOD have action ongoing to identify the types of items that should be reported as operating materials and supplies. The particular issue being reviewed is determining the conditions for using the purchase method versus the consumption method. Under the purchase method, items are expensed when they are purchased. Under the consumption method, items are reported as assets when they are purchased and expensed when they are issued to an end user. This ongoing action is included in the Army's strategic plan, and the final outcome will have a direct impact on the reported amount of operating materials and supplies.

**REPORT ON COMPLIANCE WITH LAWS
AND REGULATIONS**

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

The Army isn't yet able to fully comply with the Chief Financial Officers Act of 1990 and related requirements. However, during our review of compliance with laws and regulations, we found no material instances of unreported legal or regulatory infractions.

We tested the Army's compliance with selected provisions of laws and regulations throughout the audit. Instances of noncompliance are reportable if they could result in material misstatements to the financial statements, or if the sensitivity of the matter would cause others to perceive it as significant.

The noncompliance problems we identified were directly or indirectly tied to internal control weaknesses and the Army's inability to fully comply with the Chief Financial Officers Act (and related implementing guidance). We discuss these problems in the Report on Internal Controls.

We also tested and reviewed compliance with certain key laws that affected the Army's ability to produce reliable financial statements. We discuss four pertinent laws in the following paragraphs. However, the objective of our audit wasn't to provide an opinion on the Army's overall compliance with laws and regulations, and we do not express such an opinion.

Chief Financial Officers Act

We evaluated the Army's compliance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, and various implementing regulations issued by the Office of Management and Budget and DOD, as they relate to presentation of information in financial statements. The Army and the Accounting Service have made a concerted effort to meet the act's requirements. But current management and accounting systems weren't designed for financial statement reporting, and they can't produce reliable and auditable financial statements. Until system deficiencies are resolved, the Army and the Accounting Service will be unable to produce statements that conform to prescribed accounting guidance. Nevertheless, we have identified areas in which the Army and the Accounting Service can achieve financial reporting improvements over the short term. We discuss these areas and the necessary corrective

actions in the Report on Internal Controls, and in the audit reports listed in Annex C.

Anti-Deficiency Act

We evaluated the Army's compliance with the Anti-Deficiency Act as part of our review of the compilation of the financial statements at the Indianapolis Center. Our review at that level didn't identify any potential violations of the act. However, because of the magnitude of the Army's problem disbursements, we could not fully verify the Army's compliance with the act.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act of 1982 requires the Army and the Accounting Service to report annually to the Secretary of Defense about whether their management controls comply with the act's requirements. In their respective FY 99 annual assurance statements, the Army and the Accounting Service reported several management control weaknesses involving noncompliance with prescribed accounting principles, standards, and related requirements. The specific weaknesses most directly related to the Army's financial statements follow. Summaries of these weaknesses are in Annex B.

Army Assurance Statement

The Army reported 10 uncorrected material weaknesses for FY 99. The following weaknesses most directly affect the accuracy and reliability of the Army's financial statements:

- Financial Reporting of Real Property and General Equipment.
- Information Systems Security.
- Equipment In-Transit Visibility.
- Management of Unexploded Ordnance and Other Constituents.
- Pollution Prevention.

Defense Finance and Accounting Service Assurance Statement

The Accounting Service reported 38 uncorrected material weaknesses for FY 99. Here are examples of weaknesses that directly affect the accounting data that the Accounting Service uses to prepare the Army's principal financial statements.

- Inadequate General Ledger Control and Unreliable Financial Reporting.
- Reconciliation of Suspense Account Balances.
- Interface Between Contract Payment and Accounting Systems (Negative Unliquidated Obligations (NULO) and Unmatched Disbursements).
- Inadequate Systems Interface Between Computerized Accounts Payable System (CAPS) and Standard Army Finance Systems Redesign (SRD-1).
- Problem Disbursements.
- Fragmented and Incomplete Defense Joint Military Pay Systems (DJMS) Requirements and System Specifications Documentation.
- Fund Balances with Treasury.
- Access Deficiency to Departmental Accounting Files.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards and the U.S. Government Standard General Ledger at the transaction level. The act also requires that we report on agency compliance with these requirements.

Financial management systems didn't meet the requirements of the Federal Financial Management Improvement Act of 1996. The lack of a single integrated general ledger and the differences between status of appropriation data and the general ledger data complicated the financial statement compilation process. The Indianapolis Center made material

adjustments to the general ledger data to make it match the status of appropriation data without knowing the reasons for the differences.

The Assistant Secretary of the Army (Financial Management and Comptroller) has stated that the Army cannot provide reasonable assurance that the accounting and non-accounting systems used to record and report Army financial data are reliable because they don't meet the standards set by the Office of Management and Budget. Therefore the Army uses a consolidation of accounting data from source documents, budgetary accounting systems, and multiple field-level and department-level data inputs to produce the financial statements.

DOD has also acknowledged the existence of problems with the financial systems. In its Annual Statement of Assurance for FY 99, the Accounting Service stated:

Financial information in the Department of Defense is not always compiled and adequately maintained within accounting, finance, and other feeder systems, is not always fully compliant with regulatory and statutory requirements, and overall cannot be processed into financial statements that can withstand the rigors of financial audit.

Federal Accounting Standards

As noted in the Report on Internal Controls, the Army's financial statements weren't prepared in full accordance with Federal accounting standards. This is primarily due to the lack of adequate accounting systems.

AUDIT SCOPE AND METHODOLOGY

AUDIT SCOPE AND METHODOLOGY

Army management, with support provided by the Defense Finance and Accounting Service, is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles.
- Establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met.
- Complying with applicable laws and regulations.

We were responsible for evaluating the financial statements, related internal controls, and compliance with laws and regulations. In carrying out these responsibilities, we:

- Evaluated and, as necessary, tested relevant internal controls related to:
 - Reporting of budgetary resources.
 - General equipment.
 - Real property.
 - Inventory.
 - Liabilities.
 - The overall process for compiling the financial statements.
- Conducted limited followup reviews on previously reported problems and recommendations related to:
 - Accounting systems.
 - Fund balance with Treasury.
 - Problem disbursements.
 - Payroll.

- Progress payments.
- Construction in progress.
- Evaluated compliance with selected laws and regulations.
- Reviewed the Overview section of the Annual Financial Report for consistency with data reported in the financial statements and to test the existence and completeness assertions over performance information.

We didn't conduct audit work on programs that were classified for national security.

Except for the limitations on our work described in the body of this report, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements).

ANNEXES

REPORTED MATERIAL WEAKNESSES

In the annual assurance statements for FY 99, the Army and the Defense Finance and Accounting Service both reported uncorrected material internal control weaknesses that directly relate to the Army's financial statements. This annex summarizes those weaknesses.

Army Assurance Statement

The Army reported 10 uncorrected material weaknesses for FY 99, and 5 directly related to the accuracy and reliability of the Army's financial statements. Here is a summary of these five weaknesses as reported in the assurance statement.

1. Financial Reporting of Real Property and General Equipment.

The Army does not currently meet Federal accounting standards for the financial reporting of real property and general equipment. These standards require Federal agencies to present fairly the cost and depreciation of these assets in their financial statements. To meet this requirement, Army records must capture the correct acquisition date and cost. In most cases, current Army systems weren't designed to produce such information. As a result, information on acquisition date and cost is not always available or accurate. The Army's inability to identify an item's acquisition date and cost prevents the computation of depreciation and the determination of value for financial reporting. (Identified: FY 99. Resolution Target: FY 01.)

2. Information Systems Security. Unauthorized personnel have successfully attacked and penetrated the Army's unclassified automated information systems and telecommunications networks. These intrusions have led to the identification of systemic deficiencies in systems and network security design and implementation; incident response, containment, and implementation of countermeasures; and information systems security education, training, awareness; and professional development. To correct these weaknesses, Army leadership has, in the Command and Control Protect Program Management Plan, outlined the measures it will take to ensure the Army's portion of the Defense information infrastructure is adequately protected. (Identified: FY 96. Resolution Target: FY 03.)

3. Equipment In-Transit Visibility. Systems interface and logistics process problems cause a significant portion of the in-transit records displayed by the Continuing Balance System-Expanded to be invalid. Equipment involved had been received and reported as on hand by the

receiving units, but the receipt transactions didn't close out the shipment (in-transit) records. As a result, the Army didn't have reliable data about the value of equipment in-transit, and the value of in-transit equipment reported in the Army's financial statements was misstated by a significant but unknown amount. (Identified: FY 96. Resolution Target: FY 00.)

4. Management of Unexploded Ordnance and Other Constituents.

Neither the Army nor DOD has an effective, integrated and proactive unexploded ordnance management program that addresses the full life-cycle perspective of ranges, land withdrawal, munitions, and unexploded ordnance. Also, neither the Army nor DOD has ready access to necessary science and technology information to accurately assess and predict the operational, safety, health, and environmental or fiscal impacts to ensure the unexploded ordnance on ranges is being proactively managed. (Identified: FY 98. Resolution Target for Phase One: FY 00.)

5. Pollution Prevention. A disconnect between policy setting and funding execution has created an Army accountability issue within the environmental program. This management deficiency has resulted in a failure to identify and implement various pollution prevention requirements and opportunities that could reduce "total ownership cost" for the Army. This could result in the Army not meeting the requirements of Federal, State and local regulations on pollution prevention, and thus could likely increase future costs and potential liabilities associated with environmental compliance and restoration. (Identified: FY 98. Resolution Target: FY 00.)

Defense Finance and Accounting Service Assurance Statement

The Accounting Service reported 38 uncorrected material internal control weaknesses for FY 99. Here are summaries of some of the reported weaknesses that most directly affect the Army's financial statements as reported in the assurance statement.

1. Inadequate General Ledger Control and Unreliable Financial Reporting. The Accounting Service has a material internal control weakness in general ledger and financial reporting that is attributable to many factors in the control environment, accounting and related systems, and control procedures. Overall, the accounting systems don't have general ledgers that permit adequate recording and reporting of financial transactions. Each DOD accounting system has its own general ledger, and efforts to implement the U.S. Government Standard

General Ledger are continuing. Effective control procedures over accounting and reporting will be impossible until a single, standard general ledger is developed and implemented in the DOD systems. (Identified: FY 91. Resolution Target: FY 03.)

2. Reconciliation of Suspense Account Balances. Suspense account balances require extensive reconciliations to ensure that the accounts are used properly, supported by adequate documentation, cleared in a timely manner, and are in agreement with Treasury balances. Transactions residing in suspense accounts can conceal problem disbursements and fraud. (Identified: FY 97. Resolutions Target: FY 00.)

3. Interface Between Contract Payment and Accounting Systems (Negative Unliquidated Obligations (NULO) and Unmatched Disbursements). Both negative unliquidated obligations and unmatched disbursements are evidence of the same type of weakness: the presence of error conditions in the interface between systems and accounting systems. In DOD, payment operations for the most part are distinct from accounting, even when the payment operations are a component of the same accounting and finance office. Differences between payment systems and accounting systems are not revealed until payments are improperly recorded in the accounting systems. Large out-of-balances exist in undistributed disbursement and collection accounts and in unliquidated obligation accounts. The capabilities of the accounting systems don't permit the research of unmatched document numbers. Personnel performing reviews aren't adequately trained, and review-sampling methods are inadequate. (Identified: FY 90. Resolution Target: FY 02.)

4. Inadequate Systems Interface Between Computerized Accounts Payable System (CAPS) and Standard Army Finance System Redesign (SRD-1). The ASCII file used to update SRD-1 with accounts payable payment information can be changed. The file is unprotected and can be accessed by anyone who can read and/or change an ASCII file. As a result, any individual with access to the file can alter the information. Also, the Computerized Accounts Payable System does not have the capability to restrict access to the "remit to" address file for associates computing vendor payments. The lack of internal controls, edit checks, and audit trail in the Accounts Payable System has the potential for fraud and the misuse of government funds. (Identified: FY 98. Resolution Target: FY 00.)

5. Problem Disbursements. The Defense Finance and Accounting Service-Indianapolis Center is working with DOD agencies to fully identify and resolve problem disbursements. Problem disbursements are composed of two primary categories: unmatched disbursements and

negative unliquidated obligations. Unmatched disbursements are disbursements that accounting stations cannot match to obligations in the accounting records. A negative unliquidated obligation is a disbursement that exceeds the value of the matching detail obligation. Primary causes of problem disbursements relate to the lack of integration between the entitlement systems and the accounting systems. In-transit problem disbursements are a separate category of disbursements that have been registered to the U.S. Treasury and charged to an appropriation, but not yet distributed to an accounting station. The occurrence of problem disbursements distorts fund availability. (Identified: FY 96. Resolution Target: FY 03.)

6. Fragmented and Incomplete Defense Joint Military Pay System (DJMS) Requirements and System Specifications Documentation.

Comprehensive sets of requirements, business rules, and systems documentation doesn't exist for either the Active or Reserve Components of the system. Some documentation is maintained only in functional work areas and some is maintained in the programmer/analyst work areas. Not all existing information is current. Failure to have documented systems severely impairs and adversely impacts the primary mission of hosting and modifying military pay software with acceptable degrees of confidence and reliability. (Identified: FY 99. Resolution Target: FY 02.)

7. Fund Balances with Treasury. Appropriation balances recorded in the accounting records do not balance to the fund balances with the Treasury. (Identified: FY 99. Resolution Target: FY 01.)

8. Access Deficiency to Departmental Accounting Files. Personnel at operating locations and other outside activities have access to the Departmental Accounting Budget Execution database. Users have access to any record in the database. The Headquarters Accounting and Reporting System (HQARS) experienced data loss during FY 99 due to the high number of users accessing the database. (Identified: FY 99. Resolution Target: FY 01.)

SUPPORTING AUDIT REPORTS

1. Financial Reporting of Wholesale Munitions (to be published)
2. Financial Reporting of Budgetary Resources (to be published)
3. Financial Reporting of Liabilities (to be published)
4. Financial Reporting of Army General Equipment (to be published)
5. Financial Reporting of Construction in Progress (to be published)
6. Financial Reporting of Real Property (to be published)
7. Audit of the Compilation of the Army's FY 99 Financial Statements at the Defense Finance and Accounting Service-Indianapolis Center (Inspector General, DOD, Project Number OFI-2116)

OTHERS RECEIVING COPIES OF THE REPORT

Chief of Staff, Army
 Under Secretary of the Army
 Vice Chief of Staff
 Assistant Secretary of the Army (Civil Works)
 Assistant Secretary of the Army (Financial Management and Comptroller)
 Assistant Secretary of the Army (Installations and Environment)
 Assistant Secretary of the Army (Manpower and Reserve Affairs)
 Assistant Secretary of the Army (Acquisition, Logistics and Technology)
 General Counsel
 Director of the Army Staff
 The Inspector General
 Chief of Legislative Liaison
 Chief of Public Affairs
 Chairman, Army Reserve Forces Policy Committee
 Deputy Chief of Staff for Logistics
 Deputy Chief of Staff for Operations and Plans
 Deputy Chief of Staff for Personnel
 Assistant Chief of Staff for Installation Management
 Chief, National Guard Bureau
 Deputy Assistant Secretary of the Army for Budget
 Director, Program Analysis and Evaluation
 Commanding General, U.S. Army, Europe and Seventh Army
 Commanders
 U.S. Army Forces Command
 U.S. Army Training and Doctrine Command
 U.S. Army Materiel Command
 U.S. Army, Pacific
 U.S. Army Military District of Washington
 U.S. Army Corps of Engineers
 U.S. Army Criminal Investigation Command
 U.S. Total Army Personnel Command
 U.S. Army Aviation and Missile Command
 U.S. Army Communications-Electronics Command
 U.S. Army Industrial Operations Command
 U.S. Army Tank-automotive and Armaments Command
 U.S. Army Logistics Integration Agency
 U.S. Army War Reserves Support Command
 XVIII Airborne Corps and Fort Bragg
 I Corps and Fort Lewis
 3^d MP Group, USACIDC
 6th MP Group, USACIDC

Executive Director, U.S. Army Materiel Command Logistics Support
Activity

Directors

Armament and Chemical Acquisition and Logistics Activity

U.S. Army Research Laboratory

U.S. Army Center for Public Works

Commandant, U.S. Army Logistics Management College

Director, Center for Army Lessons Learned

Inspector General, Department of Defense

Directors

Defense Finance and Accounting Service

Defense Finance and Accounting Service-Indianapolis Center

Defense Finance and Accounting Service-Columbus Center

Defense Intelligence Agency

Defense Logistics Agency

Auditors General

Air Force Audit Agency

Naval Audit Service

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