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INSPECTOR GENERAL, DOD, OVERSIGHT
OF THE AIR FORCE AUDIT AGENCY
AUDIT OF THE FY 2000 AIR FORCE WORKING
CAPITAL FUND FINANCIAL STATEMENTS

Report No. D-2001-062

February 28, 2001

Office of the Inspector General
Department of Defense

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Acronyms

AFAA

Air Force Audit Agency



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

February 28, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 2000 Air Force Working Capital Fund Financial Statements (Report No. D-2001-062)

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 Air Force Audit Agency disclaimer of opinion on the FY 2000 Department of the Air Force Working Capital Fund financial statements, along with excerpts from the Air Force Audit Agency audit report, "Opinion on Fiscal Year 2000 Air Force Working Capital Fund Financial Statements," February 7, 2001. An audit of the Department of the Air Force Working Capital 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. For additional information on this report, please contact Mr. Brian Flynn at (703) 604-9489 (DSN 664-9489) (bflynn@dodig.osd.mil) or Mr. Byron B. Harbert at (303) 676-7405 (DSN 926-7405) (bharbert@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
Acting Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-062

February 28, 2001

(Project No. D2001FD-0051.02)

Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 2000 Air Force Working Capital Fund Financial Statements

Executive Summary

Introduction. 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, requires DoD to prepare annual audited Air Force Working Capital Fund financial statements. Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, establishes the minimum requirements for audits of these financial statements. This Bulletin requires the Inspector General, DoD, to express an opinion on the DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations. We delegated the audit of the FY 2000 Department of the Air Force Working Capital Fund financial statements to the Air Force Audit Agency (AFAA). This report is the first in a series of reports and discusses the work performed on the oversight of the Air Force Audit Agency audit of the FY 2000 Department of the Air Force Working Capital Fund financial statements.

Objective. Our objective was to oversee the Air Force Audit Agency to determine whether we can rely on the audit conducted by AFAA, as required by Government auditing standards. See Appendix A for a discussion of the audit process.

Results. The Air Force Audit Agency report, “Opinion on Fiscal Year 2000 Air Force Working Capital Fund Financial Statements,” February 7, 2001, states that the auditors were unable to express an opinion on the FY 2000 Department of the Air Force Working Capital Fund financial statements. We concur with the Air Force Audit Agency disclaimer of opinion; our endorsement of that disclaimer is Exhibit 1. Excerpts of the Air Force Audit Agency report are included as Exhibit 2 and provide the reasons for the disclaimer of opinion and identify the material weaknesses and reportable conditions associated with the internal controls and compliance with laws and regulations. The complete Air Force Audit Agency report can be accessed on the Internet at <http://www.afaa.hq.af.mil>. The FY 2000 Department of the Air Force Working Capital Fund Financial Statements can be accessed on the Internet at <http://www.dtic.mil/comptroller>.

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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,” as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” and Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, we performed oversight of the independent audit conducted by the Air Force Audit Agency (AFAA) of the FY 2000 Department of the Air Force Working Capital Fund financial statements. We reviewed the AFAA audit approach and planning and monitored audit progress at the key points.

Reviewing the AFAA Audit Approach. We used the “Federal Financial Statement Audit Manual,” January 1993, issued by the President’s Council on Integrity and Efficiency, and the “Financial Audit Manual,” December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the AFAA audit approach. Specifically, we reviewed documentation for the audit planning and strategy, entity profile, general risk analysis, cycle memorandums, audit plans and programs, and other applicable documentation of the Air Force Working Capital Fund business areas.

Monitoring Audit Progress. Through the DoD Financial Statement Audit Executive Steering Committee, and an integrated line-item oversight effort, we provided a forum for a centrally managed exchange of guidance and information. We reviewed and commented on the Air Force Audit Agency audit opinion report, which included discussions of issues on internal controls and compliance with laws and regulations. We reviewed key workpapers and summaries of Air Force Audit Agency audit results and conclusions.

In addition to the oversight procedures, we performed other procedures as necessary to determine the fairness and accuracy of the AFAA audit approach and conclusions. We reviewed findings and recommendations in previous AFAA reports.

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

- **FY2001 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)**

- **FY2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and financial systems. **(01-DoD-2.5.1)**
- **FY2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Objectives and Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. The 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.

Auditing Type, Dates, and Standards. We performed this financial statement audit from November 21, 2000, through February 7, 2001, 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 our oversight of the Air Force Audit Agency audit of the FY 2000 Department of the Air Force Working Capital Fund financial statements.

Contacts During the Audit. We contacted individuals and organizations in the DoD audit community. Further details are available on request.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, 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>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

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 Finance and Accounting Service
Director, Defense Finance and Accounting Service Denver Center

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Office of Management and Budget
General Accounting Office

Congressional Committees and Subcommittees, Chairman 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 Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

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



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

February 7, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 2000 Air Force Working Capital Fund Financial Statements (Project No. D-2001FD-0051.02)

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 Air Force Audit Agency (AFAA) the audit of the FY 2000 Air Force Working Capital Fund financial statements. Summarized as follows are the AFAA disclaimer of opinion on the FY 2000 Air Force Working Capital Fund financial statements, and the results of our review of the AFAA audit. The information provided in this memorandum contains reasons for the AFAA disclaimer. We endorse the disclaimer of opinion expressed by AFAA.

Disclaimer of Opinion. The AFAA disclaimer of opinion on the FY 2000 Air Force Working Capital Fund financial statements, dated February 7, 2001, states that AFAA was unable to express an opinion on the financial statements. We concur with the AFAA disclaimer of opinion. The AFAA disclaimer of opinion concludes that the financial information was unreliable and financial systems and processes, as well as associated internal control structures, were inadequate to produce reliable financial information, as indicated in the following examples:

- Air Force supply management systems did not provide sufficient audit trails to confirm and value the in-transit inventory reported as part of inventory held for sale on the Balance Sheet.
- Air Force depot maintenance systems lacked a transaction-driven general ledger supported by appropriate subsidiary ledgers and special journals. In addition, the depot maintenance systems did not perform percentage-of-completion accounting or properly account for cost of goods sold and work-in-process.
- The Air Force Working Capital Fund property, plant, and equipment valuation are unverifiable.
- The Air Force Working Capital Fund general ledger was inconsistent with the U.S. Government Standard General Ledger.

Internal Controls. The AFAA tested internal controls but did not express a separate opinion because opining on internal controls was not one of its objectives. However, AFAA determined that internal controls did not provide reasonable assurance of achieving the internal control objectives described in Office of Management and Budget Bulletin 01-02, "Audit Requirements for Federal Financial Statements," dated October 16, 2000. For example, the Air Force was unable to provide supporting documentation for \$22.6 million of disbursement transactions and \$516.9 million in open obligations. Additionally, the Defense Finance and Accounting Service made \$4.2 billion in improper and unsupported monthly adjustments and \$31.9 billion in improper and unsupported year-end adjustments to the Air Force Working

Capital accounting records. The Air Force and the Defense Finance and Accounting Service recognized many of the financial reporting weaknesses and reported them in their FY 2000 Annual Statements of Assurance. Details on the internal control weaknesses will be provided in separate AFAA reports.

Compliance With Laws and Regulations. AFAA identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996, AFAA work showed that the financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal financial accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

Review of Air Force Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent work that AFAA 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 AFAA work on the FY 2000 Air Force Working Capital Fund financial statements from November 21, 2000, through February 7, 2001, in accordance with generally accepted Government auditing standards.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

**Exhibit 2. Excerpts from Air Force
Audit Agency Audit
Report, “Opinion on
Fiscal Year 2000
Air Force Working Capital
Fund Financial Statements”**



DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

7 February 2001

To the Acting Secretary of the Air Force
Chief of Staff, USAF

We were engaged to audit the Air Force Working Capital Fund financial statements for the fiscal year ended 30 September 2000. The annual financial statements consist of the Balance Sheet and related Statement of Net Cost, Statement of Change in Net Position, Statement of Budgetary Resources, and Statement of Financing. Preparation of the financial statements is the responsibility of the Defense Finance and Accounting Service (DFAS) and Air Force management. This report presents our independent opinion on the financial statements, evaluation of the effectiveness of internal controls over financial reporting, and assessment of compliance with laws and regulations.

OPINION ON THE FINANCIAL STATEMENTS

We were not able to obtain sufficient evidential matter, or to apply other auditing procedures, to satisfy ourselves as to the fairness of the Air Force Working Capital Fund financial statements. Therefore, in accordance with *Government Auditing Standards* and the provisions of Office of Management and Budget (OMB) Bulletin 01-02, Audit Requirements for Federal Financial Statements, 16 October 2000, we are unable to express, and we do not express, an opinion on the reliability of the Air Force Working Capital Fund financial statements for the fiscal year ended 30 September 2000. As a result of our inability to audit, we concluded the amounts reported in the consolidated financial statements and related notes may not provide reliable information for government and public decision-making purposes.

We base our disclaimer on the inability of Air Force and DFAS to correct previously reported material deficiencies that affect the reliability of the Air Force Working Capital Fund Fiscal Year (FY) 2000 financial statements. The Air Force and DFAS continue their efforts to improve financial reporting; however, the

financial systems and processes, as well as the associated internal control structure, remain inadequate to produce reliable financial information. For example:

- Air Force supply management systems still did not provide sufficient audit trails to confirm and value the in-transit inventory reported as part of inventory held for sale on the Balance Sheet.
- Air Force depot maintenance systems lacked a transaction-driven general ledger supported by appropriate subsidiary ledgers and special journals. Also, the depot maintenance systems did not perform percentage-of-completion accounting or properly account for cost of goods sold and work-in-process.
- The Air Force Working Capital Fund property, plant, and equipment (PP&E) valuation continued to be unverifiable.
- The Air Force Working Capital Fund general ledger was inconsistent with the U.S. Government Standard General Ledger.

REQUIRED SUPPLEMENTARY INFORMATION

The Required Supplementary Information for Deferred Maintenance is not a required part of the Air Force Working Capital Fund principal financial statements. Therefore, we did not audit, and do not express an opinion on, such information. Further, we did not apply certain procedures prescribed by professional standards because the information reported derives from the same data sources as the financial statements and, as such, may not provide a reliable source for the information.

MANAGEMENT INITIATIVES

The Air Force and DFAS continue actions to improve Air Force Working Capital Fund financial data accuracy and reporting. Examples of ongoing initiatives that should contribute to this goal are discussed below. During future audits, we will evaluate the effectiveness of these actions.

- In the supply management area, the Air Force established a program management office to develop an accounting process for recording inventory at historical value. The program management office has also undertaken initiatives to identify the actions necessary to comply with generally accepted accounting principles for inventory assets and support

the information reported in the financial statements. The Air Force anticipates these efforts will be completed by FY 2003.

- In the depot maintenance area, the Air Force continues efforts to implement system corrections required to comply with federal financial accounting requirements. When implemented, the depot maintenance systems will (1) provide an automated transaction-driven general ledger, (2) maintain subsidiary support for account balances, (3) recognize revenue using the percentage-of-completion methodology, and (4) account for costs of goods sold and work-in-process based on actual costs incurred. The Air Force plans to implement the changes to the organic and contract depot maintenance systems by FY 2002.
- The Air Force has engaged accounting firms to assist in assessing the existence, completeness, and valuation of PP&E assets recorded in the databases of various capital asset systems. These efforts began in November 1998 and continued during FY 2000.
- To correct general ledger deficiencies, the Air Force and DFAS have initiatives underway to implement the U.S. Government Standard General Ledger in the Air Force Working Capital Fund accounting systems. Among these initiatives are the conversion of the Standard Material Accounting System, the Defense Industrial Financial Management System, and the Contract Maintenance Accounting and Production System to the U.S. Government Standard General Ledger. The Air Force and DFAS estimate completion of these efforts by FY 2003.

We believe these efforts are steps in the right direction and will help to resolve many of the problems with existing systems. We will continue to work closely with management to address the material deficiencies precluding an unqualified audit opinion.

REPORT ON INTERNAL CONTROLS

Management is responsible for establishing and maintaining an internal control structure to provide reasonable, but not absolute, assurance that transactions are properly recorded, processed, and summarized to (a) permit financial statement preparation in accordance with generally accepted accounting standards and (b) safeguard assets against loss from unauthorized acquisition, use, or disposal. Because of inherent limitations in any internal control, errors or fraud may nevertheless occur and not be detected. Also, projecting internal control evaluation

results to future periods is subject to the risk that procedures may become inadequate. In addition, our consideration of internal controls would not necessarily disclose all material weaknesses. Under auditing standards, a material weakness is a condition where controls do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, may occur and not be detected on a timely basis by employees performing their assigned functions. Reportable conditions involve matters coming to our attention that relate to significant deficiencies in the design or operation of the internal control structure over financial reporting that, in our judgment, could adversely affect the Air Force's ability to record, process, summarize, and report Working Capital Fund financial data.

Over the last 9 years, we identified numerous findings and made recommendations to improve internal controls related to financial reporting for the Air Force Working Capital Fund. Although we have noted progress in several areas to correct these previously identified problems, a significant number of corrective actions are still in progress. Appendix I identifies the prior audit findings and recommendations that remained open during FY 2000.

Furthermore, although we accomplished internal control testing, our financial statement audit objectives did not include providing a separate internal control opinion; accordingly, we do not express such an opinion. However, the OMB Bulletin, Audit Requirements for Federal Financial Statements, requires that we describe material weaknesses and reportable conditions identified during the audit. Therefore, the following paragraphs summarize material weaknesses and reportable conditions that existed in the design or operation of the internal control structure over financial reporting in effect at 30 September 2000. Based on these weaknesses, we determined the internal control structure did not provide reasonable assurance of achieving the internal control objectives described in the OMB bulletin. Most material weaknesses and reportable conditions presented in this report are the same as those included in prior-year Air Force Working Capital Fund financial statement audit reports. Specific weaknesses, along with recommended remedial actions, timeframes for corrective actions, and management comments, are more fully described in separate audit reports issued to Air Force and DFAS management.

SUPPORTING DOCUMENTATION

a. DFAS-Columbus did not provide supporting documentation for 32 (\$22.6 million) of 86 (\$65 million) disbursement transactions tested. (Draft Report of Audit 00068002, Air Force Working Capital Fund, Fiscal Year 2000, Collections and Disbursements)

b. Air Force fund managers were not able to provide supporting documentation for 374 (\$516.9 million) of 725 (\$891 million) Wholesale Supply and Information Services Activity Group open obligation transactions tested (such as undelivered orders outstanding, accounts payable, unfilled customer orders, and accrued expenses). (Draft Reports of Audit 00068023, Air Force Working Capital Fund, FY 2000 Statement of Budgetary Resources – Wholesale Supply Selected Accounts, and 00068024, Air Force Working Capital Fund, FY 2000 Statement of Budgetary Resources – Information Services Activity Group Selected Accounts)

ACCOUNTING ADJUSTMENTS

DFAS-Denver Center made \$4.2 billion in improper and unsupported monthly adjustments and \$31.9 billion in improper and unsupported year-end adjustments to Air Force Working Capital Fund accounting records. (Office of the Inspector General, Department of Defense, Draft Report of Project D2001FD-0014, untitled)

PERFORMANCE MEASURES

We obtained an understanding of the sources and controls related to performance measures reported in the overview to the principal statements and notes. Although we performed only a limited review, we did note a condition that, in our judgment, could adversely affect the Air Force Working Capital Fund's ability to collect, process, record, summarize, and report performance information. The Overview Section accompanying the Working Capital Fund financial statements indicated that a key performance indicator impacting support of Air Force mission capability was the Aircraft Quality Defect Rate.¹ In FY 2000, we reported that the Quality Deficiency Reporting System (G021) maintained incomplete information. Consequently, the performance results relating to depot maintenance aircraft deficiency reporting may be misstated. (Report of Audit 99062011, Quality Deficiency Reporting, 7 July 2000)

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Air Force management is responsible for complying with laws and regulations applicable to the Air Force Working Capital Fund. Issues that should concern management include compliance with laws and regulations pertaining to the objectives of Air Force Working Capital Fund programs and the activities,

¹ The Aircraft Quality Defect Rate measures the quality of completed aircraft work from programmed depot maintenance.

functions, and manner in which programs and services are delivered. Material instances of non-compliance are failures to follow requirements or violations of prohibitions contained in laws or regulations that cause us to conclude the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause others to perceive the misstatements as significant.

As part of obtaining reasonable assurance that financial statements are free of material misstatement, we tested Air Force compliance with certain laws and regulations where noncompliance could have a direct and material effect on financial statement amounts, to include requirements contained in the Federal Financial Management Improvement Act (FFMIA) and Federal Managers' Financial Integrity Act (FMFIA). Our financial statement audit objectives did not include providing a separate opinion on overall compliance with laws and regulations, and accordingly, we do not express such an opinion.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Under the Federal Financial Management Improvement Act of 1996, we are required to report whether the agency's financial management systems substantially comply with federal financial management systems requirements, federal accounting standards,² and the U.S. Government Standard General Ledger at the transaction level. Our follow-up audit work confirmed that previously reported issues continued to exist during FY 2000. Below, we address the instances of non-compliance with the three FFMIA requirements and describe the details related to the specific weaknesses, along with recommended corrective actions, timeframes for corrective actions, and management comments, in the cited reports.

a. Federal Financial Management System Requirements. For FY 2000, the financial management systems that support the Air Force Working Capital Fund did not substantially comply with federal financial management system requirements to (1) maintain adequate subsidiary records for audit trails in Air Force and DFAS financial management systems; (2) implement accounting systems with transaction-driven general ledgers; and (3) provide adequate application controls, such as separation of duties, support for transactions, transaction controls, and data reconciliation, to critical Air Force feeder systems. In addition, due to significant application control weaknesses in the accounting and feeder systems, neither the DFAS nor the Air Force could ensure the systems properly recorded, processed,

² The American Institute of Certified Public Accountants recognizes the Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board as generally accepted accounting principles for federal government agencies.

and summarized only valid transactions and provided accurate information. During the FY 2000 reporting period, the financial management systems continued to contain reportable conditions, such as inadequate access controls, insufficient audit trails and data verification/reconciliation processes, and inadequate system documentation. These weaknesses increased the risk for fraud, errors, and material misstatements to occur within the system and the resulting financial statements. The DFAS and Air Force have acknowledged many of the system weaknesses and reported them in their FY 2000 annual assurance statements on internal management controls. To address these control weaknesses, the DFAS and Air Force are eliminating or replacing non-compliant legacy systems, modifying existing systems, and changing business practices to correct previously identified control deficiencies.

b. Federal Accounting Standards. For FY 2000, the financial management systems that supported the Air Force Working Capital Fund did not substantially comply with federal accounting standards. Specifically:

(1) SFFAS No. 1, Accounting for Selected Assets and Liabilities. The Depot Maintenance Activity Group (DMAG) recorded accrued liability and work-in-process costs based on estimated amounts instead of actual costs incurred. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

(2) SFFAS No. 3, Accounting for Inventory and Related Property. The DMAG recorded the value of operating materials and supplies at current stock list prices instead of historical cost. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, FY 1998, 12 July 1999)

(3) SFFAS No. 6, Accounting for Property, Plant, and Equipment. Air Force Working Capital Fund entities did not record all costs incurred in valuing PP&E assets. (Report of Audit 98068002, Air Force Supply/Depot Maintenance Property, Plant, and Equipment; and Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

(4) SFFAS No. 7, Accounting for Revenue and Other Financing. The DMAG recorded revenue based on completed units instead of the percentage-of-completion method. (Memorandum Report 98068006, Depot Maintenance Activity Group, Air Force Working Capital Fund; and Report of Audit 98068038,

Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

In the FY 2000 Working Capital Fund management representation letter, the Air Force acknowledged the financial management systems contain several departures from federal accounting standards. The Air Force is working hard to solve these problems but will require several years to achieve substantial progress.

c. U.S. Government Standard General Ledger at the Transaction Level. For FY 2000, the Air Force Working Capital Fund accounting systems had not fully implemented the U.S. Government Standard General Ledger at the transaction level for budgetary accounts. Therefore, instead of using budgetary accounts to prepare the Report of Execution, the DFAS-Denver Center relied on proprietary and statistical accounts and data not recorded in the accounting records. As a result, the amounts presented in the Statement of Budgetary Resources and the Statement of Financing were not auditable. (Office of the Inspector General, Department of Defense, Draft Report of Project D2001FD-0014, untitled)

The DFAS plans to incorporate the U.S. Government Standard General Ledger in the Standard Material Accounting System and Defense Industrial Financial Management System. In addition, the Air Force plans to implement the U.S. Government Standard General Ledger in the Contract Maintenance Accounting and Production System. The DFAS and Air Force estimate these efforts will be completed by FY 2003.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

With respect to management's disclosure of internal control material weaknesses in the DFAS and Air Force Working Capital Fund Federal Managers' Financial Integrity Act reports, we did not identify any material weaknesses related to financial reporting not previously reported.

OBJECTIVE, SCOPE, AND METHODOLOGY

Management 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, and

- Complying with applicable laws and regulations.

The Air Force Audit Agency (AFAA) is responsible for:

- Planning and performing an audit to obtain reasonable assurance about whether the principal financial statements are reliable (free of material misstatement) and presented fairly in conformity with OMB Bulletin 97-01, Form and Content of Agency Financial Statement, 16 October 1996, as amended 11 September 2000, and applicable accounting principles;
- Obtaining reasonable assurance about whether relevant management internal controls are in place and operating effectively; and
- Testing management's compliance with selected provisions of laws and regulations and performing limited procedures to test the consistency of other information presented in the annual financial statement with the consolidated financial statements.

To fulfill these responsibilities, we:

- Examined, on a test basis, evidence supporting the amounts and disclosures in the principal financial statements;
- Assessed the accounting principles used and significant estimates made by management;
- Evaluated the overall presentation of the financial statements;
- Tested compliance with selected provisions of laws and regulations;
- Obtained an understanding of the design of internal controls, determined whether they have been placed in operation, assessed control risk, and performed tests of the reporting entity's internal controls; and
- Followed up on previously reported deficiencies.

In reviewing the Air Force Working Capital Fund consolidated financial statements, we evaluated internal controls to determine the reliability of financial and performance reporting related to the principal statements, accompanying footnotes, and performance measures.

In the area of financial reporting, we determined whether Air Force and DFAS personnel properly recorded, processed, and summarized transactions to permit the preparation of financial statements in accordance with federal accounting standards. We also (1) evaluated the safeguarding of assets against loss from unauthorized acquisition, use, or disposition; (2) obtained an understanding of the design of internal controls; (3) determined whether they were in operation; (4) assessed control risk; and (5) tested controls.

We obtained an understanding of internal control designs related to the existence and completeness of assertions regarding the performance measures included in the overview accompanying the Air Force Working Capital Fund financial statements.

The Department of Defense Inspector General (DoD IG), Denver Field Office, assisted us in reviewing the DFAS-Denver Center's compilation of the FY 2000 Air Force Working Capital Fund financial statements. We believe our audit work and that of the DoD IG provide a reasonable basis for our audit opinion.

We accomplished the audit from January to December 2000 at the Office of the Secretary of the Air Force, Financial Management and Comptroller; DFAS locations (DFAS centers and DFAS field organizations); HQ Air Force Materiel Command (AFMC); and Air Force active duty units. We provided a draft of this report to management in January 2001.

SUMMARY OF PRIOR AUDIT COVERAGE

The General Accounting Office (GAO), DoD IG, and AFAA have conducted multiple reviews related to financial management issues. We issued a disclaimer for our FY 1999 Air Force Working Capital Fund Financial Statements review (Report of Audit 99068011, Opinion on Fiscal Year 1999 Air Force Working Capital Fund Financial Statements, 9 February 2000). The GAO reports can be accessed over the Internet at <http://www.gao.gov>; DoD IG reports, at <http://www.dodig.osd.mil>; and AFAA reports, at <http://www.afaa.af.mil>.

We appreciate the cooperation and courtesies extended to our auditors.


JACKIE R. CRAWFORD
The Auditor General

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

F. Jay Lane

Salvatore D. Guli

Brian M. Flynn

Byron B. Harbert

Gerald P. Montoya