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ACCOUNTING ENTRIES MADE IN COMPILING THE FY 2000
AIR FORCE GENERAL FUNDS FINANCIAL STATEMENTS

Report No. D-2001-162

July 26, 2001

Office of the Inspector General
Department of Defense

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Acronyms

CRS	Chief Financial Officers Reporting System
DDRS	Defense Departmental Reporting System
DFAS	Defense Finance and Accounting Service
SOF	Status of Funds



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

July 26, 2001

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Accounting Entries Made in Compiling the FY 2000
Air Force General Funds Financial Statements
(Report No. D-2001-162)

We are providing this report for review and comment. We conducted the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service comments were nonresponsive because they were incomplete or did not identify the corrective actions taken or planned. We clarified Recommendation 1, and are requesting additional comments on Recommendations 1. and 2. We request comments on the final report by August 27, 2001. Specific requirements for the comments are provided in the Recommendation section of the Finding.

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. W. Andy Cooley at (303) 676-7393 (DSN 926-73934) (wcooley@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink, appearing to read "Thomas F. Gimble", is positioned above the typed name.

Thomas F. Gimble

Acting

Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-162

(Project No. D2001FD-0014)

July 26, 2001

Accounting Entries Made in Compiling the FY 2000 Air Force General Funds Financial Statements

Executive Summary

Introduction. We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD to provide audited financial statements to the Office of Management and Budget. This audit is one in a series of audits of accounting entries made by the Defense Finance and Accounting Service in preparing the FY 2000 financial statements for DoD. The audit supported the audits of the FY 2000 financial statements for DoD and the Air Force General Funds. The Inspector General, DoD, and the Air Force Audit Agency disclaimed an opinion on those financial statements. The Defense Finance and Accounting Service Denver made \$406 billion in accounting entries in three automated systems in compiling the FY 2000 Air Force General Funds Financial Statements. The FY 2000 Air Force General Funds Financial Statements reported total assets of \$86.2 billion and total net cost of operations of \$80.0 billion.

Objective. The original objective of the audit was to determine whether the Defense Finance and Accounting Service Denver consistently and accurately compiled financial data from field activities and other sources in preparing the FY 2000 Air Force General Funds Financial Statements. However, the objective was revised to determine whether the accounting entries made by the Defense Finance and Accounting Service Denver were adequately supported and complied with generally accepted accounting principles. We also reviewed applicable internal controls and compliance with laws and regulations, including the management control program.

Results. Additional improvements in the accounting entries made in compiling the FY 2000 Air Force General Funds Financial Statements are required to adequately support and comply with generally accepted accounting principles. The Defense Finance Accounting Service Denver made accounting entries for \$406.0 billion in preparing the FY 2000 Air Force General Funds Financial Statements. Of that \$406.0 billion, \$317.4 billion were unsupported and \$3.0 billion were improper. Furthermore, \$304.0 billion of the accounting entries were not properly approved before being entered into the automated systems. The Defense Finance and Accounting Service Denver made progress in significantly reducing the dollar volume of accounting entries made in two automated systems in preparing those financial statements. However, the problem with unsupported and improper accounting entries remains and affects the accuracy and reliability of the Air Force General Funds Financial Statements.

For details of the audit results, see the Finding section of the report. See Appendix A for details on the review of the management control program, as it relates to controls over accounting entries, and Appendix B for a comparison to prior audit results.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Denver, adequately support and obtain management approval for the accounting entries made in compiling the Air Force General Funds Financial Statements as required by DoD regulation and internal operating guidance.

Management Comments. The Defense Finance and Accounting Service concurred in principle with both recommendations. However, management nonconcurred that additional support was required for certain original entries made in one funds control system. Other unsupported and improper entries were made to improve the accuracy of the financial statements because of deficiencies in feeder accounting systems. A new system modification will remedy confusion over unsupported entries. Entries made prior to management approval in one system did not affect the accuracy of the financial statements or related internal controls. Other stringent controls are followed to ensure that necessary approvals are obtained prior to the preparation and release of the financial statements. See the Finding section of the report for a discussion of the management comments and the Management Comments section for the complete text.

Audit Response. Management comments are nonresponsive because they are incomplete or did not identify the corrective actions taken or planned. We disagree with management's contention that internal journal voucher guidance does not apply to original accounting entries. In addition, the system modification will not eliminate the requirement that future accounting entries be adequately supported. We therefore revised Recommendation 1. to provide increased clarity. Unapproved accounting entries undermine the reliability of the financial statements and related internal controls. We also disagree with management's contention that it is acceptable for accounting entries to be recorded in an accounting system without prior approval by management. We request that the Director, Defense Finance and Accounting Service, provide comments on the final report by August 27, 2001.

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Background

Audit Requirement. Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by the Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD to submit to the Office of Management and Budget annual financial statements that have been audited by the Inspector General, DoD. This audit is one in a series of audits of department-level accounting entries made by the Defense Finance and Accounting Service (DFAS) in preparing the FY 2000 financial statements for DoD reporting entities. The audit supported the audits of the FY 2000 financial statements for the DoD and the Air Force General Funds. The Inspector General, DoD, and the Air Force Audit Agency disclaimed an opinion on those financial statements.

Department-Level Accounting. DFAS Denver performed the department-level accounting for the Department of the Air Force and compiled the FY 2000 Air Force General Funds Financial Statements from data submitted by the Air Force and other DoD organizations. The FY 2000 Air Force General Funds Financial Statements reported total assets of \$86.2 billion and total net cost of operations of \$80.0 billion. Those financial statements are compiled by DFAS Denver from budgetary and financial data obtained from several department-level automated information systems. This audit focused on the accounting entries made by DFAS Denver in three of those systems.

Status of Funds. The Status of Funds (SOF) is part of the Departmental On-line Accounting and Reporting System. DFAS Denver uses SOF to prepare Air Force status of funds reports. The SOF receives and consolidates budget execution data, disbursement and collection data, funding amounts, U.S. Treasury expenditures by other Services, and miscellaneous inputs. The Inspector General, DoD, and the Air Force Audit Agency jointly reviewed the SOF accounting entries made during FY 2000. The Inspector General, DoD, examined accounting entries identified as constant adjustments, which are used to enter budgetary data that remain in the SOF and are not overwritten or removed by future accounting entries. The Air Force Audit Agency will separately report on its audit of other accounting entries made in SOF and the Command On-line Accounting and Reporting System.

Chief Financial Officers Reporting System (CRS). The CRS provides DFAS Denver with the capability to produce the financial statements for the Air Force General Funds. The CRS is initially populated with budgetary data extracted from the SOF. The data are converted from the SOF budget identifier codes to U.S. Standard General Ledger accounts through numerous automated posting rules. Accounting employees at DFAS Denver manually enter into CRS additional data obtained from property management systems, logistics systems, and reports from other DFAS sites, Air Force financial management and legal activities, and other Government entities. Outputs from CRS were the initial inputs made to the DFAS Arlington Defense Departmental Reporting System (DDRS) for the final preparation of the FY 2000 Air Force General Funds Financial Statements.

DDRS. DFAS Arlington developed DDRS for use in preparing the FY 2000 financial statements for Air Force General Funds and other DoD reporting entities. Outputs from CRS were used to populate DDRS. DFAS Denver then entered additional accounting entries into DDRS in compiling the Air Force General Funds Financial Statements. In addition to reviewing CRS accounting entries, the FY 2000 review included selected accounting entries made to SOF and DDRS.

Department-Level Accounting Entries. In compiling the FY 2000 Air Force General Funds Financial Statements, DFAS Denver processed 1,617 accounting entries for 406.0 billion,* which represented:

- 921 SOF constant adjustments for \$294.6 billion (absolute value),
- 583 CRS accounting entries for \$78.9 billion, and
- 113 DDRS entries for \$32.5 billion.

Objective

The original objective of the audit was to determine whether DFAS Denver consistently and accurately compiled financial data from field activities and other sources in preparing the FY 2000 Air Force General Funds Financial Statements. However, the objective was revised to determine whether the accounting entries made by the DFAS Denver in preparing those FY 2000 financial statements were adequately supported and complied with generally accepted accounting principles. Specifically, we examined the constant adjustments made by DFAS Denver in the SOF System and all accounting entries made in CRS and DDRS. We also reviewed applicable internal controls and compliance with laws and regulations, including the management control program. See Appendix A for a discussion of the scope and methodology, the review of the management control program, and prior coverage. See Appendix B for a discussion comparing the audit results for FYs 1999 and 2000.

*The dollar values of accounting entries made in double-entry accounting systems are discussed in this report only in terms of their debit values. However, the SOF System is a single-entry system, which only records one side (the debit or credit) of an accounting entry. Therefore, to avoid understating the volume of such transactions, this report discusses SOF constant adjustments in terms of their absolute dollar values.

Accounting Entries

Additional improvements in the accounting entries made in compiling the FY 2000 Air Force General Funds Financial Statements are required to adequately support and comply with generally accepted accounting principles. DFAS Denver made accounting entries for \$406.0 billion in three automated systems in preparing the FY 2000 Air Force General Funds Financial Statements. Of that \$406.0 billion, \$317.4 billion were unsupported, and \$3.0 billion were improper. Furthermore, DFAS Denver did not obtain approval for \$304.0 billion of the accounting entries made in FY 2000 prior to recording those entries in the automated systems. Those conditions occurred for several reasons.

- DoD and DFAS guidance on journal vouchers was not followed in making SOF constant adjustments and CRS accounting entries.
- The DoD Financial Management Regulation and DFAS Arlington directed forced entries and other accounting entries that were improper.
- Responsible managers ignored or were unaware of the requirement for obtaining approval for accounting entries prior to their entry into the automated systems.

DFAS Denver made progress in reducing by 90 percent the dollar volume of accounting entries made in CRS and DDRS compared to FY 1999. However, the problem with unsupported and improper accounting entries remains and affects the accuracy and reliability of the Air Force General Funds Financial Statements.

Guidance on Accounting Entries

DoD Financial Management Regulation. DoD Regulation 7000.14-R, “DoD Financial Management Regulation,” volume 6A, “Reporting Policy and Procedures,” January 2001 (as revised), provides guidance on the roles and responsibilities of DFAS and its customers regarding financial reports and the treatment of transactions from which the financial data in the reports are derived. The guidance requires DFAS to adequately support and justify in writing any adjustments to official accounting records and states that:

The documentation shall include the rationale and justification for the adjustment, the detail numbers and dollar amounts of errors or conditions that are related to the transactions or records that are proposed for adjustment, the date of the adjustment, and the name and position of the individual approving the adjustment. The documentation also shall be sufficient to provide an audit trail to the detail transaction(s) being adjusted or corrected.

DFAS Guidance. DFAS Denver uses journal vouchers to document the nature of and approval for accounting entries made by accounting employees to data in the CRS and DDRS. Automated controls in both systems prevent unapproved accounting entries from affecting the general ledger amounts included on the financial statements. Accounting entries should be posted to the general ledger and affect the general ledger only after appropriate approval has been obtained.

On October 28, 1999, the Director for Accounting, DFAS Arlington, issued a memorandum, "Journal Voucher Guidance," establishing specific guidance for documenting and approving accounting entries. On August 2, 2000, the Director for Accounting, DFAS Arlington, updated the guidance, which specifies documentation requirements for correcting and source journal voucher entries. The memorandum also established thresholds for approval of journal vouchers, which are presented in Table 3 in the finding.

The DFAS guidance did not provide any performance standards or an action plan with metrics for measuring progress in implementing the journal voucher guidance. In addition, the DFAS guidance inappropriately allowed journal vouchers to be submitted for and approved 5 workdays before all supporting documentation had been identified and made available to the approving official. No journal voucher should be submitted for approval until all supporting documentation is made available to the approving official. Appropriate changes to the DFAS guidance were recommended in Inspector General, DoD, report number D-2001-107, "Accounting Entries Made by the Defense Finance and Accounting Service Omaha to U.S. Transportation Command Data Reported in DoD Agency-Wide Financial Statements," May 2, 2001.

Reporting Categories. Based on the DoD regulation and implementing DFAS guidance, we determined whether the accounting entries were supported, unsupported, or improper. Details are provided in Appendix B on the reporting categories.

Comparison to FY 1999

Unsupported and improper accounting entries made by DFAS Denver in compiling the FY 2000 Air Force General Funds Financial Statements continue to represent material control weaknesses. However, DFAS Denver made progress in reducing the number of accounting entries made in CRS and DDRS during FY 2000. For example, the \$111.4 billion in accounting entries made in CRS and DDRS were 90 percent less than the \$1.2 trillion made in FY 1999. On the other hand, unsupported entries increased from \$66.3 billion in FY 1999 to \$317.4 billion in FY 2000. Also, the \$3.0 billion in improper entries made in CRS and DDRS during FY 2000 represented a significant increase from the \$0.3 billion made in FY 1999. Details on the comparison of FYs 1999 and 2000 audit results and explanations for the changes are provided in Appendix B.

Despite the improvements made by DFAS Denver in some areas, Table 1 shows that additional corrective actions are required to improve the documentation of accounting entries and to comply with generally accepted accounting principles.

Table 1. FY 2000 DFAS Denver Accounting Entries by Automated Information Systems (dollars in billions)			
Reporting Category	<u>Automated Information Systems</u>		
	CRS and DDRS	SOF*	Total
Supported Dollar Amounts	\$ 85.6	\$ 0.0	\$ 85.6
Quantity of Entries	507	0	507
Unsupported	\$ 22.8	\$294.6	\$317.4
Quantity of Entries	146	921	1,067
Improper	3.0	0.0	3.0
Quantity of Entries	43	0	43
Total Dollar Amounts	\$111.4	\$294.6	\$406.0
Total Entries	696	921	1,617
*For comparison purposes, the SOF constant adjustments examined in FY 2000 are shown separately because the FY 1999 audit did not examine those accounting entries.			

Unsupported Entries

As detailed in Table 2, DFAS Denver made 1,067 accounting entries for \$317.4 billion, which were not adequately supported. Accounting entries were considered unsupported if the documentation for the entry was inadequate, the entries were made to force accounting data to match for elimination purposes, or the entries were made to force amounts into the accounting system. Entries were forced if they were made to make amounts agree or to distribute amounts based on an arbitrary process.

Inadequate Documentation. As detailed below and in Table 2, inadequate support was provided for 982 accounting entries for \$300.0 billion made in the SOF and CRS.

SOF. Accounting employees at DFAS Denver manually enter selected budgetary data to SOF. Those entries were made using various source codes, which identify the source of the transaction. Source code "C" is used to enter budgetary data that constantly remain in SOF and are not overwritten or removed by future accounting entries. A review of those SOF constant

Table 2. Unsupported Accounting Entries (dollars in billions)				
Reason Unsupported	<u>Automated Information Systems</u>			
	SOF	CRS	DDRS	Total
Inadequate documentation Dollar Amounts	\$294.6	\$5.4	\$ 0.0	\$300.0
Quantity of Entries	921	61	0	982
Forced elimination entries Dollar Amounts	\$ 0.0	\$1.5	\$15.9	\$ 7.4
Quantity of Entries	0	39	39	78
Other forced entries Dollar Amounts	\$ 0.0	\$0.0*	\$ 0.0*	\$.0*
Quantity of Entries	0	6	1	7
Total Dollar Amounts	\$294.6	\$6.9	\$15.9	\$317.4
Total Entries	921	106	40	1,067
*The dollar values discussed in the report are \$155,000 for CRS and \$109,000 for DDRS, or a total of \$264,000.				

adjustments disclosed that none were supported by journal vouchers complete with supporting documentation and approved in accordance with DFAS Arlington guidance. DFAS Denver made 921 constant adjustment accounting entries for \$294.6 billion without journal vouchers, supporting documentation, and without supervisory approval. This occurred because DFAS Denver management did not believe the DFAS Arlington guidance applied to these accounting entries.

A limited review of each type of constant adjustments disclosed that documentation was subsequently found that supported each constant adjustment, though not consolidated and documented in the same manner as CRS and DDRS accounting entries. Preparation of fully documented and approved accounting entries in a timely manner is necessary to ensure that constant adjustments are valid and fully support the financial statements.

CRS. A total of 61 accounting entries for \$5.4 billion were prepared with no supporting documentation to input FY 2000 beginning balances for the Statement of Budgetary Resources (FY 1999 ending balances). DFAS Denver accounting employees provided requirements to the CRS contract programmer, who coded the requirements into the system. The system executed the programming instructions and printed the journal vouchers. However, the programming did not always produce the correct results, requiring additional research and programming. The accounting entries did not provide detailed

documentation that demonstrated that the desired results were achieved. Discussions with DFAS Denver accounting employees demonstrated that the process was not documented in accordance with DFAS Arlington journal voucher guidance, which severely limited their ability to discuss the process.

All accounting entries must be subjected to the DFAS Arlington accounting entry guidance to demonstrate that the entry process produced the correct amounts.

Forced Elimination Entries. Those elimination entries were made to comply with DoD Regulation 7000.14-R, "DoD Financial Management Regulation," volume 6B, "Form and Content of DoD Audited Financial Statements," chapter 13, "FY 2000 Adjustments, Eliminations, and Other Special Intragovernmental Reconciliation Procedures," December 2000. The DoD Regulation 7000.14-R states that for FY 2000 reporting, elimination entries will be based on the information provided by the seller/service provider and adjustments will be made based on the seller/service provider information.

The accounting centers then compare these balances to summary buyer-side data at the entity code trial balance level. Based on these comparisons, the amount of unrecorded intragovernmental transactions on the buyer-side can be calculated and the applicable accrual entries recorded.

The guidance does emphasize that the DoD accounting centers should ensure that the seller-side information from trading partners is correct. However, because of time constraints, the DoD accounting center is not required to perform a detailed reconciliation to determine why the seller-side information is correct and the buyer-side information is incorrect. For example, if the intragovernmental trading partners of the Air Force General Funds notify the Air Force General Funds that they sold it \$10,000 worth of goods and services, then the Air Force General Funds will have to show \$10,000 in the appropriate intragovernmental expense account. If the Air Force General Funds does not have \$10,000 in the account, then it must accrue the difference until it can build up to \$10,000 in the account. DFAS Denver researches the difference, but if the trading partner determines its information is correct, then DFAS Denver accrues the difference so that the accounting records agree with the trading partners. Because of time constraints involved in the financial statement preparation process, a detailed reconciliation is not performed to the sales ticket or accounts receivable detail level. This type of accounting entry is unsupported because no actual accounting event took place to support the adjustment, and a reconciliation was not performed where sales or accounts receivable documents were compared to accounting records. Additionally, the following guidance is provided to DoD accounting centers on eliminating abnormal balances in intra-DoD trading partner data. Specifically, it states the following.

This review shall identify any abnormal balances such as negative revenue. The DoD accounting centers shall work with their customers to revolve the abnormal balances and eliminate them before exchanging intra-DoD trading partner data.

Those abnormal balances are caused by deficiencies in DoD and other Federal accounting systems. As noted in DoD Regulation 7000.14-R, DoD systems were designed and implemented before the requirement existed to eliminate intragovernmental transactions. Thus, the adjustments and reconciliation process followed in preparing DoD financial statements may cause general ledger accounts to have abnormal balances compared to those normally expected in the application of generally accepted accounting principles.

DoD Regulation 7000.14-R clearly requires DoD accounting centers to work with their customers in resolving abnormal balances. However, the DoD Regulation 7000.14-R does not clearly state that unresolved abnormal balances should be reported.

As detailed below and in Table 2, DFAS Denver prepared 78 accounting entries for \$17.4 billion in the CRS and DDRS that eliminated unresolved abnormal balances or forced data to match for elimination purposes.

CRS. A total of 39 accounting entries for \$1.5 billion were made to reallocate Government accounts receivable, revenue, and unearned revenue among Federal agency sales codes for purposes of eliminating the transactions in the Government-wide financial statements. Accounting data between the seller and buyer of goods and services within the same reporting entity must be eliminated to accurately report financial data for the entity, to include the Government-wide financial statements. Therefore, goods and services provided by the Air Force General Funds to the Department of Labor and other non-DoD entities were provided to the U.S. Treasury for elimination on the Government-wide financial statements. However, the Air Force General Funds seller data were not maintained at the detail level required by the U.S. Treasury. To provide the detail necessary, an arbitrary reallocation process was programmed into the CRS. This process allocated the dollar amounts based on distributed allocations within the sales code grouping. Where no other sales codes were reported, the dollar amount was allocated to a specific sales code. Additionally, as part of this process, the CRS was programmed to identify and remove any abnormal balances. Although we discussed this with DFAS Denver management, we could not readily identify the dollar amount of the abnormal balances removed. Entries that eliminated abnormal balances were made in response to directions from DFAS Arlington. That is, DFAS Arlington interpreted the DoD guidance on abnormal balances as requiring that such arbitrary entries be made to eliminate unresolved abnormal balances before exchanging trading partner data.

DDRS. An additional 39 accounting entries for \$15.9 billion were made in DDRS to adjust accounting data based on information provided by DoD entities with which the Air Force General Funds conducts business. For example, the Air Force General Funds may purchase goods or services from a Navy entity. The Navy entity, as the selling trading partner, provides accounting information to the Air Force General Funds. Using DDRS, DFAS Denver accounting employees match the data to respective data in the

Air Force General Funds accounting records. If the data do not match, an adjustment is made to make the data agree. The following examples depict the adjustments made.

- Accounting data were accrued to match the selling trading partner data. For example, accounts payable was accrued to match a selling trading partner's accounts receivable. A total of 13 accruals were made for \$5.5 billion.
- Accounting data were reclassified to match selling trading partner data. For example, accounts payable was reclassified from a Government entity to a public entity to provide a sufficient amount to match selling trading partner data. A total of 22 reclassifications were made for \$9.9 billion.
- Accounting accruals previously made to match selling trading partner data were partially reversed based on revised data. Four reversals were made for \$0.5 billion.

To comply with generally accepted accounting principles, DFAS Denver should not arbitrarily eliminate unresolved abnormal balances. The DoD guidance should be revised to clearly state that unresolved abnormal balances must be reported in accordance with generally accepted accounting principles. No recommendations are made in this report because appropriate corrective actions are recommended in the following reports:

- Inspector General, DoD, Report No. D-2001-042, "Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statements," January 31, 2001, and
- Draft report on Inspector General, DoD, Project No. D2001FD-0014.002, "Accounting Entries Made in Compiling the FY 2000 Financial Statements for the Working Capital Funds of the Air Force and Other Defense Organizations," to be issued July 2001.

Other Forced Entries. As detailed below and in Table 2, seven CRS and DDRS accounting entries for \$264,000 were unsupported because they were forced entries.

CRS. Six accounting entries for \$155,000 were made programmatically by the CRS to eliminate abnormal balances. The abnormal balances were as a result of moving financial data from a sales code that was invalid or missing to a valid sales code prescribed by DFAS Arlington in July 2000. Sales codes were used to identify the entity selling goods or services. Because the abnormal balances were identified and eliminated programmatically, we could not determine exactly what caused the balances to be abnormal.

DDRS. One DDRS accounting entry for \$109,000 was made to balance the net cost on the Statement of Financing to the net cost on the Statement of Net Change.

Improper Entries

Accounting entries were considered improper if they were illogical or did not comply with generally accepted accounting principles. DFAS Denver accounting employees prepared 43 accounting entries in the CRS for \$3.0 billion that were illogical.

Government and Non-Government Entities. A total of 28 accounting entries were programmatically made to distribute undistributed disbursements between Government and non-Government entities. Undistributed disbursements were those made for an Air Force General Funds entity, which have not been included in accountable records and reported to DFAS. As a result, the undistributed disbursements do not have the information necessary to determine whether they were to a Government or a non-Government entity for elimination purposes. Therefore, the CRS, in accordance with DFAS Arlington guidance, was programmed to make the distribution. Specifically, the program computes the distribution based on the percentage of Government versus non-Government disbursements identified in the accounting records. This percentage is programmatically applied to the undistributed disbursements to identify the amount to be posted to Government and non-Government entities. This process assumes that the undistributed disbursements have the same ratio of Government and non-Government disbursements. This assumption cannot be verified and thus the process is not logical and calls in to question whether the correct accounting treatment was given to \$3.0 billion of disbursements.

Other Improper Entries. DFAS Denver made another 15 improper entries for \$65.4 million (difference due to rounding) representing:

- three entries for \$51.5 million made to reverse FY 1999 accounting entries, which were verbally directed by DFAS Arlington in FY 1999 to eliminate abnormal balances on the FY 1999 financial statements,
- nine entries for \$3.2 million made because of invalid sales codes,
- two accounting entries for \$2.5 million made to reclassify abnormal balances (negative accounts receivable) reported by field activities, and
- one accounting entry for \$8.1 million, which inexplicably used data as of June 30, 2000, to adjust the value of equipment with contractors to its professed balance as of September 30, 2000.

Supervisory Review

DFAS Denver did not obtain proper approval for \$304.0 billion of the accounting entries made in FY 2000 prior to recording those entries in the automated systems. Of the \$320.4 billion in unsupported and improper accounting entries, 921 constant adjustments for \$294.6 billion were made in the

SOF system without management review and approval, and three entries for \$5.1 billion were recorded in CRS prior to their being approved. Of the three CRS entries, two valued at \$3.1 billion were identified as unsupported because of inadequate documentation while the remaining entry for \$2.0 billion was determined to be an improper allocation of undistributed disbursements between Government and non-Government entities. In addition, although supported, two other CRS entries for \$4.3 billion were recorded in CRS prior to their being approved.

To ensure that accounting entries are valid and fully supported, appropriate supervisory review should be obtained prior to entering the financial data in the automated systems used to prepare Air Force General Funds Financial Statements. The *Standards for Internal Control in the Federal Government*, November 1999, established by the U.S. General Accounting Office, stresses the need to segregate key duties and responsibilities among different people to reduce the risk of error or fraud. This control should include separating the responsibilities for authorizing transactions, processing and recording them, and reviewing the transactions. No one individual should control all key aspects of a transaction or event. Similar internal control requirements are established by Office of Management and Budget Circular No. A-123, "Management Accountability and Control," June 21, 1995; the "Framework for Federal Financial Management Systems," January 1995, issued by the Joint Financial Management Improvement Program; and the DoD Financial Management Regulation.

Supervisory reviews were specified for accounting entries based on certain dollar thresholds established by the Director for Accounting, DFAS Arlington, as illustrated in Table 3.

<u>Threshold</u>	<u>Dollar Amount</u>	<u>Approving Official</u>
1	Under \$100 Million	Team Leader General Funds
2	\$100 – \$500 Million	Chief, Office of CFO Procedures
3	\$500 - \$1 Billion	Director for Accounting
4	Over \$1 Billion	DFAS Denver Director

Responsible DFAS Denver managers did not believe that management review and approval of the SOF constant adjustments were required. A lower-level manager approved the five CRS entries in anticipation of their approval by the Director, DFAS Denver. The Director, DFAS Denver, subsequently approved those five and other accounting entries without dating his signature. The effectiveness of such after-the-fact approvals is questionable when financial records can be altered without management review and approval. The absence

of required management review and approval of \$9.4 billion is a material control weakness because management may not have authorized the transactions recorded in those systems.

Summary

Although material control weaknesses remain, compared to FY 1999, DFAS Denver made progress in reducing the number of accounting entries made in CRS and DDRS in preparing the FY 2000 Air Force General Funds Financial Statements. Excluding the unsupported SOF constant adjustments, the primary cause for the remaining unsupported or improper accounting entries made by DFAS Denver in FY 2000 were uncorrected deficiencies in the automated systems it uses to prepare the Air Force General Funds Financial Statements. Other administrative documentation problems, such as those identified with the \$294.6 billion in SOF constant adjustments, should be corrected by following existing guidance. DFAS Denver needs to take proactive measures to improve the controls over the documentation of and authorization for the accounting entries made in the SOF System. DFAS Denver should also verify that appropriate documentary controls are in place with other department-level systems.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service Denver, in compliance with provisions of DoD Regulation 7000.14-R, "DoD Financial Management Regulation," March 13, 2001, and implementing internal guidance, establish procedures to:

1. Adequately support the FY 2001 and future constant "C" adjustments made in the Status of Funds System and other accounting entries made in the Chief Financial Officers Reporting System and the Defense Department Reporting System.

Management Comments. DFAS concurred in principle but did not concur that constant "C" adjustments made to Status of Funds were unsupported. Because these adjustments are original source entries, DFAS stated that additional support was not required and available support did not need to be attached to a journal voucher. Regarding the unsupported or improper entries in CRS and DDRS, DFAS stated these entries were necessary to increase the accuracy of the statements because many of the feeder systems are non-CFO compliant in capturing accounting transactions. DFAS stated that implementing the General Accounting and Finance System-Rehost will remedy the confusion of unsupported adjusting entries.

Audit Response. The DFAS comments were nonresponsive because they did not identify the corrective actions planned or taken and were incomplete. Contrary to management comments, SOF constant "C" adjustments consist of both source

entries and correcting entries, both of which require journal vouchers under the DFAS journal voucher guidance issued in August 2000. That guidance states:

- Source accounting entries are entries that have not been otherwise recorded because of system limitations or timing differences. Such entries will normally be summarized amounts for which documentation is required, even where finite transaction detail may not be available.
- Among other types, correcting entries include journal vouchers prepared based on customer requests and through analysis, reasonableness checks, or quality control procedure.

Many of the constant “C” adjustments are source entries made at the customer’s request to record the initial funding while subsequent correcting entries are made at the customer’s request to record funding changes. Other constant “C” adjustments were made based on analysis performed by SOF employees. Preparing journal vouchers for constant “C” adjustment provides a disciplined manner for documenting the support for the transactions and management’s prior approval of those adjustments. No such discipline existed for the \$294.6 billion in constant “C” adjustments made in SOF during FY 2000.

As management stated, most of the forced elimination entries and other forced entries made in CRS and DDRS were caused by accounting system deficiencies in the feeder systems used. However, this audit report identified accounting entries classified as inadequately documented. Those inadequately documented entries resulted from failure to comply with DFAS journal voucher guidance, not accounting system deficiencies. This report identified \$5.4 billion of inadequately documented CRS entries. Management comments did not address the corrective actions taken or planned to ensure that all future accounting entries will be adequately documented. The General Accounting and Finance System-Rehost (now under development) may eliminate the necessity for making some accounting entries. However, that new system will not otherwise eliminate the requirement that the accounting entries made be adequately supported. We request that DFAS reconsider its position and provide additional comments on this recommendation.

2. Require that dated approval signatures from authorized managers be obtained before accounting entries are made in the Status of Funds System and Chief Financial Officers Reporting System.

Management Comments. DFAS concurred in principle, stating that only 5 of 583 entries were made prior to obtaining supervisory approval, which did not affect the accuracy of or internal controls over the preparation of the financial statements. DFAS Denver followed stringent alternative controls to ensure that necessary approvals were obtained before the draft or final statements were prepared or made available for management or audit review. DFAS Denver will again closely monitor the approvals during the FY 2001 financial statement cycle.

Audit Response. The management comments were not responsive because they were incomplete and did not otherwise propose any corrective actions in response to the recommendation. DFAS did not identify any corrective actions planned or

taken related to the absence of approvals by DFAS managers for the 921 SOF constant "C" adjustments, valued at \$294.6 billion. Contrary to management's assertion, the five unapproved entries made in CRS undermine the reliability of the financial statements and related internal controls. Three of the five CRS were identified as unsupported or improper. Furthermore, the alternative controls followed by DFAS Denver in preparing the FY 2000 financial statements were not sufficient to prevent the five accounting entries, valued at \$9.4 billion, from being made in CRS without the approval of the Director, DFAS Denver. We also disagree with management's contention that it is acceptable for accounting entries to be recorded in an accounting system without prior approval by DFAS managers, provided such approvals are obtained before the financial statements are prepared or made available for review. DFAS managers should approve any transaction before it is recorded in an accounting system. Otherwise, DFAS managers do not have reasonable assurance on the reliability of financial reports, including financial statements and budget execution reports. We request that DFAS reconsider its position and provide additional comments on this recommendation, including corrective actions planned or taken related to the SOF constant "C" adjustments.

Appendix A. Audit Process

Scope

Work Performed. For the FY 2000 Air Force General Funds Financial Statements, we examined the support for source code “C” constant adjustments made in SOF and all accounting entries made by DFAS Denver in CRS and DDRS.

Limitation to Audit Scope. The Air Force Audit Agency examined and will separately report on its audit of accounting entries (excluding constant adjustments) made by DFAS Denver in SOF and the Command-Online Accounting and Reporting System. DFAS Denver may have made accounting entries in the Merged Accountability and Fund Reporting System or other department-level automated information systems that were not included in the scope of this audit.

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.

- **FY 2001 DoD 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-02)
- **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 finance 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 objectives and goals. This report pertains to achievement of the following functional area objective.

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

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

Methodology

Use of Computer-Processed Data. We relied on computer-processed data from the SOF, CRS, and DDRS, which process accounting data for the Air Force General Funds. We did not evaluate the general and application controls of these systems because the process for preparing and approving accounting entries at the DFAS Denver is primarily a manual process. Not evaluating the controls did not affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial related audit from June 2000 through March 2001 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did our work in accordance with generally accepted Government auditing standards, except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review. We included tests of management controls considered necessary.

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

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of DFAS Denver management controls over approval of, proper accounting of, and support for accounting adjustments. We also reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified material management control weaknesses as defined in DoD Instruction 5010.40. Management controls at DFAS Denver were not adequate to ensure that all accounting entries were proper adjustments or adequately supported. We reported similar management control weaknesses in Inspector General, DoD, Report No. D-2000-143, "Defense Finance and Accounting Service Denver Center's Accounting Entries Used in Compiling the FY 1999 Air Force General Fund Financial Statements," June 9, 2000. The recommendations, if implemented,

will improve the controls over the process for making accounting entries. We will provide a copy of the report to the senior official in charge of management controls at DFAS Denver.

Adequacy of Management's Self-Evaluation. DFAS Denver identified controls over the preparation of financial statements as an assessable unit but did not identify controls over accounting entries as an assessable unit. DFAS Denver evaluated the preparation of financial statements and controls over accounting entries. In its evaluations, DFAS Denver did not identify material weaknesses related to controls over accounting entries identified by this audit because their review was not sufficiently detailed to identify those weaknesses.

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/audit/reports>.

Appendix B. Comparison of FYs 1999 and 2000 Accounting Entries

Reporting Categories

Accounting entries made by DFAS Denver were categorized as supported, unsupported, improper, or not reviewed. In the FY 1999 audit, improper entries were included in the unsupported entries.

Supported Entries. Except for entries considered unsupported or improper, supported accounting entries are original data entries made in the accounting records for:

- data submitted by authorized organizations, other data originating within DFAS systems, and data calls made by DFAS sites to obtain data not otherwise available;
- inventory revaluation and other entries required by the DoD Regulation 7000.14-R or other published requirements; and
- year-end closing entries, reversals of required entries and closing entries, and corrections of errors.

Unsupported Entries. Accounting entries are unsupported when the documentary support or audit trails are inadequate at the time such entries were submitted for approval (or absent required approval, when the entries were made). Thus, to emphasize the underlying documentation control weaknesses, accounting entries are still identified in this report as unsupported in those instances where DFAS Denver subsequently provided additional documentary support and explanations of audit trails. Unsupported entries represent:

- elimination entries and other entries made to force agreement between accounting records because of accounting system deficiencies or other problems,
- entries made where no documentary support was available or where the documentation provided did not support the dollar amount or inadequately described the purpose and reason for making the entry, and
- entries made where the audit trails to supporting documentation were inadequate.

Improper Entries. Improper accounting entries represent those that are either illogical or contrary to generally accepted accounting principles.

Not Reviewed. Those accounting entries were identified by the audit but not reviewed because of time limitations for conducting the audit.

Comparison to Prior Year

In compiling the FY 1999 Air Force General Funds Financial Statements, DFAS Denver made accounting entries for \$1.2 trillion of which 87 entries for \$66.3 billion were unsupported and 2 entries for \$0.3 billion were improper. Details on this prior audit, which was limited to examining CRS accounting entries, are provided in Inspector General, DoD, Report No. D-2000-143.

Though material control weaknesses remain, as discussed in the Finding section of the report, DFAS Denver did make significant progress in FY 2000 in reducing the number of accounting entries made in CRS and DDRS, which is comparable to the FY 1999 audit scope. The number of accounting entries made by DFAS Denver increased by 1,165 entries while the dollar value decreased by \$816.8 billion. There are several reasons those changes occurred from FYs 1999 to 2000.

SOF Constant Adjustments. The table included in this appendix compares the quantity and value of different categories of accounting entries audited in FYs 1999 and 2000. A separate comparison of CRS and DDRS accounting entries is presented in the table because the SOF constant adjustments made in FY 2000 were not included in the scope of the FY 1999 audit. Thus, the increase in the number of accounting entries made in FY 2000 is primarily the result of including the 921 SOF constant adjustments made in FY 2000 for \$296.4 billion. For comparison purposes, including the DDRS accounting entries with CRS entries in FY 2000 is appropriate because the DDRS entries were previously made in CRS.

CRS and DDRS Entries. During FY 2000, DFAS Denver made 244 more accounting entries in the CRS and DDRS than were made in the CRS in FY 1999. However, the value of the entries made in FY 2000 were \$111.4 billion less than the value of the FY 1999 CRS entries. As shown in the following table, the increase of 244 entries in the number of accounting entries made in FY 2000 is primarily a result of decreases in the number of entries made to reverse prior year accounting entries, make prior period adjustments, and correct the status of funds. The dollar value of FY 2000 accounting entries decreased by more than 90 percent compared to FY 1999 for the following reasons.

- In FY 1999, 86 accounting entries for \$737.9 billion were made to post and reverse budgetary data and correct errors in posting logic. No similar entries were made in FY 2000.

- In FY 1999, \$202.0 billion in reclassifications were made compared to only \$20.1 billion in FY 2000. .
- The decrease in entries made to reverse prior year accounting entries is primarily a result of a single FY 1999 accounting entry for \$167.0 billion that reversed a FY 1998 accounting entry made to reclassify accounts payable from Government to public.

FYs 1999 and 2000 Accounting Entries by Automated System and Category

<u>Automated System</u> <u>Category of Accounting Entry</u>	Number of Accounting Entries		Amount (in billions)	
	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 1999</u>	<u>FY 2000</u>
<u>CRS and DDRS:</u>				
Posting of budgetary data	27	0	\$ 313.7	\$ 0.0
Reversal of budgetary data	27	0	313.7	0.0
Correcting errors in posting logic	32	0	110.5	0.0
Subtotal	86	0	\$ 737.9	\$ 0.0
Reclassification	104	125	202.0	20.1
Reversal of prior year accounting entries	33	111	172.7	27.1
Posting off-line data	50	95	40.6	12.5
Reversal of current year accounting entries	23	19	29.5	0.3
Prior period adjustments	13	108	25.0	18.9
Reallocation	73	67	3.7	4.4
Correct status of funds	6	70	0.1	0.7
Depreciation	11	11	0.9	5.6
Other	53	90	10.4	21.8
Subtotal	452	696	\$1,222.8	\$111.4
<u>SOF System:</u>				
Constant "C" adjustments	0	921	0	294.6
Total	452	1,617	\$1,222.8	\$406.0

Appendix C. 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

Non-Defense Federal Organization

Office of Management and Budget

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

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

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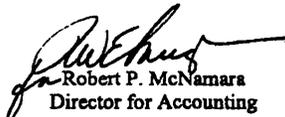
DFAS-DAS

MAY 31 2001

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

SUBJECT: Audit Report on Accounting Entries Made in Compiling the FY 2000 Air Force
General Funds Financial Statements (Project No. D2001FD-0014)

Our response to the subject audit is attached. The point of contact is Mr. David Arvin,
(703) 607-2857 or DSN 327-2857.


Robert P. McNamara
Director for Accounting

Attachment:
As stated

cc:
DFAS-DDI
DFAS-AAB/DE

**DFAS Comments on Audit Report on Accounting Entries Made in Compiling the FY 2000
Air Force General Funds Financial Statements (Project No. D2001FD-0014)**

Responses to Recommendations.

Recommendation 1. We recommend that the Director, Defense Finance and Accounting Service Denver, in compliance with provisions of DoD Regulation 7000.14-R "DoD Financial Management Regulation," March 13, 2001, and implementing internal guidance, establish procedures to:

Adequately support the constant adjustments made in the Status of Funds System and other accounting entries made in the Chief Financial Officers Reporting System and the Defense Department Reporting System.

Management Comments.

Status of Funds System, General Funds Accounting and Reporting Division:

Concur in Principle. Departmental-level adjustments are now properly documented using DoD Regulation 7000.14-R guidance. However, we do not concur that "C" coded entries are unsupported. These entries are "original source" inputs of funding documents (treasury warrants, etc.); therefore, additional supporting documentation is not required nor should they be attached to a journal voucher.

Completion Date: May 30, 2001.

Chief Financial Officers Reporting System and the Defense Department Reporting System, CFO Procedures and Reporting Office:

Concur in Principle. The DoD IG reference to unsupported and improper entries are actually entries that had to be made to increase the accuracy of the statements. Many of the feeder systems to the Air Force statements are non-CFO compliant in providing the following: environmental liabilities data from the Air Force Restoration Management Information System (AFRIMS); operating material information from the Standard Base Supply System (SBSS), Financial Inventory Accounting And Billing System (FIABS), Combat Ammunition System-Ammunition Control Point (CAS-A), etc.; or elimination data from the General Accounting and Finance System (GAFS) and Central Procurement Accounting System (CPAS) that does not capture trading partner data. The implementation of the General Accounting and Finance System-Rehost (GAFS-R) will remedy the confusion of unsupported adjusting entries.

Estimated Completion Date: October 31, 2002.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Denver, in compliance with provisions of DoD Regulation 7000.14-R "DoD Financial Management Regulation," March 13, 2001, and implementing internal guidance, establish procedures to:

Require that dated approval signatures from authorized managers be obtained before accounting entries are made in the Status of Funds System and Chief Financial Officers Reporting System.

Management Comments. Concur in principle. Only 5 out of 583 entries were made prior to obtaining supervisory approval; however, this had no effect on the accuracy of the financial statements or the internal controls over the preparation of the statements. DFAS Denver followed stringent alternative controls to ensure all necessary approvals were obtained prior to preparing any drafts or final copies of the statements or making the statements available for electronic review. DFAS Denver will again closely monitor the approvals of accounting entries during the preparation of the FY 2001 financial statements.

Estimated Completion Date: January 15, 2002.

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.

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