Audit Report

OFFICE OF THE INSPECTOR GENERAL

**DEFENSE BUSINESS OPERATIONS FUND-
COMMUNICATIONS INFORMATION SERVICES
ACTIVITY FINANCIAL STATEMENTS FOR FY 1994**

Report No. 95-219

June 5, 1995

Department of Defense

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Acronyms

JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884

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June 5, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER OF THE DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Audit Opinion on the Defense Business Operations Fund-Communications Information Services Activity Financial Statements for FY 1994 (Project No. 4RD-2009)

Introduction

We are providing this report for your information and use. Financial statement audits are required by the Chief Financial Officers Act of 1990. Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General, DoD, to express an opinion on financial statements and report on the adequacy of internal controls and compliance with laws and regulations. This report contains our opinion on the Defense Business Operations Fund-Communications Information Services Activity (the Fund) Statement of Financial Position for FY 1994. We evaluated only the Statement of Financial Position and, therefore, are not expressing an opinion on any other financial statement for the Fund.

Audit Opinion

We are qualifying our opinion on the Fund's FY 1994 Statement of Financial Position because of management's noncompliance with the policies and procedures, related to the recording of transactions in the advances and prepayments account and accounts payable account, as set forth in DoD 7000.14-R, "DoD Financial Management Regulation, volume 11B, Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund" (DoD Financial Management Regulation), December 21, 1994.

Our opinion is based on our review of the Fund's FY 1994 Statement of Financial Position dated March 1, 1995. The Fund did not liquidate $18.4 million recorded in the advances and prepayments account made for certain telecommunications services the Fund received and did not liquidate

$28.7 million recorded in the accounts payable account in related transactions. As a result, the advances and prepayments account and the accounts payable account are materially overstated by $18.4 million and $28.7 million, respectively, and equity is materially understated by $10.3 million.

Audit Objectives

The primary objective of the audit was to determine whether the Fund's FY 1994 Statement of Financial Position was presented fairly in accordance with OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We evaluated the internal control structure established for the Fund, and we assessed its compliance with the applicable laws and regulations that could have a material effect on the Statement of Financial Position. In addition, we announced the objective to identify improvements in the financial statement process that could provide beneficial data to project managers and other users of the financial statements. However, management had made major changes to improve the Fund's accounting system since our audit in FY 1992. Therefore, we did not pursue that objective.

Scope and Methodology

We examined the Fund's Statement of Financial Position for the year ended September 30, 1994. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures on that financial statement, including its accompanying Notes. Our audit also included assessing the accounting principles used and significant estimates made by management as well as evaluating the overall presentation of the Statement of Financial Position.

Scope of the Review of Internal Controls. Our audit included an assessment of whether the internal control structure provided reasonable assurance that the financial data reflected on the FY 1994 Statement of Financial Position were accurate and supported by detailed subsidiary records. The audit also included an evaluation of the procedures and controls that the Fund and the Defense Finance and Accounting Service-Denver Center used to prepare the FY 1994 Statement of Financial Position. This financial statement audit was made from April 1994 through March 1995.

Scope of the Review of Compliance With Laws and Regulations. To obtain reasonable assurance about whether the Statement of Financial Position was free of material misstatements, we tested compliance with applicable laws and regulations that may directly affect the Statement of Financial Position and with other laws and regulations designated by the OMB and DoD for inclusion in financial statement audits. We identified the key provisions of those laws and

regulations, and we reviewed transactions, documents, and other records to verify that they complied with the provisions of those laws and regulations.

Reliability of Computer-Processed Data. We performed various reviews to determine the reliability of computer-processed data provided to us. We limited our review of the general and application controls of the computer-processed data to tracking transactions through the Fund's accounting system, observing operations, conducting interviews, and verifying account balances. We performed selected reviews of other systems that generated the tariff, payment, and accounting data we used. To the extent that we reviewed the data, we concluded that the data were sufficiently reliable to meet our audit objectives.

Use of Quantitative Methods Division. We collected the data using a combination of simple random samples and multistage, stratified sample designs for selected accounts. We selected accounts based on their proportional share of the dollar value of transactions (internal controls sample) or the net value of the account (substantive testing). Using statistical sampling methods we conducted substantive testing of accounts 1015, 1311, 1750, 1759, 2111, 2113 and performed a 100-percent assessment of accounts 1415, 1416, 2118, 3211, and 3220. The projected value of our results provided us a reasonable basis to render an opinion.

Auditing Standards

We performed our audit at the Defense Information Technology Contracting Office located at Scott Air Force Base, Illinois in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin No. 93-06, January 8, 1993, and the general provisions of the President's Council on Integrity and Efficiency, "Federal Financial Statement Audit Manual," January 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Financial Position was free of material misstatements. To assess the materiality of matters that affect the fair presentation of the Statement of Financial Position and related internal control weaknesses, we relied on the guidelines suggested by the General Accounting Office and our professional judgment.

Accounting Principles

Accounting principles for use in preparation of financial statements required by the Chief Financial Officers Act of 1990 remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. Those officials are

The Director, OMB, and the Comptroller General of the United States have not issued accounting principles that will govern all aspects of financial statement reporting and that will constitute "generally accepted accounting principles for the Federal Government." Until those principles are issued, agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01. The hierarchy constitutes the "other comprehensive basis of accounting" to be used for preparing the financial statements of Federal agencies. A summary of the hierarchy defined and approved by the JFMIP principals follows:

- o statements agreed to and published by the JFMIP principals,
- o form and content requirements of the OMB,
- o accounting principles in agency guidance, and
- o accounting principles published by other authoritative sources.

To date, three accounting principles have been published by the JFMIP principals, so most accounting principles for the DoD "other comprehensive basis of accounting" are found in DoD accounting policy guidance. The DoD accounting guidance is primarily in the DoD Accounting Manual. The Office of the Under Secretary of Defense (Comptroller) has updated portions of the DoD Accounting Manual and has incorporated those sections into the DoD Financial Management Regulation.

The DoD Financial Management Regulation will eventually serve as the single DoD-wide financial management regulation for use by all DoD Components for accounting, budgeting, finance, and financial management education and training. In the interim, unless superseded by published Federal accounting principles or requirements of OMB, the policy in the DoD Accounting Manual or in the DoD Financial Management Regulation, as applicable, is the authoritative basis for preparing financial statements in accordance with the "other comprehensive basis of accounting."

Concurrent Audits

This audit is one of two audits, performed by the Inspector General, DoD, at the Defense Information Systems Agency in response to the Chief Financial Officers Act of 1990. This audit was performed in conjunction with the audit of the Defense Business Operations Fund-Defense Information Services Organization (Project No. 4RE-2005). The results of that audit were provided in Inspector General, DoD, Report No. 95-209, issued May 31, 1995.

Prior Audits and Other Reviews

The Inspector General, DoD, issued Audit Report No. 93-153, "Defense Business Operations Fund-Communications Information Services Activity," on August 6, 1993. In that report, we expressed a qualified opinion on the Fund's financial statements for FY 1992 because we were unable to obtain sufficient evidence to support two accounting adjustments. The two amounts concerned a $57 million yearend adjustment that increased operating expenses and accounts payable and a $59 million yearend adjustment that increased equity.

The Inspector General, DoD, issued Audit Report No. 94-097, "Pricing for Defense Switched Network Access Circuits," on May 13, 1993. The audit showed that the Fund's accounting system did not consistently reflect the actual value of the accounts payable liability for 12,451 circuits that were leased as part of the Defense Switched Network during March 1992. That condition occurred because the Defense Information Systems Agency had not established procedures to verify that data were accurately input in the Fund's accounting system. Management concurred with the finding and established procedures to correct the weaknesses identified in the report.

Background

The Defense Business Operations Fund-Communications Information Services Activity is a revolving fund established under the administration and management of the Director, Defense Information Systems Agency. The Fund is the largest of two Defense Business Operations Fund business areas under the direction of the Defense Information Systems Agency and is responsible for procuring information technology, such as telecommunications equipment and services and information systems, for DoD Components and other Government agencies worldwide.

The Statement of Financial Position shows the net worth of the Fund by presenting its assets and liabilities as of the end of the fiscal year. The Fund reported assets of $495.1 million and liabilities of $412.2 million as of September 30, 1994. The principle asset and liabilities accounts include Accounts Receivable ($402.5 million); Property, Plant, and Equipment ($61.9 million); and Accounts Payable ($394.8 million). Financial information in the Fund's financial statements was obtained from a general ledger system (the Federal Accounting Management Information System) as well as several other financial and nonfinancial reporting systems.

The Defense Finance and Accounting Service maintains the official accounting records; however, the Defense Information Systems Agency and the Defense

Finance and Accounting Service are responsible for preparing the Fund's financial statements. Our responsibility is to express an opinion on those statements.

Discussion

Internal Controls. We reviewed the internal control structure of the Fund and obtained an understanding of the internal control policies and procedures. We assessed the level of control risks relevant to the cycles, classes of transactions, and account balances that affected the Statement of Financial Position. Further, for the significant control policies and procedures, we performed a sufficient number of tests to provide reasonable assurance that the controls were effective and working as designed.

We did not identify internal control weaknesses during the audit that we considered to be material or reportable under the standards established by OMB Bulletin No. 93-06.

Compliance with Laws and Regulations. Fund operations generally complied with applicable laws and regulations. One exception was that the Fund did not comply with the DoD Financial Management Regulation as it relates to the advances and prepayments account and accounts payable account. The Fund did not liquidate $18.4 million recorded in the advances and prepayments account made for certain telecommunications services the Fund received and $28.7 million recorded in the accounts payable account in related transactions. The Fund's management erroneously established an accounts payable liability for those services with the intent of liquidating those amounts, along with the related amounts recorded in the advances and prepayments account, once actual costs were known. However, neither the amount in the advances and prepayments account nor the amount in the accounts payable account were liquidated at year end. As a result, the advances and prepayments account and the accounts payable account are overstated by $18.4 million and $28.7 million, respectively, and equity is understated by $10.3 million.

The cooperations and courtesies extended to the audit staff are appreciated. If you have questions on this audit, please contact Mr. Robert M. Murrell, Audit Program Director, at (703) 604-9507 (DSN 664-9507) or Mr. Patrick J. Nix,

Audit Project Manager, at (703) 604-9511 (DSN 664-9511). The distribution of this report is in the enclosure. Audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
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Enclosure

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This report was produced by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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