Audit Report

OFFICE OF THE INSPECTOR GENERAL

MANAGEMENT CONTROL PROGRAM AT DEFENSE INFORMATION SYSTEMS AGENCY, WESTERN HEMISPHERE

Report No. 95-280 July 26, 1995

Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DISA WESTHEM	DISA Western Hemisphere
KAR	Key Accounting Requirement

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July 26, 1995

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Audit Report on the Management Control Program at Defense Information Systems Agency, Western Hemisphere (Report No. 95-280)

We are providing this audit report for review and comment. This report resulted from our Audit of the Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994, Report No. 95-209. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As requested by management, we added a DoD regulation to Recommendation 2.a. The Defense Finance and Accounting Service comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. The Defense Information Systems Agency Western Hemisphere did not provide comments. We request that the Defense Information Systems Agency, Western Hemisphere provide comments by August 28, 1995.

Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529) or Mr. John M. Donnelly, Audit Project Manager, at (703) 604-9549 (DSN 664-9549). See Appendix K for the report distribution. The audit team members are listed inside the back cover.

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Report No. 95-280 **July 26, 1995**
(Project No. 4RE-2005.01)

Management Control Program at Defense Information Systems Agency, Western Hemisphere

Executive Summary

Introduction. This report resulted from the Audit of the Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994 (Report No. 95-209, May 31, 1995). In September 1994, the Director, Defense Information Systems Agency, realigned the Defense Information Services Organization and renamed it the Defense Information Systems Agency, Western Hemisphere (DISA WESTHEM). The DISA WESTHEM consists of a headquarters office and 16 Defense megacenters. Its mission is to provide information processing support to the DoD Components. The DISA WESTHEM FY 1994 customer revenues totaled $508 million.

Objectives. The overall audit objective was to evaluate the adequacy of the DISA WESTHEM FY 1994 management control program. We also evaluated the effectiveness of the Defense Finance and Accounting Service (DFAS) annual reviews of accounting systems used to process and prepare DISA WESTHEM FY 1994 financial statements.

Audit Results. The DISA WESTHEM and DFAS did not adequately review accounting system controls as required by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. As a result, DFAS and DISA WESTHEM annual reviews of accounting systems cannot be relied on to verify the adequacy of accounting system controls needed to ensure the accuracy, completeness, and reliability of DISA WESTHEM financial statements for FY 1994. Recommendations in the report, if implemented, will improve the reliability, accuracy, and usefulness of annual reviews (see Appendix I).

The DISA WESTHEM also had weaknesses in its management control program not related to accounting system controls. The DISA WESTHEM planned or implemented actions to correct the weaknesses during the audit (see Appendix C).

Summary of Recommendations. We recommend that DFAS and DISA WESTHEM establish a memorandum of agreement to coordinate annual reviews of accounting system controls to include specifying responsibilities for the DFAS system manager and DISA WESTHEM system user; train system managers and users in performing annual reviews of accounting system controls; document accounting system controls and related control testing during the reviews; and consider the results of related audits and evaluations in performing annual reviews.

Management Comments. Although DFAS nonconcurred with the recommendation to establish a memorandum of agreement to coordinate annual reviews with DISA WESTHEM, DFAS agreed to require selected users of DoD accounting systems to participate in annual reviews and will advise appropriate DFAS centers of the requirement.

The DFAS partially concurred with the recommendation to provide training to system managers and users. The DFAS stated that it would supplement an existing training program by providing guidance and points of contact to system managers and selected system users on the conduct of annual reviews. Also, DFAS requested that we add a DoD regulation to the recommendation on training.

The DFAS concurred with recommendations to document accounting controls and related control testing and to consider related audits and other evaluations when performing annual reviews. Managers will document specific annual review guide questions and consider applicable audit findings and recommendations when performing annual accounting system reviews.

The DFAS comments related to all DoD accounting systems, not just the three accounting systems in the audit scope (Appendix A). A discussion of the comments is in Part I of the report, and the complete text of the comments is in Part III.

Audit Response. The DFAS comments were fully responsive to recommendations. The DFAS planned and completed actions concerning system manager and user training satisfy the intent of the recommendation. Although DFAS nonconcurred with the recommendation to coordinate annual reviews, DFAS provided acceptable alternative actions to ensure user participation in annual accounting system reviews. In response to the DFAS request, we added the DoD regulation to the recommendation on training.

The DISA WESTHEM did not provide comments. Therefore, we request that DISA WESTHEM provide comments by August 28, 1995.

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Part I - Audit Results

Audit Background

On September 1, 1994, the Director, Defense Information Systems Agency (DISA), realigned the Defense Information Services Organization and renamed it DISA Western Hemisphere (DISA WESTHEM). As a part of the Defense Business Operations Fund-Information Processing Business Area, DISA WESTHEM mission is to provide, at competitive prices, information products and services that enable DoD Components to accomplish their missions. The DISA WESTHEM consists of a headquarters office and 16 Defense megacenters. The DISA WESTHEM employs about 6,000 military and civilian personnel. For FY 1994, DISA WESTHEM sales of information products totaled $508 million. Our audit focused on the management control program for the accounting systems at DISA WESTHEM and on the annual reviews of those systems.

DoD, Federal, and Statutory Requirements Related to Accounting System Controls. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987 (the Directive), implements requirements in Office of Management and Budget Circular A-123, "Internal Control Systems," August 4, 1986. The Directive provides policy, prescribes procedures, and assigns responsibilities for DoD Components' management control programs. The Directive requires DoD organizations to implement a comprehensive system of management controls to provide reasonable assurance that assets are used properly and that programs are efficiently and effectively managed. The Directive also requires a review of management controls that are an integral part of an accounting system for compliance with accounting principles, standards, and related requirements established by the General Accounting Office and the Office of Management and Budget. The Directive states that specific DoD policies for evaluating accounting systems are in DoD Manual 7220.9-M, "Department of Defense Accounting Manual," chapter 12, October 1983. DoD 7000.14-R, "Financial Management Regulation" (the Regulation), volume I, chapter 3, May 1993, superseded chapter 12 of the DoD Accounting Manual.

The Regulation implements the statutory and Office of Management and Budget requirement to review accounting systems and to report to Congress and the President on whether the systems comply with Comptroller General standards. The Regulation states that the annual report will be based on annual reviews of accounting system controls conducted by system managers and users and on detailed cyclical evaluations of accounting system controls conducted by an independent Defense Finance and Accounting Service (DFAS) review team.

Definition of an Accounting System. An accounting system is the structure of methods and procedures used to record, classify, accumulate, analyze, summarize, and report information on the financial condition and operating position of an organization. As defined in the Regulation, accounting systems:

o consist of the various functional operations involved in authorizing, recording, classifying, analyzing, and reporting financial information related to financing sources, gains, expenses, losses, transfers, assets, liabilities, equity, and management controls; and,

o encompass the procedures and processes from the time at which a transaction is authorized; through processing of the data, either manually or automatically; to issuance of financial and management information statements and reports.

The accounting systems DISA WESTHEM used for processing and reporting its FY 1994 financial information are discussed in Appendix D.

Management Control Objectives. The objectives of management controls, as prescribed by the Directive, are to provide management with reasonable assurance that:

o obligations and costs comply with applicable law;

o assets are safeguarded against waste, loss, unauthorized use, and misappropriation;

o revenues and expenditures applicable to agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained; and

o programs are efficiently and effectively carried out in accordance with applicable law and management policy.

Accounting System Review Process. The Regulation discusses two types of reviews performed as part of the accounting system review process: annual reviews and cyclical reviews. The Regulation specifies 13 key accounting requirements with which accounting systems must comply. The accounting requirements are a composite of requirements of the General Accounting Office, Office of Management and Budget, Department of the Treasury, and DoD. The Regulation states that system managers will conduct annual reviews of accounting systems and that DFAS evaluation teams will perform cyclical reviews of accounting systems to determine their compliance with the 13 key accounting requirements. The Regulation further states that a material noncompliance with a key accounting requirement requires corrective action within a reasonable period. The 13 key accounting requirements and a brief description of each requirement are in Appendix E.

Annual Reviews. The DFAS is responsible for establishing procedures for conducting annual reviews of accounting system controls. The DFAS assigned the responsibility for performing annual reviews to DFAS system managers. The Regulation states that users of DoD accounting systems shall work with DFAS system managers in conducting the annual reviews and in producing the documented results of management's assessment.

In FYs 1993 and 1994, DFAS prepared and issued a System Manager/User Review Guide (the Review Guide) to assist managers and users of DoD accounting systems in conducting annual reviews of accounting system controls. The Review Guide contains questions for system managers to answer in determining compliance of their accounting systems with applicable key accounting requirements.

Cyclical Reviews. On a cyclical basis, DFAS review teams conduct an independent, comprehensive evaluation (Consolidated System Evaluation) of accounting systems controls. The Regulation states that DFAS will perform a cyclical review of each accounting system once every 3 years. We did not evaluate the process for cyclical reviews of accounting systems. In 1994 DFAS performed a Consolidated System Evaluation of one of the three accounting systems in our audit scope. The evaluation concluded that the system did not comply with key accounting requirements. Appendix B discusses the results of that evaluation.

Audit Objectives

The announced audit objective was to evaluate the adequacy of the DISA WESTHEM management control structure for FY 1994. As part of the objective, we also evaluated the effectiveness of the DFAS annual reviews of accounting systems that processed and prepared DISA WESTHEM FY 1994 financial statements. Appendix A discusses the audit scope and methodology. Appendix B provides a summary of prior coverage related to the audit objectives. Appendix C discusses actions DISA WESTHEM implemented or planned during the audit to correct weaknesses in the management control program and the status of an uncorrected material management control weakness.

Annual Reviews of Accounting System Controls

The DFAS and DISA WESTHEM did not adequately review accounting system controls as required by DoD Directive 5010.38 and DoD Financial Management Regulation 7000.14-R.

Inadequate review of accounting system controls occurred because DFAS and DISA WESTHEM did not:

o coordinate the performance of annual reviews to include specifying responsibilities of the DFAS system manager and DISA WESTHEM system user;

o train DFAS system managers or system users in performing annual reviews;

o document accounting system controls and control reviews; and,

o consider prior audits and other evaluations of system performance.

As a result, DFAS and DISA WESTHEM annual reviews of accounting systems, a principal tool for implementing a management control program, cannot be relied on to verify the adequacy of accounting system controls, which constitutes a material management control weakness. Verification of accounting system controls helps ensure the accuracy, completeness, and reliability of DISA WESTHEM financial statements.

Conducting Annual Accounting System Reviews

Coordinating the Performance of Annual Reviews. A primary reason for annual reviews is to verify that accounting controls are adequate to ensure the accuracy, completeness, and reliability of the accounting system users' financial statements. The DFAS accounting system managers and DISA WESTHEM system users are responsible for establishing specific accounting system controls because system managers and users are involved in the various functional operations that comprise an accounting system as defined by the Regulation. System users authorize accounting transactions and participate, directly or indirectly, in recording, classifying, and analyzing the transactions. The DFAS system managers, on the other hand, are responsible for ensuring the accuracy of financial information from the point of data entry into the accounting system through reporting of the financial information. The Regulation requires that users work with system managers in conducting annual reviews of accounting system controls and in producing the documented results of the assessments of

system compliance with key accounting requirements. The lack of user participation in annual reviews results in less assurance that accounting controls are adequate to detect or prevent the input of unauthorized or inaccurate financial information into the accounting systems.

Reviews of Accounting Systems Supporting DISA WESTHEM. We evaluated the FYs 1993 and 1994 annual reviews of accounting system controls for three accounting systems owned and operated by the DFAS: the Defense Business Management System, the Industrial Fund Accounting System, and the Standard Finance System. Appendix D provides details on how the systems operate and on the accounting functions they perform. The three DFAS systems processed 71 percent ($360 million) of the $508 million in FY 1994 revenue for DISA WESTHEM (see Appendix A). Also, the Under Secretary of Defense (Comptroller) selected the Industrial Fund Accounting System as the interim financial system[1] for the Defense Business Operations Fund-Information Processing Business Area. The three systems were used to prepare the FY 1994 financial statements for DISA WESTHEM. The FYs 1993 and 1994 annual reviews of accounting system controls for the three accounting systems were flawed and, therefore, could not be relied on to provide reasonable assurance on the accuracy and completeness of financial statements produced by the systems.

Defense Business Management System. For the FYs 1993 and 1994 annual reviews, the DFAS system manager for the Defense Business Management System performed the annual reviews without coordinating with system users or documenting Review Guide responses. In addition, the system manager certified the system as compliant with requirements prescribed by the General Accounting Office and the Office of Management and Budget. However, a Consolidated System Evaluation report, "Evaluation of the Appropriated Accounting Sub-System of the Defense Business Management System at Defense Finance and Accounting Service-Columbus Center," April 15, 1994, concluded that the system did not conform to the principles, standards, and related requirements of the General Accounting Office; guidelines of the Office of Management and Budget; and requirements of DoD. The team that performed the Consolidated System Evaluation cited 57 conditions requiring corrective actions and made specific recommendations to correct those conditions. The DFAS system manager should have coordinated the FY 1994 annual review with the team that performed the Consolidated System Evaluation. Coordination would have permitted the manager to determine the specific accounting system control weaknesses associated with the 57 conditions.

Industrial Fund Accounting System. The DFAS system manager for the Industrial Fund Accounting System did not coordinate the annual reviews with system users or document Review Guide responses. In FYs 1993 and 1994, the DFAS system manager affirmatively answered system user questions in the Review Guide without coordinating with the system user. The DFAS system manager's answers were based on his knowledge of accounting

[1]The accounting system that will be used until a decision is reached to develop a new system or to continue with the current system.

principles, accounting procedures, and accounting system capabilities. However, the documented responses may have been significantly different if the DFAS system manager had input on the user's practices and supporting documentation.

Standard Finance System. The DFAS system manager delegated completion of the FY 1994 review to a person who had no knowledge of or experience in management controls, did not understand many of the Review Guide questions, and did not document Review Guide answers. The reviewer answered many questions in the FYs 1993 and 1994 Review Guides as "not applicable" with an explanation that user input needed to answer the question was not obtained. Additionally, the FY 1994 annual review did not consider the results of Army Audit Agency Audit Report No. SR 94-485, "Audit of the Army's FY 1993 Financial Statements," August 30, 1994 (see Appendix B). The DFAS headquarters personnel advised the cognizant DFAS center director that previous audit report results should be considered in the next annual review.

Participation of System Manager and System User in Accounting System Reviews

Review Guide Questions Requiring User Input. Based on our analysis of the FY 1994 Review Guide and on subsequent visits to DISA WESTHEM field offices, we identified 55 of 208 Review Guide questions that required user input because the questions related to functional operations of DISA WESTHEM. We analyzed the 55 questions to determine the specific DISA WESTHEM accounting function covered by each question. Appendix F, Table F-1, summarizes the number of questions by accounting function and includes a representative question for each function. Table F-2 shows each Review Guide question by user function as determined by our analysis.

Coordinating User Participation. The DFAS system managers did not inform system users at DISA WESTHEM organizations that annual reviews would be performed. Further, DFAS system managers were not trained that user input was necessary for a reliable, accurate, and complete review.

Completing the Review Guide. The Review Guides completed for the Defense Business Management System and the Industrial Fund Accounting System were unreliable because in answering questions needing user input, DFAS system managers did not coordinate with users. In addition, the DFAS system manager for the Standard Finance System did not provide answers to questions that required user input.

Detecting the Need for User Input. A DFAS oversight team, which performed reviews of selected FY 1994 Review Guides in October 1994, detected the lack of user input for the FY 1994 annual review of the Standard Finance System. The DFAS system manager had noted on the FY 1994 Review Guide that certain questions could not be answered because user input had not

been obtained. The oversight team advised the appropriate DFAS center of the need for user input in conducting annual reviews. The oversight team recommended that the DFAS system manager obtain user input in performing the FY 1995 annual review. As of February 8, 1995, the DFAS oversight team had not completed reviews of the FY 1994 Review Guides for the Defense Business Management System or for the Industrial Fund Accounting System.

Training System Managers and System Users

DoD Training Requirements Related to Management Control Responsibilities. The Directive states that DoD managers shall be provided training in their management control responsibilities. However, DFAS system managers and DISA WESTHEM users were not trained to perform reliable annual reviews of accounting systems or to complete the Review Guide to accurately reflect the results of the annual review.

System Manager Training. The DFAS did not establish a training program to ensure system managers could effectively conduct annual reviews. System managers:

o had little or no previous experience performing and documenting accounting system reviews;

o did not understand the meaning or intent of certain Review Guide questions;

o were not certain as to which FYs 1993 and 1994 Review Guide questions required supporting documentation and, therefore, did not provide supporting documentation for those questions; and

o answered questions based on their knowledge of accounting system requirements rather than on accounting system capabilities.

System User Training. The DISA WESTHEM had not established a training program to ensure system users could effectively participate in annual system reviews. Training in completing the Review Guide was needed at three Defense megacenters we visited. Megacenter officials stated that DFAS did not provide annual review training to their system users and that the users were unfamiliar with the Review Guide. We believe that training is needed because personnel at the megacenters, as system users, are responsible for answering certain Review Guide questions (see Appendix F) concerning specific accounting transactions and related controls evaluated during the annual review.

DFAS Initiatives. The DISA WESTHEM personnel at the megacenters told us that DFAS had trained them in how to use the Industrial Fund Accounting System. The training, which is an ongoing program, covered a users manual and how to input accounting transactions. We believe that the DFAS training program could be expanded to include system user participation in annual reviews.

Documenting Annual Reviews of Accounting System Controls

DoD Requirements for Supporting Documentation for Annual Reviews. Although the Directive and the Regulation require supporting documentation for annual reviews, the annual reviews for FYs 1993 and 1994 did not have supporting documentation on the controls reviewed. The FY 1993 Review Guide stated that documentation was mandatory to support questions. System managers indicated on the FY 1993 Review Guide that supporting documentation was available; however, they did not provide the supporting documentation for our review. The FY 1993 Review Guide also specified that acceptable testing procedures, criteria, and standards be used in reviewing accounting system controls. The FY 1994 Review Guide did not specify that supporting documentation was required and did not specify using acceptable testing procedures, criteria, or standards in reviewing accounting system controls.

DoD Regulatory Guidance Related to Management Controls. The Directive requires that management controls be documented to ensure that specific control objectives are met. The Directive distinguishes between system documentation and review documentation. System documentation is written material on organizational structure, operating procedures, and responsibilities and authorities for accomplishing programs and activities. Review documentation is written material showing the type and scope of accounting system control reviews, key findings, and recommended corrective actions. The Directive states that all reviews of management controls should produce written materials documenting what was done and what was found. Annual accounting system reviews require both system documentation and review documentation to support answers to specific Review Guide questions.

Documentation was required to support affirmative responses to 112 questions on the FY 1994 Review Guide. None of the affirmative answers were supported by documentation. Of the 112 questions, 88 required system documentation and 24 required review documentation to include documentation on tests of accounting system controls. Appendix G, Table G-1 summarizes the 88 Review Guide questions requiring system documentation, shows the categories of system controls, and provides representative questions for each type of system control. Table G-2 lists, by key accounting requirement, each Review Guide question requiring system documentation. Appendix H, Table H-1 summarizes the 24 Review Guide questions requiring review

documentation, by type of review control, and provides representative questions for each type of review control. Table H-2 lists, by key accounting requirement, each Review Guide question requiring review documentation.

Air Force Audit Agency Identified Need for Documenting Annual Reviews. Air Force Audit Agency Report No. 93066024, October 3, 1994, emphasized the need for documentation to support accounting system reviews. The Air Force Audit Agency determined that a DFAS Defense Accounting Office did not maintain documentation to support the determination that an accounting system complied with key accounting requirements. The Air Force Audit Agency concluded that the Defense Accounting Office personnel who performed the review did not fully understand the review requirements or documentation needed to support their assessment, and, as a result, the Air Force was susceptible to waste, loss, or misappropriation. Appendix B provides additional details on the results of the Air Force audit.

Benefits of Documentation in Support of Annual Reviews. Documentation not only lends credibility to annual reviews, but also is needed so the review results can be relied on to expedite other reviews and audits. For example as a preparatory step in performing cyclical reviews of accounting systems, DFAS review teams requested that system managers provide documentation on completed transaction tests and on system controls. That documentation can also be relied on for financial statement audits. For example, the planning process for financial statement opinion audits and audits of accounting system controls could be expedited by analyzing documentation associated with annual reviews. Additional time needed for system managers and users to gather documentation for annual reviews should be minimal because Review Guide responses indicated that documentation should be readily available. Most important, annual accounting system reviews will be significantly strengthened by the documentation of previously reported accounting system weaknesses and management assurances that those weaknesses have been or will be corrected.

Considering Audits and Other Evaluations

In planning annual reviews, DFAS system managers did not use the results of other system audits, studies, and evaluations to identify potentially inadequate, weak, or vulnerable management controls. The FYs 1993 and 1994 Review Guides required system managers to consider other indicators of system performance, such as audit reports, system evaluations, and system change requests. The Review Guides specified that such performance indicators were to be gathered and reviewed and that the results were to be used in evaluating the accounting system. Further, the Review Guides required system managers to consider quality assurance reviews, audit findings and reports, past system evaluations, and software acceptance test results to determine the need to test controls over key accounting requirements. However, as described on pages 6 and 7 of the report, the system managers for the Defense Business Management System and the Standard Finance System did not consider the results of specific audits and evaluations. Appendix B describes the specific accounting system

weaknesses detected during those and other audits and evaluations of the three accounting systems in the audit scope. Because system managers did not consider the results of audits and other evaluations, annual reviews did not focus on documented accounting system weaknesses. As a result, annual reviews were not planned or performed to determine whether adequate corrective actions were planned or taken to correct accounting system control weaknesses cited in the reports.

Conclusion

The FY 1994 management control program for the Defense Business Management System, the Industrial Fund Accounting System, and the Standard Finance System, cannot be relied on to verify the accuracy, completeness, and reliability of DISA WESTHEM FY 1994 financial statements. Accounting system controls designed to prevent or detect material errors, omissions, and misstatements in DISA WESTHEM FY 1994 financial statements were not adequately reviewed to determine whether the controls were in place and working. Therefore, DISA WESTHEM financial statements may contain material errors, omissions, or misstatements and cannot be relied on in making informed business decisions. A copy of this report will be provided to the senior official responsible for management controls within the Defense Information Systems Agency and the Defense Finance and Accounting Service.

The Review Guide is a well-designed tool for performing annual reviews of accounting systems. The Review Guide questions are specifically designed to assist management in determining whether adequate accounting controls are in place and working to ensure that an accounting system is producing complete and reliable financial reports. If DFAS system managers and DISA WESTHEM system users are trained in and coordinate in properly completing and documenting the Review Guide, it will provide credible and useful data on whether an accounting system meets generally accepted Government accounting requirements.

Recommendations, Management Comments, and Audit Responses

Revised Recommendation. As requested in the DFAS comments on the draft report, we added the reference to DoD Regulation 7000.14-R in Recommendation 2.a.

1. We recommend that the Director, Defense Finance and Accounting Service and the Director, Defense Information Systems Agency, Western

Hemisphere establish a Memorandum of Agreement to provide the specific responsibilities for system managers and system users in performing the FY 1996 and subsequent annual reviews.

Management Comments. The DFAS nonconcurred, stating that a Memorandum of Agreement with DISA was not needed because existing guidance in the Review Guide and the Regulation require user participation in annual reviews. However, DFAS stated that the existing guidance would be reinforced to specifically require inclusion of selected system users in each annual accounting system review of migratory[2] and interim migratory accounting systems and would be considered in annual accounting system reviews of selected legacy[3] accounting systems. Also, memorandums transmitting annual Review Guides to DFAS centers would require user participation in annual accounting system reviews.

Audit Response. Although DFAS nonconcurred with the recommendation, the proposed user participation in annual accounting system reviews satisfies the intent of the recommendation.

2. We recommend that the Director, Defense Finance and Accounting Service:

a. Implement the requirements of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, and DoD 7000.14-R, "Financial Management Regulation," volume I, chapter 3, May 1993, by establishing a training program on the purpose, objective, scope, and performance of annual accounting system reviews for the system managers of the Standard Finance System, the Defense Business Management System, and the Industrial Fund Accounting System, and for system users at the Defense Information Systems Agency, Western Hemisphere.

Management Comments. The DFAS partially concurred, stating that training on the conduct of annual reviews is provided to participants at an annual DFAS Federal Managers' Financial Integrity Act section 4 conference.

The DFAS stated that some DoD Components do not participate in the annual conference and that some DoD Components do not have assigned section 4 coordinators. For DoD Components that do not participate in the annual conference, appropriate DFAS centers will provide guidance to assist system managers and selected system users on the conduct of annual system reviews. The DFAS also stated that system managers will be provided points of contact from appropriate DFAS centers and DFAS headquarters to answer specific questions concerning the conduct of annual accounting system reviews.

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[2]An existing or planned and approved automated information system that has been designated to support a functional process on a DoD-wide basis.

[3]An existing accounting system that has not been selected as a migratory or interim migratory automated information system.

b. Implement the requirements of DoD Directive 5010.38, "Internal Management Control Program," April 17, 1987, by specifying in the FY 1996 and subsequent System Manager/User Review Guides that system managers must retain system and review documentation supporting affirmative responses to System Manager/User Review Guide questions. Documentation must evidence that:

o accounting system controls are in place, and

o periodic control testing was performed to demonstrate that the controls were working as designed.

Management comment. The DFAS concurred, stating that the FY 1996 Review Guide will require systems managers to retain documentation supporting answers provided in the annual system review.

c. Direct system managers to consider the results of audits and other related evaluations of the accounting system controls in completing the FY 1996 and subsequent System Manager/User Review Guides.

Management Comments. The DFAS concurred, stating that the annual System Manager/User Review Guide will require system managers to examine prior reviews, evaluations, or audits and to consider any applicable audit finding or recommendation in the system review process. Further, DFAS will forward copies of audit findings on potential Federal Managers' Financial Integrity Act weaknesses to appropriate section 4 coordinators for consideration in their current year Federal Managers' Financial Integrity Act program.

3. We recommend that the Director, Defense Information Systems Agency, Western Hemisphere, issue a policy memorandum to the Directors, Defense megacenters, directing them to schedule training on the conduct of FY 1996 annual accounting system reviews for employees that perform accounting functions and functions related to the entry of accounting data into an automated accounting system for the Defense Finance and Accounting Service.

Management Comments. The DISA did not comment on a draft of this report. Therefore, we request that DISA provide comments in its response to the final report.

Part II - Additional Information

Appendix A. Scope and Methodology

Audit Scope

We judgmentally selected 8 of 16 assessable units at DISA WESTHEM to evaluate the effectiveness of the DISA WESTHEM FY 1994 management control program. In addition, we evaluated the annual reviews of three DFAS accounting systems used to prepare the DISA WESTHEM FY 1994 financial statements. The three accounting systems were the Industrial Fund Accounting System, the Defense Business Management System, and the Standard Finance System. Those three systems processed financial information for 46 of the 62 DISA WESTHEM reporting units. The 46 units reported FY 1994 revenues of $360 million (71 percent of FY 1994 revenues totaling $508 million). We selected revenues as a basis for the measurement of accounting system support, because DISA WESTHEM Plant, Property, and Equipment* accounts were processed through site-unique accounting systems and were not reflected in DFAS accounting systems. We did not evaluate the process for cyclical reviews of accounting systems.

Audit Methodology

For each of the eight assessable units, we:

o determined the extent to which management control objectives and techniques were documented by unit managers;

o interviewed the assessable unit managers to determine the methodology they used in performing risk assessments of their units;

o evaluated the methodology, scope, and results of management control reviews performed by unit managers;

o determined whether unit managers received training in performing annual reviews of management controls; and,

o obtained and reviewed the managers' performance standards for inclusion of management control responsibilities as a critical element.

We also reviewed the reasonableness of the assessable unit structure at DISA WESTHEM and obtained and evaluated the DISA WESTHEM FY 1994 Annual

*Plant, Property, and Equipment is the selected account that will be discussed in Report No. 95-209, "Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994," May 31, 1995.

Assurance Statement to determine whether it clearly represented the work performed by assessable unit managers. Finally, we evaluated DISA and DISA WESTHEM oversight of the management control program.

For each of the three DFAS accounting systems, we:

o evaluated the FYs 1993 and 1994 accounting system review guidance and oversight DFAS provided to the system managers;

o evaluated the FYs 1993 and 1994 annual reviews performed by system managers, and interviewed system managers to determine the methodology they used in completing the reviews;

o reviewed all available documentation supporting the accounting system reviews;

o determined the extent to which a system manager relied on the input from DISA WESTHEM or other DFAS components in completing the reviews; and,

o analyzed other accounting system reviews performed by DFAS.

We also interviewed officials at three DISA WESTHEM Defense megacenters to determine the extent to which personnel at the megacenters performed the accounting functions covered by the annual reviews and the extent to which those personnel participated in the FY 1994 annual reviews.

We reviewed management control and accounting system review documentation dated from October 1992 through November 1994. We did not use computer-processed data or statistical sampling procedures to evaluate the adequacy of the DISA WESTHEM management control program or the DFAS accounting system reviews.

Audit Period, Standards and Locations. We performed this financial related audit from December 1994 through February 1995 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls considered necessary. Appendix J lists the organizations visited or contacted.

Appendix B. Summary of Prior Audits and Other Reviews

During the last 5 years, the General Accounting Office and the Army Audit Agency issued audit reports discussing the Standard Finance System, the Naval Audit Service issued one report discussing the Industrial Fund Accounting System, and the Air Force Audit Agency issued one report discussing the annual accounting system review process. Also, DFAS issued a Consolidated System Evaluation on a major subsystem of the Defense Business Management System.

General Accounting Office Report No. GAO/AIMD-93-1 (OSD Case No. 9276-E), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Years 1992 and 1991," June 30, 1993. The report states that inadequacies in the Army's accounting system and the system's failure to comply with DoD and Army financial policies prevented the General Accounting Office from expressing an opinion on the financial statements. Further, several weaknesses discussed in the report were repeat findings from the audit of the Army's FY 1991 financial statements. The report also states that after a $196 billion correction for computer errors, an additional $7 billion adjustment, for which no supporting documentation existed, was necessary to reconcile general ledger balances with budgetary data that DFAS considered to be accurate. Although the report does not specifically reference the Standard Finance System, that system and a DFAS processing center provide a significant portion of the accounting services for the Army.

Army Audit Agency Report No. SR 94-485, "Audit of the Army's FY 1993 Financial Statements," August 30, 1994. The report discusses FY 1993 Army financial transactions at the DFAS-Indianapolis Center and six accounting offices. The audit scope included an evaluation of financial transactions supporting financial data processed by the Standard Finance System, one of five primary accounting systems. The Army Audit Agency determined that the accounting systems and processes did not produce auditable financial statements required by the Chief Financial Officers Act.

The Army Audit Agency found accounting system weaknesses concerning:

- lack or inadequacy of subsidiary ledgers;
- failure to properly post financial transactions to the general ledger;
- review, identification, and correction of inappropriate or incorrect general ledger balances;
- accounting personnel lacking knowledge of how to use the general ledger, evaluate the relationship between accounts, research and correct errors, and maintain adequate filing systems; and
- inadequate audit trails for collection and disbursement vouchers.

The Army Audit Agency disclaimed an opinion on the Army's cash flow statement and made specific recommendations to correct the conditions. The Army generally concurred with the recommendations and stated that corrective actions would be implemented. The DFAS did not agree with the Army auditors' recommendation to establish subsidiary ledgers for general ledger accounts in the Standard Finance System and another Army accounting system, because the DFAS believed that adequate subsidiary ledgers already existed. The Army Audit Agency stated that the subsidiary ledgers referenced in the DFAS comments do not retain transaction-level detail. Therefore, the Army auditors will not be able to test general ledger balances and opine on future Army financial statements until the Army is able to provide an automated file of detailed transactions.

Naval Audit Service Report No. 036-S-92, "Followup Audit of Automated Cost Accounting System for Naval Regional Data Automation Centers and Naval Data Automation Facilities," March 18, 1992. The report discussed Navy data processing sites using the Navy Industrial Fund Accounting System. The Naval Audit Service determined that management's actions were generally effective in eliminating previous weaknesses in accounting system controls. However, Navy auditors found that data processing sites performed customer work that exceeded available customer funding and that management controls were not adequate to prevent the cause and elimination of customer overruns. The Naval Audit Service also found errors in data entry and source documentation. Navy auditors recommended specific actions to correct the conditions, and the Navy agreed with the recommendations, stating that corrective actions were or would be implemented.

Air Force Audit Agency Report No. 93066024, "Review of Application Controls Within the Financial Inventory Accounting and Billing System," October 3, 1994. The audit was part of a series of audits related to the Chief Financial Officers Act of 1990. The report states that a Defense Accounting Office inappropriately reported that the Financial Inventory Accounting and Billing System was in compliance with accounting and management control requirements of the Federal Managers' Financial Integrity Act because the Defense Accounting Office had not performed system and transaction testing needed to support that assessment. Further, as part of the review, the Air Force Audit Agency determined that the Defense Accounting Office did not maintain documentation of other analyses it performed to support the conclusion that the Financial Inventory Accounting and Billing System complied with key accounting requirements prescribed in DoD Regulation 7000.14-R, "Department of Defense Financial Management Regulation," May 1993.

The report concludes that Defense Accounting Office personnel who performed the review did not fully understand the review requirements or documentation needed to support their assessment, and, as a result, the Air Force was susceptible to waste, loss, or misappropriation of $41 billion of assets processed by the Financial Inventory Accounting and Billing System.

The Air Force recommended that DFAS perform required system and transaction testing and maintain test results and other documentation to support future reviews of the system. The DFAS concurred in principle, but stated that

DFAS developed the Review Guide to describe the specific steps system managers should follow in performing annual reviews. The DFAS also stated that the Review Guide does not require system managers to perform system and transaction testing and that the Review Guide was the only documentation required by DFAS to support a general review. The DFAS evaluation teams performed consolidated system evaluations, which are detailed reviews of accounting systems that include system and transaction testing.

The Air Force Audit Agency stated that the FY 1994 Review Guide was significantly weakened when DFAS deleted the following significant requirements that had been included in the FY 1993 Review Guide. The FY 1993 Review Guide required that system managers:

o certify the compliance of their system with the key accounting requirements in DoD Regulation 7000.14-R;

o perform system and transaction testing to validate compliance of the systems with key accounting requirements; and

o retain assessment and supporting documentation for 1 year for possible audit review.

The Air Force auditors stated that DFAS should reinstitute the requirements in the Review Guide to make it an effective review tool. The Air Force Audit Agency referred this issue to the Inspector General, DoD. This report discusses the need for effective annual reviews of accounting system controls and the need for the FY 1996 and subsequent year Review Guides to specify retaining system and review documentation.

Defense Finance and Accounting Service. The DFAS issued the Consolidated System Evaluation report, "Evaluation of the Appropriated Accounting Sub-System of the Defense Business Management System at Defense Finance and Accounting Service-Columbus Center," April 15, 1994. The purpose of the evaluation was to determine whether the Defense Business Management System was operating in accordance with the accounting principles promulgated by the General Accounting Office as implemented by the Office of Management and Budget and DoD. The scope of the evaluation included a review of selected transactions performed by system managers and users. The evaluation stated that the Defense Business Management System did not conform to the principles, standards, and related requirements of the General Accounting Office and Office of Management and Budget guidelines and DoD requirements. The evaluation team identified 57 conditions and made specific recommendations to correct the conditions. The evaluation team found the following weaknesses:

o management controls were not in place to prevent duplicate vendor payments,

o reconciliations were inconsistent between accounting branches,

o work areas lacked standard operating procedures,

- additional training was needed by both system managers and users,
- multiple sources performed data entry,
- large backlogs of transactions existed in some areas, and
- the Defense Business Management System did not use the standard general ledger.

The DFAS Columbus generally concurred with recommended actions or recommended acceptable alternative actions. The evaluation team is tracking the status of corrective actions.

Appendix C. Other Matters of Interest

DISA WESTHEM Management Control Program. In addition to accounting system control weaknesses discussed in the finding, we detected other weaknesses in DISA WESTHEM management control program. The DISA WESTHEM FY 1994 management control program did not fully comply with the requirements of DISA WESTHEM Instruction 630-125-6, "DCA Internal Management Control Program," July 23, 1987. Specifically, DISA WESTHEM did not:

o properly segment its assessable unit structure because its 16 megacenters, which comprised the majority of its mission and resources, were categorized as only one of 16 assessable units;

o establish a management control plan;

o perform timely risk assessments;

o perform management control reviews for 7 of 8 units; and

o include management control program duties in the performance plans of assessable unit managers as a critical performance element.

During the audit, DISA WESTHEM implemented or planned actions to correct the weaknesses in its program. The DISA WESTHEM resegmented its assessable unit structure to more accurately reflect its mission; prepared a 5-year management control plan in FY 1995, requiring in-depth risk assessments and management control reviews for all assessable units; and issued a directive requiring that performance plans for assessable unit managers include management control duties as a critical performance element. These actions, if fully implemented, will correct the weaknesses.

Material Weakness in Computer System Security. The DISA WESTHEM referenced an uncorrected material internal control weakness concerning computer system security in its FY 1994 Annual Statement of Assurance. The weakness was detected during prior Inspector General, DoD, audits. The following DoD audit reports identified numerous occurrences of the material management control weakness that adversely affected computer system security at DISA WESTHEM information processing centers:

o Audit Report No. 94-065, "Controls Over Operating System and Security Software Supporting the Defense Finance and Accounting Service," March 24, 1994;

o Audit Report No. 94-060, "General Controls for Computer Systems at the Information Processing Centers of the Defense Information Services Organization," March 18, 1994;

o Audit Report No. 93-133, "Controls Over Operating System and Security Software Supporting the Defense Finance and Accounting Service," June 30, 1993; and,

o Audit Report No. 93-002, "Controls Over Operating System and Security Software Supporting the Defense Finance and Accounting Service," October 2, 1992.

The Director, DISA WESTHEM, concurred with the findings and recommendations, and provided responsive corrective actions.

The Inspector General, DoD, performed a followup audit to verify that corrective actions on previously reported computer system security weaknesses were implemented. Inspector General, DoD, audit report "Controls Over Operating System and Security Software and Other General Controls for Computer Systems Supporting the Defense Finance and Accounting Service," Report No. 95-263, June 29, 1995, states that DISA WESTHEM made commendable efforts to implement prior audit recommendations at the audited locations, but that additional corrective actions were still required. Management concurred with the report recommendations and planned actions, which will correct the conditions noted during the audit.

Appendix D. Description of Accounting Systems

Industrial Fund Accounting System. The Industrial Fund Accounting System is a batch-oriented Defense Business Operations Fund accounting system that is custom-designed to support fee-for-service providers of Government information technology and services. The Industrial Fund Accounting System processed only about $22.7 million of DISA WESTHEM FY 1994 total customer revenues of $508 million. However, on November 16, 1994, the Defense Business Operations Fund Corporate Board selected the Industrial Fund Accounting System as the interim approved system for the information processing business area. Therefore, DISA WESTHEM plans to use the Industrial Fund Accounting System to process all accounting transactions by the beginning of FY 1996. The Industrial Fund Accounting System consists of three subsystems: accounting, budgeting, and chargeback.

Accounting Subsystem. The accounting subsystem consists of eight transaction driven applications and an on-line data entry and telecommunications network. The accounting subsystem is designed to support multiple remote entities and has the capability to meet corporate financial reporting requirements. The eight applications include a property accounting system and a general ledger system that provide trial balances and the required financial statements.

Budget Subsystem. The budget subsystem is a real-time, on-line database management information system used to develop Defense Business Operating Fund billing rates using the fee-for-service concept.

Chargeback Subsystem. The chargeback subsystem provides billing and utilization data for human and other resources involved in the production of data processing services. The process is accomplished through a combination of capturing data from automated logs (for example, central processing unit time, input and output time, and tape mounts) from a variety of computer hardware, and labor and nonlabor costs passed from the accounting subsystem through an automated interface to the customer.

Defense Business Management System. The Defense Business Management System is a fully automated integrated management system that consists of four major subsystems. The four subsystems are the Personnel Subsystem, the Payroll Subsystem, the Resource Administration Subsystem, and the Appropriation Accounting Subsystem. All Defense Business Management System subsystems, except the Personnel Subsystem, perform finance and accounting related functions. In FY 1994, the Defense Business Management System processed about $246 million in revenues for DISA WESTHEM, or about 48 percent of DISA WESTHEM FY 1994 revenues. Major Defense Business Management System accounting functions include:

- general ledger accounting;
- budgetary accounting and funds control;

o cost accounting, including job order cost accounting and unit cost accounting capability;

o accounting for receivables and payables;

o a fully integrated civilian payroll system, and military payroll accounting functions; and

o accounting and managerial reporting.

Standard Finance System. The Standard Finance System is a fully automated, Army-wide standard accounting system designed to provide comprehensive accounting support at Army installations and effective general ledger control over all assets. In FY 1994, the Standard Finance System processed about $91.2 million in revenues for DISA WESTHEM, or about 18 percent of DISA WESTHEM FY 1994 revenues. The Standard Finance System was developed by the Army to provide full disclosure of financial information of Army activities, general ledger control and accountability of funds and other assets, and data required to support budgetary and management decisions.

Appendix E. Key Accounting Requirements

The DFAS established 13 key accounting requirements, which are included in the Regulation. The FY 1993 and FY 1994 Review Guides contain questions designed to assist system managers and users in determining whether accounting system controls are in place and working for the 13 key accounting requirements. Responses to questions related to seven key accounting requirements are mandatory and must be completed for all DoD accounting systems. The Review Guides require the reviewer to determine the applicability of the other six key accounting requirements to the specific accounting system under review.

Key Accounting Requirement (KAR) 1, General Ledger Control, and Financial Reporting

The system must have general ledger control and maintain a general ledger account structure for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources. The system must list both control and subsidiary general ledger accounts by titles and numbers with a definition of each account and be based on double-entry accounting. Subsidiary accounts shall be reconciled to the control accounts at least monthly. This KAR is applicable to all systems.

KAR 2, Property and Inventory Accounting

The system must account in quantitative and monetary terms for the procurement, receipt, issue, and control of plant property, equipment, inventory, and material. Property records should contain information on equipment description, acquisition date, original cost, estimated life, location, and depreciation. Proper accounting controls should exist for Government-owned property held and used by contractors. Inventory accounting must include accounting controls over the acquisition and issuance of materials, the comparison of physical inventories and records, the planning for procurement and utilization, and effective custody of the materials.

KAR 3, Accounting for Receivables Including Advances

The system must account for all accounts receivable (all debts to the U.S. Government). Accounts receivable shall be recorded accurately and promptly to provide timely and reliable financial information. Accounts receivable shall be reduced upon collection of funds, which shall be deposited as expeditiously as possible and recorded in the accounting records or when offset by previously established collateral. For uncollectible amounts, the accounts receivable balance should be reduced. An allowance for uncollectible accounts must be established to provide full financial disclosure. The accounts receivable process should include documenting the efforts made to collect delinquent debts.

Advances shall be recorded as assets until receipt of the goods or services or until contract terms are met. Advances must be promptly recorded and subject to accounting controls and must be reconciled to general ledger control accounts.

KAR 4, Cost Accounting

Cost accounting must involve accounting analysis and reporting on costs of production of goods or services, or operation of programs, activities, functions, or organizational units. Cost accounting shall be provided in the accounting system, as necessary, to support pricing decisions, productivity improvement decisions, performance measurement, efficiency comparisons of like activities, and activities of the Defense Business Operations Fund. Defense Business Operations Fund accounting shall provide an effective means for controlling the cost of goods and services produced or furnished by Defense Business Operations Fund activities. Cost accounting should be used to measure the costs of specific projects and processes in determining operating results. All applicable costs should be accumulated in the accounting system.

KAR 5, Accrual Accounting

Accrual accounting must recognize the accountable aspects of financial transactions or events as they occur. Transactions may be recorded in accounting records as they occur or be adjusted monthly to the accrual basis. Accrual accounting should be used to meet the specific needs of management and Congress.

Accrued expenditures and revenues must be recorded only when supported by prescribed documentary evidence on the basis of initial documentation received and must be adjusted subsequently, if necessary, upon receipt of accurate documentation. Examples of acceptable initial documentation include receiving reports, bills of lading, job description sheets, certified unpaid invoices, and journal vouchers showing administrative estimates by responsible officials.

When liabilities are incurred as work is performed rather than when deliveries are made, accruals must be recorded from performance reports for the affected accounting period. Unpaid personnel compensation and benefits that have been earned as of the end of the pay year must be accrued in full or in part, and should be recognized annually in the financial statements. Accrued payroll for the salaries and wages for civilian and military personnel and related accounts must be recorded and reconciled with the actual payroll. This KAR is applicable to all accounting systems.

KAR 6, Military and Civilian Payroll Procedures

Payroll systems must incorporate controls of both gross and net payroll amounts and payroll deductions to ensure smooth payroll processing action and to minimize incorrect payments. Procedures will be available to verify that only authorized deductions are made from pay and that all deductions are supported by proper documentation. Accounting entries for authorized deductions from pay must be verified. Timely, accurate, and complete individual and subsidiary records are maintained for all payroll and related accounts. The general ledger and personnel records shall be reconciled to payroll records.

KAR 7, System Controls (Fund and Internal)

The system must show the appropriations and funds to be accounted for and a description of the accounting entity's proposed fund distribution and control process. Administrative fund controls must verify that funds are used economically, efficiently, and only for properly authorized purposes and prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements.

The system must have adequate management controls to prevent, detect, and correct errors and irregularities that may occur within the system. Separation of duties and responsibilities must be maintained for initiating, authorizing, processing, recording, and reviewing transactions.

Automated systems must have system security and integrity for authorized processing to include procedures and controls that protect hardware, software, and documentation from physical damage and unauthorized access. The KAR 7 is applicable to all accounting systems.

KAR 8, Audit Trails

The financial transactions on accounting system processes must be adequately supported with pertinent source documents. All transactions, including those

that are computer-generated and computer-processed, must be traceable to individual source records maintained in the accounting system. Audit trails enable tracing a transaction from its source to the resulting record or report and vice versa. A key test of the adequacy of an audit trail is whether tracing the transaction from the source or from the result will permit verification to the amount recorded or reported. The KAR 8 is applicable to all systems.

KAR 9, Cash Procedures and Accounts Payable

The system shall be designed to verify timely payments based on properly approved disbursement documents. Payment procedures must comply with the Prompt Payment Act. Cash discounts should be taken when determined to be financially advantageous to the DoD. Cash shall be deposited as expeditiously as possible and immediately recorded.

Accounts payable should be recorded when goods or services are received. For items manufactured to specifications, the accounting system shall reflect the appropriate account payable, including contract retentions, for each accounting period based on contract terms or on reasonable estimates of unbilled contractor performance.

Accounts payable for services performed shall be determined based on performance as evidenced by payroll records, progress billings, or other available data. Reasonable estimates of the cost of services performed before the end of a reporting period shall be made for annual financial reporting purposes in the absence of invoices or other available data.

KAR 10, System Documentation

The accounting system must have adequate system documentation, including documented interfaces between accounting system segments. The system must also adequately document the functional user's accounting requirements. Such documentation must be available in user manuals and subsystem specifications. The detailed documentation must be comprehensive and shall include a combination of descriptions of processes; flowcharts and narrative description; diagrams; basic accounting entries, including adjusting and closing entries; illustrations or samples of source documents for input; and reports. It shall also include management controls incorporated within the accounting system. The documentation must demonstrate conformance with DoD requirements for system documentation and should facilitate maintenance operations and transaction testing. The documentation shall have enough detail so that testing of the system could cover an entire transaction, from initial authorization through processing, posting to the accounts, and reporting. The system documentation shall be created to be easily understood by computer personnel and system accountants assigned to develop applicable software or to develop the flow of the accounting review process and shall demonstrate readily to

users, auditors, and evaluators the system's conceptual processes and procedures. The documentation should indicate the mission, organization, description, objectives, financial management requirements, and boundaries of the system. The KAR 10 is applicable to all accounting systems.

KAR 11, System Operations

Accounting system operations shall be adequately planned and organized to assure that financial management and accounting objectives are met in an economical and efficient manner. Financial systems shall not only contain all data required to achieve their intended purposes, but also be simple to operate.

The existing and planned hardware should be adequate to efficiently process current and projected future transactions and should be sufficiently compatible to interface effectively with other systems.

Detailed procedures for system operation and maintenance must be established. Also, periodic system reviews must be performed to assure that the system complies with accounting system requirements, that operating problems are promptly identified and corrected, and that enhancements are incorporated as appropriate. The KAR 11 is applicable to all accounting systems.

KAR 12, User Information Needs

The accounting system must satisfy users' needs of quality, accuracy, timeliness, and reliability to facilitate management's decisionmaking process. The system shall also satisfy users' reporting requirements, particularly as they relate to end of the month reports. The KAR 12 is applicable to all systems.

KAR 13, Budgetary Accounting

The accounting system shall support budget formulation and budget requests and control budget execution. Programming, budgeting, accounting, reporting, classification, and coding structure should be uniform, mutually consistent, and synchronized with the organizational structure so that actual activity can be compared with enacted budgets, to support future budget formulation for each activity. Presidential, congressional, and DoD decisions shall be recorded in the system, which shall be able to track such decisions. The system shall record budget resources at the appropriate level and shall account for all budget and appropriation accounts prescribed by DoD.

Appendix F. Key Accounting Requirement Questions Needing User Input

Table F-1 summarizes the number of Review Guide questions related to the accounting functions performed by DISA WESTHEM. The footnotes include a brief description of the questions relating to each function and a representative question taken from the Review Guide.

Table F-1. Review Guide Questions Requiring User Input by Accounting Function

Accounting Function	No. of Questions
Authorization function[1]	12
Recording function[2]	16
Classification function[3]	10
Analysis function[4]	17
Total	**55**

[1]Questions concern accounting policies, procedures, controls, and selected tests that ensure only authentic and approved accounting transactions are recorded.
Sample question. Are key duties and responsibilities for authorizing, processing, recording, reviewing transactions, issuing or receiving assets, inventory control, expenditure processing, assigned to separate individuals?

[2]Questions cover accounting policies, procedures, controls, and selected tests that ensure the accuracy and completeness of accounting transactions.
Sample question. Do you record in your financial records the value for property and equipment acquired by transfer without reimbursement at the transferor's recorded acquisition cost minus accumulated depreciation; plus transportation, installation, and other costs of obtaining the property into use?

[3]Questions cover accounting policies, procedures, controls, and selected tests that ensure financial transactions are input into the proper account or subaccount.
Sample question. Are repair and maintenance costs incurred to keep property in satisfactory operating condition accounted for as current operating costs?

[4]Questions may cover accounting policies, procedures, and controls, but primarily are concerned with control tests that verify the accuracy, completeness, and integrity of accounting transactions.
Sample question. Are inventories periodically verified and accounting records adjusted accordingly?

Table F-2 classifies each Review Guide question related to a DISA WESTHEM accounting function.

Table F-2. Review Guide Questions Requiring User Input

KAR[1]	User Accounting Function[2]	Question Numbers
2	Recording Function Classification Function Analysis Function	3, 6, 9 2, 4, 5, 8 7, 10
3	Authorization Function Recording Function	5, 10 2, 8, 9
4	Recording Function Classification Function	4 3
5	Recording Function Classification Function	1, 2, 3 4
6	Authorization Function	15, 21
7	Authorization Function Recording Function Classification Function Analysis Function	6, 10, 11 5, 9 2, 3 4, 8
8	Authorization Function	2, 3
9	Authorization Function Recording Function Classification Function Analysis Function	9, 20 1, 15 3 5, 7, 10, 16, 17, 18, 19, 21
11	Authorization Function Recording Function Analysis Function	11 10 9
12	Classification Function Analysis Function	5 2, 7, 8, 10
13	Recording Function	5

[1]The key accounting requirements are described in Appendix E.

[2]For each key accounting requirement, we categorized the review questions, using the accounting system function performed by users as described in DoD Financial Management Regulation 7000.14-R, volume 1, May 1993.

Appendix G. Key Accounting Requirement Questions Needing System Documentation

Table G-1 summarizes the number of Review Guide questions requiring supporting evidence for affirmative answers. The footnotes include a brief description of the questions relating to each system control and a representative question taken from the Review Guide.

Table G-1. Review Guide Questions Requiring Accounting System Documentation

System Controls	No. of Questions
System capability[1]	25
System control procedure[2]	25
System output[3]	6
System security controls[4]	5
User records[5]	14
User control procedure[6]	13
Total	**88**

[1]Questions concern accounting capabilities of the automated system.
Sample question. Does the system documentation describe the system objectives and include diagrams of modules or accounting processing cycles with explanatory notes?

[2]Questions cover automated procedural controls for accounting information in the automated system.
Sample question. Does the system employ effective procedures to prevent duplicate payments?

[3]Questions cover specific output documents of the automated accounting system.
Sample question. Does the component maintain reporting schedules and a list of system-generated reports, the report due dates, and the report recipients?

[4]Questions cover security controls built into the automated accounting system.
Sample questions. Are files adequately protected from loss or unauthorized changes while being accessed and maintained?

[5]Questions cover various aspects of transactions recorded by system users.
Sample question. Do you record the acquisition and construction of capital assets at cost plus the costs of construction, transportation, installation, handling, and storage costs and any related costs of obtaining and preparing the property?

[6]Questions cover system user accounting controls.
Sample question. Do audit trails exist from source documents to financial statements and vice versa?

Table G-2 classifies each Review Guide question related to system controls as determined by our analysis.

Table G-2. Review Guide Questions Requiring Accounting System Documentation

KAR[1]	Review Category[2]	Question Numbers
1	System capability System control procedure System output	1, 2, 15, 20 7 11, 12, 17
2	System capability User records	7 2, 3, 4, 5, 6, 8, 9
3	User records User control procedure	2 5, 10
4	System capability System procedure	1, 2, 3, 11 8
5	User control procedure	3, 4
6	System capability System procedure System output User records User control procedure	19 2, 5, 6, 8, 10, 11, 14, 17 4 2 15, 21
7	System capability System procedure User records User control procedure	1, 2, 3, 7, 14 16, 17, 18, 19, 21, 22, 23 6, 9 8, 10
8	System procedure User control procedure	1, 4 2, 3

See footnotes on next page.

KAR[1]	Review Category[2]	Question Numbers
9	System capability System procedure User records User control procedure	23 14 1, 7, 9 9, 20
10	System capability System procedure	5, 6, 8, 9 7
11	System capability System procedure System security	6 7, 8 10, 11, 12, 13
12	System capability System procedure System output System security	6 10 1, 2 4
13	System capability	1, 2, 3, 4, 6

[1]The key accounting requirements are described in Appendix E.

[2]For each key accounting requirement, we categorized the questions based on our analysis of the type of documentation required by the question.

Appendix H. Key Accounting Requirement Questions Needing Review Documentation

Table H-1 summarizes the number of Review Guide questions requiring supporting evidence for affirmative answers. The footnotes include a brief description of the questions relating to each review control and a representative question from the Review Guide.

Table H-1. Review Guide Questions Requiring Review Documentation

Type of Review Control	No. of Questions
Account reconciliations[1]	6
Account analyses and comparisons[2]	4
Control testing[3]	9
Other reviews[4]	5
Total	**24**

[1]Questions concern accounting reviews to determine whether related account balances agree or whether actual assets support account balances.
Sample question. Are subsidiary accounts reconciled to control accounts?

[2]Questions concern reviews to determine the propriety of account balances and the propriety of accounting entries supporting account balances.
Sample question. Are abnormal account balances identified, investigated, and corrected in a timely manner?

[3]Questions concern specific tests designed to determine whether accounting transaction and processing controls are adequate.
Sample question. Did acceptance testing cover the entire flow of transactions from initial authorization through processing, posting to the accounts, and reporting?

[4]Questions cover reviews not included in the above categories.
Sample question. Is the propriety of individual user and terminal authority levels periodically reviewed?

Table H-2 classifies each Review Guide question related to review controls.

Table H-2. Review Guide Questions Requiring Review Documentation

KAR[1]	Review Documentation Category[2]	Question Numbers
1	Account reconciliation Account analyses and comparisons Control testing	3 6, 9 10
2	Account reconciliation	10
4	Account analyses and comparisons Other reviews	10 9
5	Account reconciliation	6
6	Account reconciliation	22, 23, 24
7	Control testing	4, 15
8	Control testing	3
9	Control testing Other reviews	10 18
10	Control testing	2, 3, 4
11	Control testing Other reviews	15 9, 14
12	Account analyses and comparisons Other reviews	9 5

[1]The key accounting requirements are described in Appendix E.

[2]For each key accounting requirement, we categorized the questions based on our analysis of the type of review documentation required by the question.

Appendix I. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
1.	Management Control. Improves the reliability and quality of annual reviews.	Nonmonetary.
2.a.	Management Control. Provides DFAS and DISA WESTHEM employees necessary skills to perform their responsibilities in performing annual reviews.	Nonmonetary.
2.b.	Management Control. Improves accuracy and usefulness of annual accounting system reviews.	Nonmonetary.
2.c.	Management Control. Strengthens the annual review process and improves the reliability and quality of annual reviews.	Nonmonetary.
3.	Management Control. Results in DISA WESTHEM personnel being adequately trained to participate in annual reviews.	Nonmonetary.

Appendix J. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Department of the Navy

Auditor General, Naval Audit Service

Defense Agencies

Defense Finance and Accounting Service, Arlington, VA
- Defense Finance and Accounting Service, Richmond Detachment, Richmond, VA
- Defense Finance and Accounting Service, Indianapolis, IN
- Defense Finance and Accounting Service, Columbus, OH
- Defense Finance and Accounting Service, Cleveland, OH
- Defense Finance and Accounting Service, Pensacola, FL
- Defense Accounting Office, Fort Ritchie, MD

Defense Information Systems Agency, Arlington, VA
- Defense Information Systems Agency, Western Hemisphere, Denver, CO
- Defense Megacenter, Dayton, OH
- Defense Megacenter, Chambersburg, PA
- Defense Megacenter, Mechanicsburg, PA
- Information Processing Center, Pensacola, FL

Appendix K. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency
  Director, Defense Information Systems Agency, Western Hemisphere
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
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- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Part III - Management Comments

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

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DFAS-HQ/AD

JUN 27 1995

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT DIRECTORATE, INSPECTOR GENERAL, DOD

Subject: Revised Response to DoDIG Draft Report, "Management Control Program at Defense Information Systems Agency, Western Hemisphere," dated April 11, 1995, (Project No. 4RE-2005.01)

In a memorandum dated May 12, 1995, subject as above, we provided comments as requested in your memorandum dated April 11, 1995, to recommendations directed to the Defense Finance and Accounting Service (DFAS) in the subject report. After reviewing our previous comments, I determined that our comments warranted revision. At a meeting on June 13, 1995, between representatives of your office and the DFAS, we discussed the draft revised DFAS comments. Based on those discussions, our revised comments are attached.

My point of contact is Mr. William J. deBardelaben. He may be contacted on (703) 607-1581/79.

Edward A. Harris
Deputy Director for Business Funds

Attachment

Revised Response to DoDIG Draft Report, "Management Control Program at Defense Information Systems Agency, Western Hemisphere," dated April 11, 1995, (Project No. 4RE-2005.01)

- **RECOMMENDATION 1:** Director, Defense Finance and Accounting Service and the Director, Defense Information System Agency, Western Hemisphere establish a Memorandum of Agreement to provide the specific responsibilities for system managers and system users in performing the FY 1996 and subsequent annual reviews.

  DFAS COMMENTS: Nonconcur. DFAS does not concur with the need for a Memorandum of Agreement with system users. The requirement that system managers and users participate in the completion of annual systems reviews is stated in the Defense Finance and Accounting Service (DFAS) Systems Manager/User Review (SM/UR) Guide and in the DoD Financial Management Regulation, FMR 7000.14-R, Chapter 3, Volume 1. DFAS, however, will reinforce these guidances by requiring that selective "users," where appropriate, be included in each systems review. Additionally, user participation in systems reviews will also be stated in the transmittal memorandum accompanying the SM/UR Guide. Appropriate user participation will be required for interim migratory and migratory systems reviews and considered for selected legacy systems reviews.

- **RECOMMENDATION 2:** Director, Defense Finance and Accounting Service:

  a. Implement the requirements of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, by establishing a training program on the purpose, objective, scope, and performance of annual accounting system reviews for the system managers of the Standard Financial System, the Defense Business Management System, and the Industrial Fund Accounting System, and for the Defense Information System Agency, Western Hemisphere system users.

  b. Implement the requirements of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, and DoD Financial Management Regulation, FMR 7000.14-R, Volume 1, May 1993, by specifying in the FY 1996 Systems Manager/User Review Guide that system managers must retain system and review documentation supporting affirmative responses to Review Guide questions. Documentation must evidence that:

  - accounting system controls are in place, and

1 Attachment

Final Report Reference

o periodic control testing was performed to demonstrate that controls were working.

c. Direct system managers to consider the results of audits and other related evaluations of the accounting system controls in completing the FY 1996 System Manager/ User Review Guide.

DFAS COMMENTS TO RECOMMENDATION 2.a.: Partially concur. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, is not the only reference for this issue. DoD Directive 5010.38, paragraph D.5. states: "Specific policies for the evaluation of Internal Management Controls that are an integral part of accounting systems are prescribed in DoD Accounting Manual, 7220.9-M, Chapter 12." DoD 7220.9-M, Chapter 12 was replaced by the DoD Financial Management Regulation, FMR 7000.14-R, Volume 1, Chapter 3, "Accounting System Conformance, Evaluation, and Reporting." Suggest that the reference to DoD Directive 5010.38 be supplemented with a reference to the FMR 7000.14-R.

Revised

Interim guidance is issued in the annual DFAS SM/UR Guide and during the annual DFAS FMFIA Section 4 Conference held for all DoD Components. The FMR 7000.14-R is being revised to reflect interim revisions and new and emerging OMB guidance resulting from the revised OMB Circular A-123 which is scheduled to be finalized midsummer 1995.

Current OMB circulars and DoD directives place the responsibility for compliancy of FMFIA systems on the individual systems managers, and require that annual FMFIA self-evaluations be based on the collective knowledge of the managers gained from the daily operation of agency programs and systems. Therefore, systems managers are responsible for assigning knowledgeable, experienced, and fully qualified individuals to complete the systems reviews. The DFAS SM/UR Guide is designed so that qualified accountants should be able to understand and respond properly to all requirements and questions. Should questions arise, DFAS Headquarters and Center points-of-contact have been provided. At the annual DFAS FMFIA Section 4 Conference, training in the execution of systems reviews is provided to all participants. However, not all DoD Components participate in the annual conferences; neither do all DoD Components have FMFIA Section 4 coordinators. For those systems managers and selective "users" that do not participate in the annual conference, the appropriate DFAS Center will provide points-of-contact to assist and provide guidance as required.

DFAS COMMENTS TO RECOMMENDATION 2.b.: Concur. The SM/UR Guide does assist managers in performing the self-assessment

and does provide the means to document the review process. However, in the FY 1996 SM/UR Guide, we will add the requirement that systems managers retain documentation supporting their reviews used to prepare or support answers provided in the systems review.

DFAS COMMENTS TO RECOMMENDATION 2.c.: Concur. The SM/UR Guide does require systems managers to examine the results of prior reviews, evaluations or audits and to consider any applicable audit finding or recommendation in the systems review process. Also, copies of audit findings covering potential FMFIA weaknesses are forwarded by DFAS to the appropriate FMFIA coordinator for consideration in their current year FMFIA Program.

Audit Team Members

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

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