Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE BUSINESS OPERATIONS FUND-DEFENSE INFORMATION SERVICES ORGANIZATION FINANCIAL STATEMENTS FOR FY 1994

Report No. 96-001 October 4, 1995

Department of Defense

Additional Copies

To obtain additional copies of this report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DBOF	Defense Business Operations Fund
DBOF-DISO	DBOF-Defense Information Services Organization
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DISA WESTHEM	DISA Western Hemisphere
DMC	Defense Megacenter

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

October 4, 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
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY WESTERN HEMISPHERE

SUBJECT: Audit Report on the Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994 (Report No. 96-001)

We are providing this audit report for information and use. This report discusses deficiencies identified during the audit of the Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994 (Report No. 95-209, May 31, 1995). We considered comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529). See Appendix F for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-001 **October 4, 1995**
(Project No. 4RE-2005.02)

Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994

Executive Summary

Introduction. The Defense Business Operations Fund was established on November 26, 1991, by United States Code, (U.S.C.) title 10, section 2208. The Chief Financial Officers Act of 1990 (31 U.S.C. 501) requires an annual financial audit of working capital funds, such as the Defense Business Operations Fund. On May 31, 1995, we issued a report on the Defense Business Operations Fund-Defense Information Services Organization (DBOF-DISO) FY 1994 financial statements. During that audit, we identified management control weaknesses and noncompliance with laws and regulations that we considered to be material and reportable under Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. As a result of those findings, we issued a disclaimer of opinion on the financial statements. This report contains recommendations to correct the deficiencies identified in our audit of the DBOF-DISO financial statements.

Audit Objectives. Our objective was to determine whether the DBOF-DISO property, plant, and equipment balances reported on the Statement of Financial Position for FY 1994 were presented fairly in accordance with generally accepted accounting principles or the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. Also, we evaluated the management control program established for the DBOF-DISO, and we assessed compliance with applicable laws and regulations that could have a material effect on the financial statements.

Audit Results. The Defense Information Systems Agency Western Hemisphere (DISA WESTHEM) did not prepare and present FY 1994 financial statements for the DBOF-DISO that were accurate or in compliance with laws and regulations.

o The data DISA WESTHEM used to develop the property, plant, and equipment line item for the FY 1994 financial statements were not based on valid acquisition values. As a result, we estimated that 70 percent of the $892.5 million (total acquisition value) for property, plant, and equipment on the DBOF-DISO financial statements was inaccurate or not supported by source documentation (Finding A).

o The FY 1994 financial statements were not prepared in compliance with the DoD Financial Management Regulation and DoD Form and Content guidance. As a result, $61.1 million was not reported properly and the footnotes to the financial statements were inaccurate (Finding B).

Recommendations in this report, if implemented, will facilitate the preparation of financial statements that are accurate and in compliance with laws and regulations. They will also correct the material internal control weaknesses

identified by the audit (Appendix A). See Appendix D for a summary of all potential benefits resulting from the audit.

Summary of Recommendations. We recommend establishing procedures and controls for the timely and accurate recording of capital assets and for reconciling the financial accounts to the property book system. We also recommend that accountable property officers receive additional training in the proper accounting treatment of capital assets and that DISA WESTHEM implement the DoD standard property accounting system. Furthermore, we recommend that the accounting entry for the depreciation expense be corrected.

Management Comments. The Defense Information Systems Agency concurred with all recommendations. Management anticipates releasing a draft instruction containing policy and procedures on maintaining source documents affecting capital assets by October 1995. Management controls should be implemented by January 1996. Also, DISA WESTHEM accountable property officers received personal property management training in July 1995. Further, management stated that the Defense Property and Accounting System will be implemented beginning November 1, 1995, and should be completed by August 1996. Additionally, management agreed to report depreciation expense and related footnotes in accordance with DoD guidance. A detailed discussion of management comments is in Part I of the report, and the complete text of the comments is in Part III.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 3
Finding A. Financial Records Supporting the Reporting of Property, Plant, and Equipment in FY 1994 Financial Statements 4
Finding B. Reporting of Depreciation Expense for FY 1994 9

Part II - Additional Information

Appendix A. Scope and Methodology
Scope 16
Statistical Sampling Methodology 17
Management Control Program 19
Compliance with Laws and Regulations 20
Appendix B. Summary of Prior Audits and Other Reviews 21
Appendix C. Military Department and Defense Agency Data Processing Organizations Capitalized by the Defense Information Systems Agency Western Hemisphere 23
Appendix D. Summary of Potential Benefits Resulting From Audit 26
Appendix E. Organizations Visited or Contacted 27
Appendix F. Report Distribution 28

Part III - Management Comments

Defense Information Systems Agency Comments 32

Part I - Audit Results

Audit Background

Public Law 102-172, "Department of Defense Appropriation Act of 1992," section 8121, November 26, 1991, consolidated the DoD stock and industrial funds and established the Defense Business Operations Fund (DBOF). The Defense Information Systems Agency (DISA) oversees through delegation from the Under Secretary of Defense (Comptroller) two DBOF business areas: the Communications Information Services Activity and the Defense Information Services Organization (DBOF-DISO). The Defense Information Systems Agency Western Hemisphere (DISA WESTHEM)[1] is a DBOF activity that provides information processing, software development, and related technical support to DoD customers on a fee-for-service basis.

During FY 1994, as part of the Data Center Consolidation Plan and Defense Management Report Decision 918, DoD established 16 Defense megacenters (DMCs) and authorized the transfer of 54 Defense information processing centers to DISA from the Military Departments and Defense Logistics Agency. The DISA WESTHEM provides operational and financial management for the Defense megacenters and legacy[2] sites. As of April 15, 1994, DISA WESTHEM had capitalized 64 Military Department and Defense agency information processing centers, including 16 Defense megacenters and 48 legacy sites. The Navy and DISA WESTHEM agreed that the Navy would report the FY 1994 revenues and cost of operations for the 13 Naval Computer and Telecommunication Station information processing centers.

Inspector General, DoD, Audit Report No. 95-209, "Defense Business Operations Fund-Defense Information Services Organization," May 31, 1995, disclaimed an opinion on the FY 1994 financial statements. That audit identified management control weaknesses and noncompliance with laws and regulations considered to be material and reportable under Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. This report contains recommendations to correct the material management control weaknesses and noncompliances.

---

[1]The DISA established the Defense Information Technology Services Organization May 10, 1992. On July 26, 1993, DISA organized portions of three subordinate organizations, including the Defense Information Technology Services Organization, and established the Defense Information Services Organization. On October 14, 1994, DISA realigned Defense Information Services Organization functions and renamed the organization DISA WESTHEM.

[2]A legacy site is a Defense Information Processing Center that will have its information processing work load transferred to a DMC.

Audit Objectives

The announced audit objective was to determine whether the property, plant, and equipment balances reported on the DBOF-DISO FY 1994 Statement of Financial Position were presented fairly in accordance with generally accepted accounting principles or the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. Also, we evaluated the management control program established for DBOF-DISO, and we assessed compliance with applicable laws and regulations that could have a material effect on the financial statements. Appendix A discusses the audit scope and methodology, material management control weaknesses, and material noncompliances with laws and regulations. Appendix B provides a summary of prior audit coverage related to the audit objectives.

Finding A. Financial Records Supporting the Reporting of Property, Plant, and Equipment in FY 1994 Financial Statements

The data in the general ledger accounts, which DISA WESTHEM used to develop the property, plant, and equipment line item in the FY 1994 financial statements, were not based on valid acquisition values as defined in the DoD Accounting Manual, chapter 31, "Financial Control of Assets." The general ledger data were not based on valid acquisition values because DISA WESTHEM did not:

o establish property records that showed the acquisition value of capital assets, as required by the DISA-Defense Information Technology Services Organization Instruction 270-165-1, "Equipment," February 16, 1993, at the DMCs and legacy sites;

o verify, in accordance with Instruction 270-165-1, that DMCs and legacy sites implemented procedures to reconcile capital asset data with property records;

o train accountable property officers in proper accounting treatment of property, plant, and equipment; and

o use one standard property accounting system at the DMCs and legacy sites to record the inventory of property, plant, and equipment.

As a result, we estimated that about 70 percent of the $892.5 million (total acquisition value) for property, plant, and equipment cannot be substantiated. Additionally, other financial statement line items and customer rate determinations that are based on the value of property, plant, and equipment are inaccurate.

DISA WESTHEM Financial Reporting of Property, Plant, and Equipment

The Director, DISA WESTHEM Logistics, is responsible for property management and accounting processes, including initial asset valuation and validation. In May 1994, the Director, DISA WESTHEM Logistics, directed DMC directors and senior site representatives to provide lists of assets capitalized into the Defense Information Services Organization from their respective sites. Assets to be reported predominantly included capital equipment assets (having an acquisition value of $15,000 or more with a life

expectancy of 2 years or more) and capital software assets procured (purchased or leased to own) with capital investment funding. The data on the capital assets are in the property, plant, and equipment general ledger accounts.

Property, Plant, and Equipment General Ledger Accounts. The DoD Accounting Manual, chapter 31, "Financial Control of Assets" (chapter 31), states that acquisition cost[3] is the primary basis of accounting for property and requires that property be assigned a dollar value before being recorded in an accounting system. The property records contain the detailed information on quantities and unit prices that support the summary figures reflected in the property accounting system. A property record should include source documents that substantiate the dollar value of the property. Source documents include: contracts, invoices, receiving reports, payment vouchers, issue and shipping documents, and transfer documents. Those documents provide the data for updating the property management system and should accompany the asset upon its transfer. If such documentation is not available, the accountable property officer should estimate the dollar value and document the basis for the estimate. However, chapter 31 states that estimates of fair market value should not be used to obtain precision in making property accounting estimates. Instead, the property officer's objective should be to provide timely and economical financial data that are both useful and reasonably reliable for control, information, and accountability purposes.

Maintenance of Property Records. Instruction 270-165-1 delineates responsibility and establishes policy and procedures pertaining to the maintenance of property records and the property management system. Property records must support procurement and utilization decisions, including those related to identifying excess property that may be available for reuse, transfer, or disposal. All acquisitions, dispositions, and transfers of accountable property must be supported by source documents that detail all transactions affecting the actual value of the asset.

About 30 percent of the acquisition value for sampled property, plant, and equipment had no supporting source documents. Before the transfer of the information processing centers to DISA, the Military Departments and Defense agencies centrally maintained acquisition cost data, usually within the contract files. Copies of documents containing acquisition cost data were not furnished to DISA WESTHEM property officers to use in establishing their property records.

Reconciliation of Capital Assets to Property Records. Instruction 270-165-1 requires monthly reconciliation of capital assets to the property management system at each site. Instruction 270-165-1 also requires that physical inventories be performed quarterly or upon the appointment of a new accountable property officer. Management at the DMCs and legacy sites has

[3]Acquisition cost consists of the amount, net of authorized discounts paid or payable for the property, plus the transportation, installation, and other related costs of obtaining the property in the form and place to be put into use.

not established procedures to require their property officers to perform those reconciliations and inventories. Source documents obtained at the DMCs and legacy sites visited (see Appendix C) showed that:

o system upgrades were not included in the valuations of capital assets;

o system features were grouped together and included in the valuation without explanation or identification; and

o multipieced assets were allocated duplicative costs.

About 40 percent of the asset valuations for sampled property, plant, and equipment were incorrect when compared to the source documents.

Unrecorded Automated Data Processing Assets. The audit sample included selected items in the computer room to verify that those items were recorded in the property book and in the capital asset listings received from DISA WESTHEM Logistics. At two DMCs, we identified unrecorded assets valued at more than $4.2 million. At DMC Chambersburg, equipment valued at more than $1.5 million had been bar coded, but not recorded in the property books for DMC Chambersburg. The accountable property officer stated that the equipment was not included in the DMC property books because ownership had not been determined. At DMC Columbus, $2.7 million in capital equipment that had been received on-site was not posted to the property book.

Unrecorded Software Assets. At each DMC or legacy sample site reviewed, we compared the number of software line items to the number of software assets reported by DISA WESTHEM Logistics. Our comparison showed that two legacy sites reported no capital software to DISA WESTHEM Logistics; yet, those same sites operated mainframe computers that performed data processing services for their customers. Because of the lack of documentation, we could not determine the acquisition value of that capital software. The lack of a unique identifier, such as a bar code or serial number, makes the reconciliation of software difficult. Unlike hardware, software does not easily lend itself to "wall-to-wall" inventories.

Training Accountable Property Officers. The accountable property officers at the DMCs and legacy sites are familiar with and follow guidance related to the accountability of DISA WESTHEM property, but have not been trained in accounting requirements in the DoD Accounting Manual. Accountable property officers did not follow procedures requiring valuations to be documented and did not use proper procedures when adjusting valuations. As a result, about 30 percent of the acquisition value for sampled items was unsubstantiated and an additional 40 percent was incorrect. Because those property officers provide the input that is used for the general ledger accounts, they need training in the proper accounting procedures for capital assets.

Use of a Single Standard Property Accounting System to Record Property, Plant, and Equipment Inventory. The DISA WESTHEM used multiple and different property systems to account for its property, following a policy of "where is, as is" for capitalized sites. That policy allows a capitalized site to continue using the property system in place unless DISA WESTHEM implements another system. Because a variety of systems was used to account for property, plant, and equipment, input provided by DISA WESTHEM sites was not uniform or complete. As of December 20, 1994, the Under Secretary of Defense (Comptroller) designated the Defense Property and Accounting System as the standard property system for DoD. On February 17, 1995, the Director, Defense Information Systems Agency, approved the Defense Property and Accounting System for use as the DISA property accountability system. As of July 21, 1995, DISA WESTHEM had not implemented the Defense Property and Accounting System at the DMCs or legacy sites.

Effects on the Reliability of Financial Statements

Decision makers cannot rely on the DBOF-DISO financial statements in making informed management decisions. About 70 percent of the acquisition cost of property, plant, and equipment cannot be substantiated. Either the capital asset valuations (40 percent) did not agree with the DISA WESTHEM property records or source documentation (30 percent) did not exist to support the valuations of capital assets. Therefore, any line items in the financial statements that are based on the dollar value of the property, plant, and equipment accounts would have to be disclaimed because of the high percentage of unreconciled capital asset valuations. The DISA WESTHEM Resource Management staff uses the dollar value of property, plant, and equipment to prepare line accounts in each of the four principle financial statements for the DBOF-DISO.

Recommendations and Management Comments

A. We recommend that the Director, Defense Information Systems Agency, Western Hemisphere:

1. Establish specific site procedures for maintaining source documents that provide details on transactions affecting capital property to include: acquisitions, whether by purchase or transfer as of the date the property is received; and disposals or retirements in accordance with Defense Information Systems Agency-Defense Information Technology Services Organization Instruction 270-165-1, "Equipment," February 16, 1993.

Management Comments. Management concurred, stating specific site procedures for maintaining source documents will be in draft DISA WESTHEM

Instruction 270-165-X, "Management of and Accountability for DISA WESTHEM Personal Property." The instruction is anticipated to be released for implementation by October 1995.

2. Establish and implement management controls in accordance with Defense Information Systems Agency-Defense Information Technology Services Organization Instruction 270-165-1, "Equipment," February 16, 1993, that will provide reasonable assurance inventories are reconciled to the property system records, that capital assets are correctly recorded, and that the assigned valuations and property transactions are properly documented.

Management Comments. Management concurred, stating a management control requirement will be developed and implemented within DISA WESTHEM. The requirement will include an annual site visit to audit the accounting records. The estimated completion date for development of the requirement is January 1996.

3. Train the appointed accountable property officer at the megacenters and legacy sites in the proper accounting procedures for capital assets and the recording of transactions affecting capital property from acquisition to disposal.

Management Comments. Management concurred, stating a training conference for all accountable property officers within DISA WESTHEM was conducted July 10 through 14, 1995.

4. Implement the designated DoD standard property accounting system, which is currently the "Defense Property and Accounting System,"[4] at the megacenters and if appropriate, at legacy sites.

Management Comments. Management concurred, stating the standard property accounting system for DoD will be implemented beginning in November 1995 with completion expected by August 1996.

[4]This system also called the Defense Property Accountability System.

Finding B. Reporting of Depreciation Expense for FY 1994

The DISA WESTHEM did not report depreciation expense and related footnotes properly for the FY 1994 financial statements for the Defense Business Operations Fund-Defense Information Services Organization.

The DISA WESTHEM did not prepare the FY 1994 financial statements in accordance with the DoD 7000.14-R, "Financial Management Regulation," December 1994; "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," October 1994; and generally accepted accounting principles.

As a result, FY 1994 capital asset depreciation expense is potentially understated by as much as $61 million. Additionally, the customer rates for future periods could be understated. An understatement of customer rates would result in funding shortages when replacement of capital assets is needed.

Responsibilities for Financial Statement Preparation

The DISA WESTHEM and the Defense Finance and Accounting Service-Cleveland Center (DFAS-Cleveland) were jointly responsible for preparing the FY 1994 financial statements of the DBOF-DISO.

Responsibilities of DISA WESTHEM. The DISA WESTHEM is responsible for implementing DoD policies and procedures in preparing the financial statement and for ensuring that DBOF-DISO complies with all applicable laws and regulations. In addition, DISA WESTHEM is responsible for providing accurate financial data to DFAS-Cleveland.

Responsibilities of DFAS-Cleveland. The DFAS-Cleveland is responsible for entering the financial data furnished by DISA WESTHEM into a financial system and for producing the financial statements. The operation, maintenance, and data integrity of the financial system is also a DFAS-Cleveland responsibility. The DFAS-Cleveland prepared the FY 1994 DBOF-DISO financial statements using financial data provided by DISA WESTHEM.

DoD Regulation and Guidance for Financial Statement Preparation

DoD Financial Management Regulation. The DoD 7000.14-R, Financial Management Regulation, volume 11B, "Reimbursable Operations, Policy, and

Procedures-Defense Business Operations Fund," December 1994, issued by the Under Secretary of Defense (Comptroller), establishes policies, procedures, and reporting requirements for the management and operations of DBOF-DISO. DoD 7000.14-R, chapter 58, "Capital Assets," requires DISA WESTHEM to capitalize transferred capital assets at the net book value based on the existing or calculated depreciation schedule. The depreciation schedule is the basis for reporting capital assets and the associated depreciation costs on the financial records and statements. Depreciation costs are included in the rates DISA WESTHEM charges to DoD customers for services provided. Including depreciation costs in customer rates allows DBOF-DISO to accumulate additional funding in the corpus, which provides the financing for the Capital Investment Program. The Capital Investment Program provides DBOF-DISO the capability to reinvest in the infrastructure of the information processing business area.

DoD Guidance on Form and Content of Financial Statements. The "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," October 1994, issued by the Under Secretary of Defense (Comptroller), provides form and content guidance for preparing the financial statements. The guidelines set forth disclosure requirements and provide an outline for financial statement preparation that allows each DoD Component the flexibility to develop and include information useful to both its financial managers and program managers in making decisions. Also, the guidance incorporates form and content provisions set forth in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. The DISA WESTHEM must comply with DoD guidance and Bulletin No. 94-01 in the form and content of its financial statements.

Preparation of FY 1994 Financial Statements

In preparing the FY 1994 financial statements, DBOF-DISO generally complied with applicable laws and regulations, except for the material noncompliances discussed below. Material instances of noncompliance are failures to follow requirements or violations of prohibitions in laws or regulations for which the aggregation of the misstatements resulting from those failures or violations is material to the Principal Statements. The results of our compliance testing showed the following material instances of noncompliance.

Reporting of Depreciation Expense for FY 1994. The DISA WESTHEM did not prepare the FY 1994 DBOF-DISO Statement of Operations in compliance with DoD 7000.14-R. The DISA WESTHEM improperly reported a potential $61.1 million of depreciation expense for FY 1994. As a result, customer rates could be understated by $61.1 million, which will cause a shortage of funding for the Capital Investment Program.

The DFAS-Cleveland posted $112.6 million in depreciation expense for FY 1994 based on data from DISA WESTHEM. The DFAS-Cleveland

recorded the following accounting entry to improperly reclassify a portion of that depreciation expense relating to assets transferred in FY 1994 from former Army and Air Force sites.

Accounting Entry to Reclassify Depreciation Expense

	Debit (millions)	Credit (millions)
Assets Capitalized-Contributed	$61.1	
Invested Capital Used		$61.1

Provisions for the Exclusion of Depreciation Expense from Customer Rates. Provisions in DoD 7000.14-R provide for excluding depreciation expense from customer rates; however, DISA WESTHEM did not comply with those provisions. The following provisions allow for the exclusion of depreciation expense from customer rates:

o acquisition of facilities using the Military Construction appropriation, or

o receipt of a waiver from the Under Secretary of Defense (Comptroller).

The capital assets transferred from the former Army and Air Force sites do not meet the acquisition requirements for using the Military Construction appropriation. The DISA WESTHEM neither requested nor received prior approval from the Under Secretary of Defense (Comptroller) to exclude depreciation costs from customer rates. Therefore, the exclusion of depreciation expense from customer rates by DISA WESTHEM is a material noncompliance with DoD 7000.14-R. The DISA WESTHEM should direct DFAS-Cleveland to reverse the reclassification accounting entry and to make the associated adjusting entry for the FY 1995 financial statement. Also, DISA WESTHEM should include the depreciation costs in future customer rates.

Footnote Disclosures to the Financial Statements. The DoD Form and Content guidance contains footnote requirements for financial statements and specific instructions on footnote disclosures that are to be prepared as part of the annual financial statement relating to property, plant, and equipment.

Property, Plant, and Equipment. The DISA WESTHEM did not properly categorize property, plant, and equipment shown in Note 15 to the financial statements. The DoD Form and Content guidance requires DBOF-DISO to report the value for property, plant, and equipment by major classes of fixed assets in Note 15. Note 15 should show the depreciation method, service life, acquisition value, accumulated depreciation, and net book value for each major class of fixed assets. The DISA WESTHEM did not report in Note 15 $37.7 million in automated data processing software and $14.3 million in leases that existed as of September 30, 1994. Automated data processing software and leases are major classes of fixed assets, and DISA WESTHEM should report them in Note 15 to meet the requirements of DoD Form and Content guidance.

In addition, the total net book value for Note 15 should support the net book value on Line 1.k. of the Statement of Financial Position. For the FY 1994 Financial Statements, the total net book value in Note 15 is $1.8 million more than the value shown on the Statement of Financial Position. Note 15 does not support the net book value on the Statement of Financial Position or provide an explanation for the difference that exists. For FY 1995, DISA WESTHEM should provide an explanation for the difference in reported values or ensure that the note accurately supports the Statement of Financial Position.

Leases. The DISA WESTHEM did not disclose the value of leases, descriptions of lease agreements, and lease funding data in Note 18 to the financial statements. The DoD Form and Content guidance requires DISA WESTHEM to report the value of capital and operating leases, a description of lease arrangements, and show lease funding data in Note 18. Note 18 to the financial statements states that leases were not applicable for FY 1994. Our review of the DISA WESTHEM property data base as of September 30, 1994, showed a total of 85 property records designated as leases valued at $14.3 million.

Net Position. Note 20 to the financial statements does not support the net position balance on the Statement of Financial Position. The DoD Form and Content guidance classifies the elements of the net position into various categories within Note 20, which supports amounts reported on the Statement of Financial Position for net position. The following differences exist between the Net Position balances in Note 20 and those balances shown on the Statement of Financial Position: the Invested Capital balance shows a difference of $62.9 million, and the Cumulative Results of Operations balance has a difference of $58.4 million. The DISA WESTHEM should have prepared Note 20 to support the Net Position balance shown on the Statement of Financial Position or provided an explanation for the differences.

Compliance with DoD 7000.14-R and DoD Form and Content guidance will improve the accuracy and reliability of the financial statements.

Recommendations and Management Comments

B. We recommend that the Director, Defense Information Systems Agency Western Hemisphere:

1. Report depreciation expense on the financial statements in compliance with DoD 7000.14-R, "Financial Management Regulation," volume 11B, chapter 58, "Capital Assets," December 1994.

Management Comments. Management concurred, stating capital asset depreciation expenses will be reported in compliance with the Financial Management Regulation.

2. Direct the Defense Finance and Accounting Service-Cleveland Center to reverse the yearend accounting entry that reclassified $61.1 million of depreciation expense in FY 1994.

Management Comments. Management concurred, stating DISA WESTHEM Resource Management will direct the DFAS-Cleveland Center to process the appropriate adjustment entries. Adjusting entries will be processed and reported in accordance with DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity.

3. Prepare footnotes to the financial statements for FY 1995 and future years according to the DoD Form and Content Guidance applicable for that particular fiscal year.

Management Comments. Management concurred, stating the financial Statements will be prepared in accordance with DoD Form and Content Guidance and the DoD Financial Management Regulation.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We examined the financial statements for DBOF-DISO for the year ended September 30, 1994. The statements, dated March 1, 1995, included the Overview and Notes to the four Principal Statements: Statement of Financial Position, Statement of Operations (and Changes in Net Position), Statement of Cash Flows, and Statement of Budget and Actual Expenses. Our opinion is based on the March 1, 1995, financial statements.

Scope of the Review of Management Controls. Our audit included an assessment of the reasonableness of the property, plant, and equipment financial data reflected in the FY 1994 financial statements. We evaluated the procedures and controls that the DISA WESTHEM and the Defense Finance and Accounting Service-Cleveland Center used to prepare the FY 1994 financial statements.

Scope of the Review of Compliance with Laws and Regulations. To obtain reasonable assurance about whether the Principal Statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements and compliance with laws and regulations designated by the Office of Management and Budget 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, dated from July 1985 through December 1994, 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 did not complete a review of the general and application controls of the computer-based systems used by management to control property-related financial transactions. Instead, we completed tests on transactions to determine whether the accounting entries were made in accordance with generally accepted accounting standards or the other comprehensive basis of accounting. Also, we reviewed the financial information in management's overview of the DBOF-DISO. To the extent that we reviewed the data, we concluded that the data were sufficiently reliable to meet our audit objectives.

Audit Period, Standards, and Locations. We performed this financial audit from April 1994 through July 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 E lists the organizations visited or contacted.

Statistical Sampling Methodology

Sampling Purpose. The objective of this audit was to test the validity of the capital assets account of the FY 1994 financial statement for the DBOF-DISO. For each sample item from the capital assets account, the audit staff made a determination that the value was substantiated by supporting documentation or that it was contradicted by substantial supporting documentation or that not enough supporting documentation existed to make a determination. The initial goal was to project the net value of the capital assets based on the sample data and to determine whether the projection was materially different from the value reported in the financial statements.

Universe Represented. The initial field of items was composed of 51 sites,* 44 of which DBOF-DISO capitalized from the Military Departments and Defense agencies during FY 1994. After screening to omit sites with no reported assets, 35 sites remained that comprised the universe on which the financial statement line item for property, plant, and equipment was based (see Appendix C).

Sampling Design. We used a multistage sampling plan to collect data during the management control and substantive testing phases of the audit. We grouped the sites into two strata based on a site's former status as a Military Department or Defense agency organization. We selected sites with the highest book value from each losing organization (the Military Departments, Defense Logistics Agency, and DISA WESTHEM) for a "high dollar" stratum. We pooled the remaining sites into a second stratum and selected five of them at random. In both strata, we used cluster sampling methods. In the high-dollar stratum, we drew sample items from all five sites. At each sample site, we selected the sample to evaluate from the capital asset line items furnished by the Director, DISA WESTHEM Logistics, using a probability proportional to size design, in order to make dollar projections with greater precision for the number of items sampled. The probability proportional to size design method selects items based on their proportion of the value of all items for a given characteristic. In this instance, we sampled items based on the acquisition cost. We drew the probability proportional to size design items "with replacement." A more detailed description can be found in *Sampling Techniques*, by William S. Cochran, or in *Elementary Survey Sampling*, Sheaffer, Mendenhall, and Ott. Sampling "with replacement" allows a given item to be selected more than once, based roughly on its proportion of the total acquisition value. Table A-1 summarizes the data in the two strata for the 10 sites.

*Sites reported as assets of the Navy for FY 1994 were excluded from the universe.

Table A-1. Summary Data for Sampled Sites

	DISA WESTHEM Logistics Value (millions)	Value of Items Examined (millions)	No. Items Examined
High Dollar Sites Stratum			
DMC Columbus	$42.9	$22.8	55
DMC Dayton	60.3	31.2	55
DIPC Pentagon	36.3	19.9	53
DMC Mechanicsburg	65.1	28.7	55
DMC St. Louis	59.8	34.2	57
Other Sites Stratum			
DMC Chambersburg	39.3	13.4	55
DIPC Puget Sound	7.9	7.0	55
DIPC Richmond	22.7	12.6	55
DMC Sacramento	24.9	13.0	55
DIPC San Antonio	29.7	23.9	52

Categorizing Sample Items. For each sample item selected, we determined which of three categories it best fit: Not Documented, Matched, or Different. If we could not find official acquisition documents, vendor documents, or comparable means of substantiating the acquisition cost of a sample item, we categorized that item and its acquisition cost as "Not Documented." When documentation was adequate to make a determination of acquisition value, we distinguished between those for which the supporting documentation matched the acquisition cost (Matched) provided by DISA WESTHEM Logistics and those that did not match (Different). Our original objective was to project a net value for the capital assets based on audit-determined values for the sample items; however, we could substantiate and match the acquisition cost of less than one third of the sample items. Therefore, we did not have the basis in substantiated costs to project the net value of the capital assets or to render an opinion on whether the sample projection fell within the limits of materiality for the account.

Statistical Sampling Results. We projected the value of those items for which we could substantiate acquisition cost (Matched), items with documented differences in cost (Different), and items for which the cost could not be substantiated (Not Documented). Table A-2 summarizes those projected values.

Table A-2. Projected Acquisition Cost of Property, Plant, and Equipment
(millions)

Acquisition Cost Category	Value of Universe	Point Estimate	Lower Bound	Upper Bound
Matched	$892.5	$265.5	$261.3	$279.6
Different	$892.5	$354.2	$349.1	$359.4
Not Documented	$892.5	$272.8	$268.6	$277.0

The overall results show that the acquisition costs we could substantiate as valid represent only about 30 percent of the acquisition cost of the capital assets. Based on the sample results, we projected with 95-percent confidence, that the true value of items with substantiated acquisition costs would fall in the range of $261.3 million to $279.6 million. We obtained sufficient documentation for 40 percent to substantiate the acquisition cost of the item, but the substantiated cost did not reconcile with the acquisition cost as reported by DISA WESTHEM Logistics. The interval for Different costs is $349.1 million to $359.4 million. For the remaining 30 percent (Not Documented), we were unable to obtain the documentation needed to substantiate the acquisition cost. The range here is $268.6 million to $277.0 million. Given that the projected values of Different and Not Documented acquisition costs comprised more than two-thirds of the acquisition value, we could not calculate a net value for the account. About one-third of the items' acquisition value had not been established, which far exceeds the limits of materiality. Consequently, we were obliged to disclaim an opinion on the FY 1994 financial statements. The disclaimer was issued in Inspector General, DoD, Report No. 95-209, "Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994," May 31, 1995.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Management Controls Reviewed. We reviewed management control procedures relating to the recording of property, plant, and equipment for the FY 1994 financial statements. We also evaluated the procedures and controls that DISA WESTHEM and DFAS-Cleveland used to prepare the FY 1994 financial statements. The management control program within DISA WESTHEM is discussed in Inspector General, DoD, Audit Report No. 95-280, "Management Control Program at Defense Information Systems Agency, Western Hemisphere," July 26, 1995.

Adequacy of Management Controls. We identified three material weaknesses and reportable conditions as defined by Office of Management and Budget 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993:

o management control systems were not implemented at the site level;

o property book systems lacked source documentation to validate the reliability of the data maintained; and

o property book systems did not support accounting requirements and reconciliations were neither performed nor documented.

See Finding A for details. Recommendations A.1. through A.4., if implemented, will correct those weaknesses. See Appendix D for all benefits associated with the audit. A copy of the report will be provided to the senior official responsible for management controls within DISA.

Compliance with Laws and Regulations

The DISA WESTHEM managers are responsible for ensuring that DBOF-DISO complies with all applicable laws and regulations. We evaluated DBOF-DISO for material instances of noncompliance with laws and regulations. The property, plant, and equipment accounts on which we based our evaluation are in each of the four principal financial statements and related footnotes to the statements dated March 1, 1995. Such tests of compliance are required by the Chief Financial Officers Act of 1990.

Results of Audit. The DISA WESTHEM did not comply with provisions of the DoD Financial Management Regulation and the DoD Guidance on Form and Content in the reporting and disclosure of its property, plant, and equipment. See Finding B for details. Recommendations B.1. and B.3., if implemented, will correct the noncompliances.

Appendix B. Summary of Prior Audits and Other Reviews

In the last 5 years, the Inspector General, DoD, issued six reports on financial statements and financial related audits at the Defense Information Systems Agency pursuant to the Chief Financial Officers Act of 1990. Those audits provided coverage of the information services areas of the Defense Business Operations Fund within the Defense Information Systems Agency.

Inspector General, DoD

Inspector General, DoD, Report No. 95-280, "Management Control Program at Defense Information Systems Agency, Western Hemisphere," July 26, 1995. The report states that 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. Also, DISA WESTHEM had weaknesses in its management control program not related to accounting system controls. The report recommends that DFAS and DISA WESTHEM 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 were responsive to the recommendations.

Inspector General, DoD, Report No. 95-219, "Defense Business Operations Fund-Communications Information Services Activity Financial Statements for FY 1994," June 5, 1995. The report issued a qualified opinion on the statements 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. The report contains no recommendations.

Inspector General, DoD, Report No. 95-209, "Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994," May 31, 1995. The report disclaims an opinion on the FY 1994 financial statements because the property, plant, and equipment account could not be reconciled to source documentation. The report contains no recommendations.

Inspector General, DoD, Report No. 93-153, "Defense Business Operations Fund-Communications Information Services Activity Financial Statements for FY 1992," August 6, 1993. The report issued a qualified opinion on the FY 1992 financial statements because of scope limitations and noncompliances with laws and regulations. The scope limitations related to insufficient

supporting evidence for two accounting adjustments to the financial statements and management controls over capital assets. Management's noncompliances with laws and regulations related to footnote disclosures and the Statement of Budget and Actual Expenses not being in conformance with DoD guidance, "Form and Content of Financial Statements For FY 1992 Financial Activity," October 28, 1992. Also, identified were noncompliances of the Federal Managers' Financial Integrity Act related to performance standards, training, risk assessments, and testing. The report contains no recommendations.

Inspector General, DoD, Report No. 93-151, "Compliance with the Federal Managers' Financial Integrity Act at the Defense Commercial Communications Office," July 26, 1993. The report states that the management control program was not in full compliance with the requirements of the Federal Managers' Financial Integrity Act related to performance standards, training, risk assessments, and testing. Management concurred with the report and had taken actions during the audit to correct the deficiencies.

Inspector General, DoD, Report No. 92-121, "Defense Industrial Fund-Communications Services Activity Financial Statements for FY 1991," June 30, 1992. The report issued a qualified opinion on the FY 1991 financial statements because of scope limitations and noncompliances with laws and regulations. The scope limitations related to $97 million in donated and procured assets that were not verified due to material management control weaknesses in FYs 1990 and 1991. Also identified was an exclusion of certain lease obligations for capital equipment, an unsupported "Reserve for Capital Assets Depreciation" valued at $46.8 million, a $21.3 million understatement of the "net disbursements" caused by a $21.3 million overstatement of "accrued expenses not requiring outlays," and unaudited yearend figures for FY 1990. Management's noncompliances with laws and regulations related to the recording of military interdepartmental purchase requests and capital leases. The report contains no recommendations.

Appendix C. Military Department and Defense Agency Data Processing Organizations Capitalized by the Defense Information Systems Agency Western Hemisphere

Table C-1 lists the sites capitalized by DISA WESTHEM as of April 15, 1994. The DMCs are listed first, and the legacy sites, whose workload requirements will transfer to the DMCs, are listed by organization.* Former Naval Computer and Telecommunication Station sites are excluded because the Navy and DISA WESTHEM agreed the Navy would report the revenues and cost of operations for those sites.

Table C-1. Capitalized Sites Reported for FY 1994
(Amounts as of September 30, 1994)

DMC Sites	Total Capital Assets
Army	
DMC Chambersburg	$ 39,316,629
DMC St. Louis	59,823,473
DMC Rock Island	43,128,789
DMC Huntsville	29,359,971
Navy	
DMC Mechanicsburg	65,120,261
Air Force	
DMC Dayton	60,280,932
DMC Montgomery	24,289,218
DMC San Antonio	39,632,030
DMC Ogden	55,599,401
DMC Oklahoma City	60,061,114
DMC Warner Robins	30,482,162
DMC Sacramento	24,902,486
Defense Agency	
DMC Columbus	42,933,664
DMC Denver	37,255,844

*The 16 sites capitalized having no capital assets are excluded.

Table C-1. Capitalized Sites Reported for FY 1994 (Cont'd)
(Amounts as of September 30, 1994)

Legacy Sites	Total Capital Assets
Army	
Army Information Service Center	$ 150,597
Navy[1]	
DIPC Pearl Harbor	1,652,804
DIPC Puget Sound	7,875,314
DIPC San Diego	7,679,021
DIPC Philadelphia	27,014,244
DIPC Norfolk	6,540,182
DIPC Oakland	3,037,813
DIPC Charleston	4,551,872
DIPC Bureau of Naval Personnel Arlington	17,582,918
Air Force	
DIPC San Antonio	29,738,917
DIPC Randolph Air Force Base	18,720,640
Defense Agency	
DIPC Battle Creek	18,442,035
DIPC Richmond	22,737,549
DIPC Alexandria[2]	36,349,200
DIPC Philadelphia	10,932,905
DIPC Stockton	4,677,422
DISO-Denver	120,362
DIPC Cleveland	22,823,020
DIPC Indianapolis	21,575,638
DIPC Kansas City	16,838,215
DIPC Dayton	1,272,142
Total of audit universe	**$892,498,784**

[1]Defense Information Processing Center
[2]Formerly Office of the Secretary of Defense/Air Force Computer Services Office.

Sources: DISA WESTHEM Resource Management, Business Management Division, "DISO Defense Management Report Decision 918 Capitalization" list, April 15, 1994; and DISA WESTHEM Logistics capital asset listing as of September 30, 1994.

By agreement between DISA and the Navy, the assets of the following Naval Computer and Telecommunication Station sites (Table C-2) were reported by the Navy for FY 1994 and were, therefore, excluded from our universe.

Table C-2. Capitalized Sites Reported by Navy in FY 1994

Sites	Total Capital Assets
DIPC San Francisco	$ 2,123,014
Lemoore (Satellite/San Francisco)	--
DIPC Honolulu	734,055
DIPC Hampton Roads	5,398,706
NCTC* Washington Headquarters	--
DIPC Pensacola	5,336,970
Corpus Christi (Satellite/Pensacola)	--
Orlando (Satellite/Jacksonville)	--
DIPC Newport	302,976
Great Lakes (Satellite/Newport)	--
DMC San Diego	14,169,520
DIPC Washington (Navy Yard)	10,322,901
DMC Jacksonville	11,538,714
Total	**$49,926,856**

*Naval Computer and Telecommunication Command.

Sources: DISA WESTHEM Resource Management, Business Management Division, "DISO Defense Management Report Decision 918 Capitalization" list, April 15, 1994; and DISA WESTHEM Logistics capital asset listing as of September 30, 1994.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
A.1.	Management Controls. Establishes management controls to ensure property records are maintained to support the acquisition value of capital assets.	Nonmonetary.
A.2., A.3.	Management Controls. Establishes management controls to ensure capital assets are inventoried, reconciled, recorded, valued, and documented in compliance with existing guidelines.	Nonmonetary.
A.4.	Management Controls. Establishes one standard property accounting system to record the inventory of property, plant, and equipment in compliance with DoD guidance.	Nonmonetary.
B.1., B.2., and B.3.	Compliance with Regulations. Results in financial statements that comply with DoD guidance.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Defense Organizations

Defense Finance and Accounting Service, Cleveland Center, Cleveland, OH
Defense Information Systems Agency, Washington, DC
- Defense Information Systems Agency Western Hemisphere, Fort Ritchie, MD
- Defense Information Systems Agency Western Hemisphere, Denver, CO
  - Army Information Services Center, Fort Ritchie, MD
  - Defense Megacenter Chambersburg, Chambersburg, PA
  - Defense Megacenter Columbus, Columbus, OH
  - Defense Megacenter Dayton, Wright-Patterson Air Force Base, OH
  - Defense Megacenter Mechanicsburg, Mechanicsburg, PA
  - Defense Megacenter Sacramento, McClellan Air Force Base, CA
  - Defense Megacenter St. Louis, St. Louis, MO
  - Defense Information Processing Center-Alexandria, Arlington, VA
  - Defense Information Processing Center-Puget Sound, Bremerton, WA
  - Defense Information Processing Center-Richmond, Richmond, VA
  - Defense Information Processing Center-San Antonio, San Antonio, TX
  - Defense Information Technology Contracting Office, Scott Air Force Base, IL

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller/Chief Financial Officer)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

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
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Non-Defense Federal Organizations and Individuals (cont'd)

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
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 Information Systems Agency Comments

DEFENSE INFORMATION SYSTEMS AGENCY
701 S. COURT HOUSE ROAD
ARLINGTON, VIRGINIA 22204-2199

IN REPLY REFER TO: Inspector General

19 SEP 1995

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: Director, Readiness and Operational Support

SUBJECT: DoDIG Draft Audit Report on the Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994 (Project No. 4RE-2005.02)

Reference: DoDIG Draft Report, subject as above, 16 Aug 95

The Defense Information Systems Agency concurs with the subject report findings and recommendations. Our detailed management comments are at the enclosure. The point of contact for this action is Ms. Sandra J. Leicht, Audit Liaison, on (703) 607-6316.

FOR THE DIRECTOR:

1 Enclosure a/s

RICHARD T. RACE
Inspector General

Quality Information for a Strong Defense

MANAGEMENT COMMENTS TO DODIG DRAFT AUDIT REPORT ON THE DEFENSE OPERATIONS FUND-DEFENSE INFORMATION SERVICES ORGANIZATION FINANCIAL STATEMENTS FOR FISCAL YEAR 1994 (Project No. 4RE-2005.02)

1. **Recommendation A.1:** Establish specific site procedures for maintaining source documents that provide details on transactions affecting capital property to include: acquisitions, whether by purchase or transfer as of the date the property is received; and disposals or retirements in accordance with Defense Information Systems Agency-Defense Information Technology Services Organization Instruction 270-165-1, "Equipment," February 16, 1993.

DISA Comments: Concur with the recommendation. Specific site procedures for maintaining source documents will be contained in DISA WESTHEM Instruction 270-165-X (Draft), "Management of and Accountability for DISA WESTHEM Personal Property," when published. The instruction provides policy, procedures, and delineates responsibility for personal property accountability and management within DISA WESTHEM. The instruction addresses property accountability, equipment identification, ownership, equipment acquisition, inventories, accounting for capital assets, reports, and for the transfer and disposal of property. A copy of the draft instruction is at Attachment 1. This instruction is in its final stages of staffing and is anticipated to be released for implementation by October 1995. *

2. **Recommendation A.2:** Establish and implement management controls in accordance with Defense Information Systems Agency-Defense Information Technology Services Organization Instruction 270-165-1, "Equipment," February 16, 1993, that will provide reasonable assurance inventories are reconciled to the property system records, that capital assets are correctly recorded, and that the assigned valuations and property transactions are properly documented.

DISA Comments: Concur with the recommendation. Upon the final approval of the DISA WESTHEM Instruction 270-165-X, an internal management control requirement will be developed and implemented within DISA WESTHEM. This requirement will consist of an annual site visit which will include an audit of the accounting records, personnel training, and determination of additional assistance that may be required. The estimated completion date for the

*Attachment 1 omitted because of length. Copies will be provided upon request.

development of this control requirement is January 1996.

3. **Recommendation A.3:** Train the appointed accountable property officer at the megacenters and legacy sites in the proper accounting procedures for capital assets and the recording of transactions affecting capital property from acquisition to disposal.

DISA Comments: Concur with the recommendation. The Deputy Chief of Staff for Logistics, DISA WESTHEM, conducted a 5-day training conference in conjunction with the USDA Graduate School from 10-14 July 1995 at Hagerstown, Maryland, for all accountable property officers within DISA WESTHEM. A copy of the course agenda is at Attachment 2. All the defense megacenters (DMC) were in attendance with the exception of one. On site training for that DMC will be coordinated and provided at a later date.

4. **Recommendation A.4:** Implement the designated DOD standard property accounting system, which is currently the "Defense Property and Accounting System," December 20, 1994, at the megacenters and if appropriate, at legacy sites.

DISA Comments: Concur with the recommendation. The standard property accounting system for DOD, "Defense Property and Accounting System," will be implemented beginning on or about 1 November 1995 and should be completed by August 1996.

5. **Recommendation B.1:** Report depreciation expense on the financial statements in compliance with DOD 7000.14-R, "Financial Management Regulation," volume 11B, chapter 58, "Capital Assets," December 1994.

DISA Comments: Concur with the recommendation. DBOF Information Services capital asset depreciation expenses are recorded and reported in accordance with DOD 7000.14-R, Volume 11B, Chapters 52 and 58. Effective 1 October 1994 (FY 1995), all capital assets and related depreciation expense accounting are maintained and reported via the Property Accounting System and appropriate general ledger entries posted monthly to the Industrial Fund Accounting System (IFAS) and the Central Data Base system for inclusion in DISA Westhem monthly and annual financial statements.

6. **Recommendation B.2:** Direct the Defense Finance and Accounting Service-Cleveland Center to reverse the year-end

*Attachment 2 omitted because of length. Copies will be provided upon request.

accounting entry that reclassified $61.1 million of depreciation expense in FY 1994.

DISA Comments: Concur with the recommendation. DISA Westhem Resource Management will direct the DFAS-Cleveland Center to process the appropriate adjustment entries for the $61.1M portion of FY94 depreciation expenses recorded to Appropriated Capital Used as a financing source per DOD 7000.14-R, Volume 11B, Chapter 52. Adjusting entries will be processed and reported IAW DOD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity, dated September 1994, Chapter 4, paragraph D. This should be accomplished by 20 November 1995.

7. **Recommendation B.3:** Prepare footnotes to the financial statements for FY 1995 and future years according to the DOD Form and Content Guidance applicable for that particular fiscal year.

DISA Comments: Concur with the recommendation. FY 1995 Chief Financial Officer Statements will be prepared in accordance with the DoD Form and Content Guidance and the DoD 7000.14-R, Volume 11B, to assure accurate reporting and reconciliation with the principal statements with full disclosure of all required or material information necessary and appropriate to provide financial and program managers with accurate reporting of the results of operations in financial terms and to make informed decisions based this information. This should be accomplished by 20 November 1995.

Audit Team Members

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

Thomas F. Gimble
Salvatore F. Guli
Mary Lu Ugone
Cecelia Miggins
Pamela F. Smith
Susan Lippolis
Rhonda Ragsdale
Margaret Bennardo
Kimberly Slater
Nancy C. Cipolla
Henry D. Barton
Cristina Maria H. Giusti