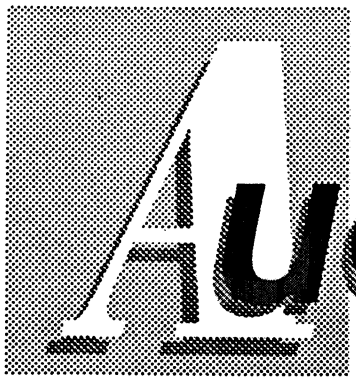

OFFICE OF THE INSPECTOR GENERAL

DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE NAVY DEFENSE BUSINESS OPERATIONS FUND FY 1995 FINANCIAL STATEMENTS

Report No. 97-027

November 22, 1996

Department of Defense

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Acronyms

CDB	Central Data Base
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
IG	Inspector General
NAS	Naval Audit Service

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

November 22, 1996

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Audit Report on Defense Finance and Accounting Service Work on the Navy Defense Business Operations Fund FY 1995 Financial Statements (Report No. 97-027)

We are providing this report for review and comment. We considered Office of the Under Secretary of Defense (Comptroller) comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Under Secretary of Defense (Comptroller) provide the planned implementation dates for Recommendations 1., 2., 3., and 4. by January 22, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-8868 (DSN 664-8868) or Mr. Edward A. Blair, Acting Audit Project Manager, at (216) 522-6091 (DSN 580-6091). 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. 97-027 **November 22, 1996**
(Project No. 5FI-2013)

Defense Finance and Accounting Service Work on the Navy Defense Business Operations Fund FY 1995 Financial Statements

Executive Summary

Introduction. The Defense Finance and Accounting Service (DFAS) Cleveland Center, Cleveland, Ohio, maintains Navy accounting records and prepares the Department of the Navy's financial statements for both the Defense Business Operations Fund and the General Fund.

The Chief Financial Officers Act of 1990 (the Act), as amended by the Government Management Reform Act of 1994, requires the Inspector General, DoD, to audit the financial statements of DoD activities in accordance with applicable generally accepted Government auditing standards. However, the Act allows delegation of the audit work. The Inspector General, DoD, delegated the audit of the Navy Defense Business Operations Fund FY 1995 financial statements to the Naval Audit Service. The Inspector General, DoD, assisted the Naval Audit Service by performing audit work at the DFAS Cleveland Center.

Audit Objectives. The primary audit objective was to determine whether the DFAS Cleveland Center consistently and accurately compiled financial data from field activities and other sources for the FY 1995 Consolidated Financial Statements of the Navy Defense Business Operations Fund. We also planned to determine whether FY 1995 ending balances reported by DFAS Cleveland Center are usable as beginning balances for FY 1996 financial statements. However, we were unable to do so because insufficient FY 1995 data were provided. We reviewed the management control program as applicable to our other audit objectives. We did not render an opinion on the financial statements.

Audit Results. The Defense Finance and Accounting Service Cleveland Center accurately compiled financial data from field entities and other sources into the FY 1995 Consolidated Financial Statements of the Navy Defense Business Operations Fund. However, the DFAS Cleveland Center did not have the required controls over the processes used to compile the Navy Defense Business Operations Fund financial statements to ensure that errors do not occur in future year financial statements. We identified the following deficiencies.

o Standard written procedures were not in place for receiving and entering adjustments to the financial data reported for the Navy Defense Business Operations Fund. We reviewed adjustments to the financial statements and determined that the DFAS Cleveland Center made $5.8 billion in adjustments without initially developing adequate support or obtaining supervisory approval.

o Controls had not been established over the manual input process for financial statement data. Errors occurred as a result of the manual transfer of the financial statement data from the DFAS Cleveland Center's Central Data Base mainframe system

to the Microsoft Excel spreadsheet desktop computer program required by the DFAS Indianapolis Center. These errors can be prevented if DFAS Cleveland Center establishes an automated program for transferring data from the mainframe data base to the spreadsheet.

o The DFAS Cleveland Center published inaccurate line-item crosswalks for financial data. Because of existing automated controls, the errors resulting from the inaccurate crosswalks were not transferred to the financial statements. However, the published crosswalks need to be corrected.

The DFAS Cleveland Center's management control program could be improved by strengthening controls over the compilation of the Navy's financial statement data. Appendix A discusses the management control weaknesses we identified during the compilation of the Navy Defense Business Operations Fund financial statements.

Summary of Recommendations. We recommend that the Director, DFAS, require the DFAS Cleveland Center to establish and implement written procedures for adjusting financial reports. The written procedures should fulfill the responsibilities for financial reporting, as required by DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6, "Reporting Policy and Procedures," February 12, 1996. Specifically, controls over the adjustment process need to be improved. We also recommend that the Director, DFAS, direct the DFAS Cleveland Center to establish an automated process for transferring financial statement data from the Central Data Base to the spreadsheet used by the DFAS Indianapolis Center; correct errors in published crosswalks; and establish procedures for future changes to crosswalks. Implementation of the recommendations in this report will provide improved management controls and will help to ensure more accurate financial statements.

Management Comments. The Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller), in responding for the Director, DFAS, concurred with all audit recommendations. He agreed on the need for written procedures to require adequate support for official accounting record adjustments, for standard operating procedures to ensure consistency and standardization in the adjustment and consolidation of financial statements, and for an automated process to transfer financial statement data from the Central Data Base to a spreadsheet application. He also agreed that the existing crosswalk should be reviewed and any errors corrected. The Deputy Chief Financial Officer indicated that DFAS Cleveland Center is now developing corrective actions. See Part I for a discussion of management comments and Part III for the complete text of management comments.

Audit Response. We consider the response and proposed corrective actions commendable; however, management did not provide the dates for implementation of the corrective actions. Therefore, we request the Deputy Chief Financial Officer to indicate when the corrective actions will be implemented. We ask that comments be provided by January 22, 1997.

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Part I - Audit Results

Audit Background

Chief Financial Officers Act of 1990. Public Law 101-576, the Chief Financial Officers Act of 1990, November 15, 1990, requires the annual preparation and audit of financial statements for Government corporations and for trust funds, revolving funds, and substantial commercial activities of 23 Executive departments and agencies. The Chief Financial Officers Act also requires the Inspectors General (IGs), or appointed external auditors, to audit the financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget. Public Law 103-356, the Government Management Reform Act of 1994, title IV, October 13, 1994, amends the Chief Financial Officers Act of 1990, requiring each Executive agency to issue agency-wide audited financial statements beginning in FY 1996 and annually thereafter. The IG, DoD, delegated the audit work for the Navy Defense Business Operations Fund (DBOF) FY 1995 financial statements to the Naval Audit Service (NAS). The IG, DoD, assisted the NAS by performing work at the Defense Finance and Accounting Service (DFAS) Cleveland Center. The audit work included examining the processes used to prepare the Navy's financial statements.

Defense Finance and Accounting Service. DFAS was established as the result of DoD Directive 5118.5, "Defense Finance and Accounting Service," November 26, 1990. DFAS was chartered to standardize and consolidate DoD accounting and finance operations formerly carried out by various DoD activities and the Military Departments. Headquarters, DFAS, is in Arlington, Virginia, and the DFAS Centers are in Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri. DFAS has a number of smaller operating locations.

DFAS Cleveland Center. The DFAS Cleveland Center provides a variety of accounting and financial reporting functions for the Department of the Navy. The DFAS Cleveland Center:

o maintains departmental records and data submitted by field accounting activities and other sources;

o performs accounting and reporting functions for all Navy appropriations, funds, and accounts at the field activity level, the major command level, and the Department of the Navy level; and

o provides financial management and accounting services for the Navy's prior-year and current-year appropriations.

Defense Business Operations Fund. The DBOF was created by the Congress on October 1, 1991, by combining DoD- and Service-owned revolving funds previously called stock and industrial funds. The table below shows all Navy-operated business areas and the types of funds in which they were created.

Defense Business Operations Fund Business Areas

Business Areas	Fund Type
Supply Management (Navy and Marine Corps)	Stock
Distribution Depot	Stock
Logistics Support Activities	Stock
Depot Maintenance	
Aviation	Industrial
Shipyards	Industrial
Ordnance	Industrial
Transportation	Industrial
Base Support	Industrial
Information Services	Industrial
Defense Printing Service	Industrial
Research and Development	
Naval Surface Warfare Center	Industrial
Naval Air Warfare Center - Aircraft	Industrial
Naval Air Warfare Center - Weapons	Industrial
Navy Command, Control and Ocean Surveillance Center	Industrial
Naval Research Laboratories	Industrial
Naval Facilities Engineering Service Center	Industrial
Naval Undersea Warfare Center	Industrial
Component Level - Assistant Secretary of the Navy (Financial Management and Comptroller)	Industrial

The DBOF business areas also include revolving funds established from DFAS, the Defense Commissary Agency, the Defense Information Systems Organization, the Defense Reutilization and Marketing Service, and the Defense Industrial Plant Equipment Center. DBOF was established and designed to increase productivity, decrease costs, and accurately measure cost and performance. All services provided by DBOF organizations are billed directly to customers based on established unit costs.

The DFAS Cleveland Center uses the Central Data Base (CDB) as its primary DBOF accounting system. The CDB interfaces with field activities to generate the financial statements. For FY 1995, the Navy DBOF consolidated statements reported assets of $20.6 billion and revenues of $25.8 billion.

Audit Objectives

Our audit objective was to determine whether the DFAS Cleveland Center consistently and accurately compiled financial data from field activities and other sources for the Navy FY 1995 DBOF consolidated financial statements.

We also planned to determine whether FY 1995 ending balances reported by the DFAS Cleveland Center are usable as beginning balances for the FY 1996 financial statements. However, we were unable to do so because insufficient FY 1995 data were provided. We reviewed the management control program as it related to our other audit objectives. Appendix A discusses the audit scope and methodology and the management control program. Appendix B is a summary of prior audits. See Appendix C for other matters of interest pertaining to the general fund financial statements.

Compilation of the Navy DBOF Financial Statements

The DFAS Cleveland Center did not have adequate controls over the process of compiling information for the Navy DBOF financial statements. Controls were inadequate because:

o standard written procedures for compiling and reporting information for Navy financial statements did not exist;

o controls over the manual processing of financial statement data were inadequate; and

o published crosswalks included incorrect line items.

We did not identify material misstatements on the final Navy DBOF financial statements resulting from the DFAS Cleveland Center's compilation efforts. However, the DFAS Cleveland Center made adjustments of $5.8 billion to the Navy financial statements without initially developing adequate supporting documentation (see Appendix D). DFAS also made erroneous manual adjustments totaling $170.2 million to the Navy FY 1995 Consolidated Financial Statements. In addition, published crosswalks prepared by DFAS Cleveland Center for the Navy's use incorrectly showed errors in the financial statements. The DFAS Cleveland Center corrected these errors before issuing the final Navy FY 1995 DBOF Consolidated Financial Statements. However, if these management control weaknesses are corrected, the DFAS Cleveland Center could provide greater assurance that the Navy FY 1996 Consolidated DBOF and General Fund Financial Statements will not contain misstatements (see Appendix C).

Responsibilities for Financial Reporting

The DoD Components and DFAS must follow DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6, "Reporting Policy and Procedures," February 12, 1996, which defines responsibilities for the preparation, certification, and submission of financial reports. The DoD Components and DFAS are required to support adjustments to financial data. When adjustments are required, the documentation should provide enough detail to stand alone in support of such adjustments. DoD Regulation 7000.14-R gives the requirements for adjusting financial statements.

Requirements for DoD Components (DFAS Customers). The DoD Components must adequately document and support any proposed adjustment.

o The documentation should include evidence of the need for the adjustment in sufficient detail to provide an audit trail to the source transaction that requires the adjustment.

o The DoD Component may be required to review and approve documentation of adjustments proposed by DFAS.

o The DoD Component should maintain records of notifications by DFAS that DFAS has made adjustments.

Requirements for DFAS. DFAS should identify the requirement for adjustments to financial data.

o DFAS should adequately support and justify in writing any adjustments to the official accounting records. The documentation should consist of evidence that supports the need to correct the error and adjust the balances in sufficient detail to provide an audit trail to the source transaction that requires the adjustment.

o The documentation should include the rationale and justification for the adjustment, the numbers and dollar amounts of errors or conditions related to the transactions or records being adjusted, the date of the adjustment, and the name and position of the individual who approved the adjustment.

o The head of the applicable DFAS section shall ensure that any proposed adjustment to an annual report is documented and supported. The adjustment will be processed if the reasons for it are adequately documented and supported and an identifiable audit trail to the source transaction exists. The documentation shall include the name, position, and title of the approving official, as well as the date approved.

Standard Procedures for Compiling Financial Statements

The DFAS Cleveland Center did not have standard written procedures for compiling and reporting the Navy's financial statements. DoD Regulation 7000.14-R (volume 6) states that the Director, DFAS, should establish procedures to ensure that the process for preparing financial reports is consistent, timely, and auditable, and that controls are in place to ensure accurate reports. Adjustments were made without adequate supporting documentation to provide audit trails. Procedures for approving and entering adjustments were inconsistent or did not exist. The lack of standard procedures caused errors that, if not resolved, could cause the financial statements to be misstated. Establishing standard procedures and management controls should ensure that adjustments to financial data are properly authorized, supported, and approved. Appendix D lists the adjustments we reviewed.

Supporting Documentation and Audit Trails. Audit trails required additional explanation or were nonexistent. Audit trails allow transactions to be traced

through a system. Audit trails should allow a transaction to be traced from initiation through processing to final reports. DoD Regulation 7000.14-R requires the DFAS Centers to adequately support and justify in writing any adjustment to the official accounting records; however, documentation for adjustments was not always provided or was often insufficient for establishing an audit trail. Also, the DFAS Cleveland Center did not obtain proper support or written authorization from Navy organizations before making adjustments to financial statement data, as required by DoD Regulation 7000.14-R. They based adjustments on telephone calls or facsimile copies of documents that did not contain enough support. Personnel in the DFAS Cleveland Center's Accounting Operations Directorate said they made telephone calls and used facsimile copies because of time constraints.

The supporting documentation did not provide the rationale, detailed numbers, or dollar amounts needed to arrive at the source transactions. In some cases, the DFAS Cleveland Center initially could not explain why adjustments were made, and could not support adjustments of $5.5 billion. After we discussed these adjustments with accounting personnel, they provided documentation to authorize and support $5.1 billion of the questioned adjustments. For example, DFAS Cleveland Center personnel could not initially explain or support a $733.2 million adjustment that the Navy made to record equipment on the Individual Material Readiness List. They also could not initially support a $677.5 million adjustment to the Non-Operating Change account. That adjustment stemmed from adjustments recommended by Navy personnel in FY 1994.

Additional examples included a $2.3 billion adjustment to Accounts Receivable, Federal; Accounts Receivable, Non-Federal; Accounts Payable, Federal; and Accounts Payable, Non-Federal. The DFAS Cleveland Center also made a $1.3 billion adjustment to Accounts Receivable, Non-Federal, and to the Debt, Federal account. The DFAS Cleveland Center did not initially support the $2.3 billion or the $1.3 billion adjustments in a way that fully explained how the numbers were calculated and recorded to the financial statements. Initially, the DFAS Cleveland Center also had no supporting explanation for why the $1.3 billion adjustment was charged to the Accounts Receivable, Non-Federal, line item. Adjustments should not be made until they are fully supported. These adjustments also were not reviewed by the appropriate supervisor. Supervisory review and approval could have identified adjustments that were not adequately supported, and therefore additional supporting information would have been required before an adjustment was entered.

Other adjustments that did not initially have adequate support or authorization totaled $4.1 billion. The DFAS Cleveland Center subsequently provided the supporting documentation; however, better procedures need to be established for obtaining, supporting, and approving adjustments to the financial statements.

Support for Footnotes to the Financial Statements and Support for Related Adjustments. Footnotes were neither supported nor consistent with the information in the financial statements. For the Navy Distribution Depot business area, the Statement of Operations and Changes in Net Position reported $185.8 million more than the trial balance on the line-item account titled

"Adjustments." The footnotes to the financial statements (Note 27) reflected a $400.5 million prior-period adjustment; however, the Distribution Depot trial balance reflected a $586.3 million prior-period adjustment, a difference of $185.8 million. We requested that the DFAS Cleveland Center provide supporting documentation for the $400.5 million prior-period adjustment, but they initially could not.

The Navy Logistics Support Activity business area also had a difference between the amount reported on the financial statements and the reported trial balance for the line-item account titled "Adjustments." Note 27 of the footnotes to the financial statements reported $0 as a prior-period adjustment. The Navy Logistics Support Activity business area trial balance reported a negative $160 million. We questioned DFAS personnel about the difference and asked them to support any adjustments they may have made. We subsequently noted that the prior-period adjustment was changed from $0 to a negative $160 million on the financial statements and the footnotes, as supported by the trial balance; however, the DFAS Cleveland Center could not provide any additional support for these changes. If footnotes are not properly supported and consistent with the information in the financial statements, the users of the financial statements may be misled. To ensure correctness, the DFAS Cleveland Center should support, review, and approve the financial statement footnotes and related adjustments before they are issued.

Approval of Adjustments. The DFAS Cleveland Center does not have published local operating procedures (similar to procedures at other DFAS Centers) that define separation of duties and responsibilities for making adjustments to financial statements, and management approval is not required before an adjustment can be made. Approval controls are designed to provide reasonable assurance that recorded transactions are approved by appropriate individuals in accordance with management criteria. The DFAS Cleveland Center could not provide the names and positions of individuals who approved all of the adjustments we reviewed. This policy does not conform to DoD Regulation 7000.14-R. Without proper approval, the DFAS Cleveland Center could make adjustments that adversely affect the financial statements. For example, a $385,000 adjustment from the Invested Capital account to the Other Net Position account was made in the Distribution Depot business area, causing the Invested Capital account to be overstated and the Other Net Position account to be understated. A $241,000 adjustment was also made to the same accounts in the Navy Logistics Support business area. These erroneous adjustments, although not material, show how easily unintentional errors can occur in the preparation of large, complicated financial statements. If a supervisor had reviewed and approved the adjustments before they were made, the errors could have been prevented. The DFAS Cleveland Center should establish adequate management controls to ensure that adjustments cannot be made unless approved and signed by the appropriate supervisor.

Consistency of Procedures. Employees responsible for accounting for the various business areas did not use consistent procedures when making adjustments to the financial statements. DoD Regulation 7000.14-R states that the Director, DFAS, should establish procedures to ensure that repetitive or comparable financial reports are prepared consistently, using the same

procedures, practices, and systems. The DFAS Cleveland Center made changes to the Supply Management business area based on guidance from the Naval Supply Systems Command, Navy Stock Fund Division, but did not make similarly authorized adjustments to the Distribution Depot and Logistics Support Activities business areas. As a result, both Accounts Payable, Federal, and Accounts Payable, Non-Federal, were initially overstated by $78.9 million. Additionally, when DFAS Cleveland Center personnel made manual adjustments to business area line items, they did not always enter the adjustments into the spreadsheet used to consolidate the financial statements. At other times, they entered adjustments at the consolidated statement level, but did not enter it at the business area level. Consistent and documented procedures are needed to ensure that adjustments are properly entered into the necessary business areas or financial statement systems being used. The DFAS Cleveland Center subsequently corrected these inconsistencies; however, if better management controls are established, the risk of misstatements on the financial statements will be reduced.

Manual Processing of Financial Statement Data

The DFAS Cleveland Center is responsible for compiling the Navy and Marine Corps financial statements. After compilation, the financial statements are transmitted to the DFAS Indianapolis Center for production and further consolidation with other DoD Components' statements.

The DFAS Cleveland Center receives all Navy financial data directly into the mainframe CDB, while the Marine Corps data is received in hard-copy format from the DFAS Kansas City Center. The financial data that the DFAS Cleveland Center receives from Navy organizations is not in DoD Standard General Ledger format. Because the Navy uses its own chart of accounts, the CDB must convert the data into DoD Standard General Ledger format. (See Appendix C for additional information regarding standard accounting systems).

Manual Transfer of Financial Data. The DFAS Indianapolis Center requires the other DFAS Centers to submit the Military Departments' financial statements in a Microsoft Excel spreadsheet; therefore, the DFAS Cleveland Center must transfer the financial statement information from the mainframe CDB system to a spreadsheet that runs on desktop computers. Because DFAS Centers are required to use a desktop computer spreadsheet instead of using a mainframe system, personnel at the DFAS Cleveland Center must manually enter financial data into the spreadsheet. An automated program to download the data from the CDB to the spreadsheet would improve controls over this process. Controls were not in place to ensure that the data entered were accurate and complete.

As a result, the Navy's records and financial statements initially contained inaccuracies. However, the errors in manual entry, which caused line items to be initially misstated, were corrected before the final statements were issued. Accounting personnel incorrectly entered line-item balances into the

spreadsheet. They incorrectly adjusted data on one business area's financial statement, but did not enter the adjustment on the consolidated financial statements. Manual entries caused errors totaling $9.6 million on the Depot Maintenance Aviation FY 1995 Financial Statements and $170.2 million on the Navy FY 1995 Defense Business Operations Fund Consolidated Financial Statements. Because the DFAS Cleveland Center had not established controls to ensure that the same adjustments were made to both the business area and consolidated statements, errors could occur and line items could be misstated.

The CDB processes and enters financial data for the appropriate line item on the financial statements. Personnel at the DFAS Cleveland Center could improve the process of preparing the statements by eliminating manual entries of line-item data into the spreadsheet. Until a mainframe conversion to DFAS Indianapolis becomes available, an automated process should be used to ensure that line items recorded in the CDB are correctly recorded in the spreadsheet required by the DFAS Indianapolis Center.

Crosswalking Financial Data Line Items to Financial Statements

According to the "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," DFAS is responsible for operating and maintaining financial systems, entering data from DoD Components in the systems, and ensuring the continued integrity of the data.

The DFAS Cleveland Center uses a CDB crosswalk to convert data from trial balances to the financial statements. The CDB contains trial balance data that are already in standard general ledger format. The CDB automatically crosswalks these data to the financial statements. The DFAS Cleveland Center published a crosswalk that was manually prepared for distribution. The purposes of the crosswalk were to illustrate how trial balance data are converted to the financial statements and to assist users in reconciling their financial statement data. The crosswalk, issued on October 23, 1995, for use by Navy and other DoD organizations, was not accurate. Navy and DoD organizations that used the crosswalk could not accurately verify line-item account balances on the financial statements.

Three line items on the published crosswalk were incorrect, causing a difference of about $18.9 million from the crosswalked data produced by the CDB. We used the published crosswalk to transfer trial balance data to financial statement line items for verifying the accuracy of the financial statement line items generated by the CDB. Three line items did not agree with the trial balance data that we had transferred to the financial statements. We asked DFAS Cleveland Center personnel to determine why these three line items did not agree. We obtained printouts of the CDB crosswalk for the three incorrect line items. These printouts showed that the CDB crosswalk differed from the published crosswalk. Personnel at the DFAS Cleveland Center stated that the CDB crosswalk accurately converted financial data, and that errors must have

occurred when the published crosswalk was prepared. However, we did not verify that the entire automated CDB crosswalk was correct because the DFAS Cleveland Center did not provide it to us. The crosswalk that was published and manually prepared was the only crosswalk provided for our use in verifying line-item balances on the financial statements.

These errors did not affect the financial statements issued by the DFAS Cleveland Center because those statements were prepared using the automated CDB crosswalk. DFAS officials informed us that the CDB contained automated controls to correct errors of this nature. However, in order to ensure that financial statements are not misstated, both automated and published crosswalks must be correct. Inaccurate crosswalks can cause errors and confusion. Users of these crosswalks rely on them to verify that data on the financial statements are correct. Data cannot be properly verified if the crosswalks are inaccurate. The DFAS Cleveland Center must ensure that all crosswalks are accurate and uniformly prepared.

Summary

The audit did not identify material misstatements on the final Navy FY 1995 DBOF Consolidated Financial Statements as a result of the DFAS Cleveland Center's compilation efforts. However, management controls were not sufficient to ensure that future financial statements prepared by the DFAS Cleveland Center will consistently and accurately compile the financial data from field activities and other sources. Adjustments to the FY 1995 DBOF financial statements were not always authorized, and supporting documentation was not available to provide audit trails. The DFAS Cleveland Center did not have adequate controls over the approval of adjustments to financial statements. The manual transfer of data caused errors to occur, and published crosswalks required corrections. Until the DFAS Cleveland Center implements standard operating desk procedures, such as documentation requirements and controls over adjustments, financial statements may be misstated.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service, require the Defense Finance and Accounting Service Cleveland Center to establish written procedures to ensure that the process for preparing financial reports is consistent, timely, and auditable, and that controls are in place to provide for the accuracy of the reports, as required by DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6, "Reporting Policy and Procedures," chapter 2, February 12, 1996.

Specifically, the Defense Finance and Accounting Service Cleveland Center should:

1. Establish written procedures to ensure that all adjustments to official accounting records are adequately supported, justified in writing, and properly approved; and provide an audit trail to the detailed transactions being adjusted.

2. Develop and implement standard operating desk procedures for use by accounting personnel in compiling and adjusting financial statements. Procedures should be reviewed annually and updated as necessary.

3. Establish an automated process for transferring financial statement data from the Central Data Base to the Microsoft Excel spreadsheet required by the Defense Finance and Accounting Service Indianapolis Center. The automated process should ensure that the data in the Central Data Base match the data in the financial statements.

4. Correct all crosswalk errors and establish procedures to verify that crosswalk changes are tested and proven to accurately present data in the financial statements.

Management Comments and Audit Response. The Office of the Under Secretary of Defense (Comptroller) in responding for the Director, DFAS, concurred with all audit recommendations. The Deputy Chief Financial Officer indicated that written procedures would be developed to ensure that all adjustments to official accounting records are adequately supported and that standard operating procedures would be developed to ensure consistency and standardization in the adjustment and consolidation of financial statements. The Deputy Chief Financial Officer also indicated that the DFAS Cleveland Center approved a system change request that will provide the capability to electronically download financial statement data to a spreadsheet application and that the DFAS Cleveland Center is currently reviewing the existing crosswalk to correct any errors. All of the proposed corrective actions were responsive; however, completion dates were not provided. We request that the Deputy Chief Financial Officer, in response to the final report, provide specific implementation and completion dates for these corrective actions.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Methodology

Methodology. For the industrial fund and the stock fund business areas, we reviewed DBOF trial balance data from the CDB. We compared these data with the FY 1995 financial statements for the business areas, dated December 1, 1995, and received on December 7, 1995. The financial statements for the business areas were then compared with the FY 1995 Navy DBOF Consolidated Financial Statements provided to us on December 29, 1995. We compared the FY 1995 Navy Consolidated Financial Statements for accuracy and consistency. We then presented discrepancies to DFAS Cleveland Center officials for further review, explanation, and support.

Audit Period and Standards. We performed this financial-related audit from May 1995 through February 1996. The audit was preformed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We evaluated whether significant control policies and procedures had been properly designed and were operating effectively, and we reviewed management controls related to our other audit objectives.

Use of Computer-Processed Data. To achieve the audit objectives, we relied on computer-processed data from the DFAS Cleveland Center's CDB and the Centralized Expenditure Reporting System. We did not evaluate the overall reliability of the data. However, we compared the data to hard copies of trial balance data. We found no errors that would prevent us from relying on the computer-processed data.

Limitations to Audit Scope. Preparation of the FY 1995 General Fund financial statements was not required by the Chief Financial Officers Act of 1990, and the Navy made limited progress in issuing them. As a result, we reviewed only the DBOF Department of the Navy-level reporting process for the FY 1995 financial statements. To support the Naval Audit Service in its audit of the Navy DBOF, we performed audit work related to the functions performed by the DFAS Cleveland Center. Appendix E lists the other organizations we contacted. In accordance with the IG, DoD, audit plan for FY 1995, we limited our review to the Statement of Financial Position and the Statement of Operations and Changes in Net Position. The information used to prepare the financial statements was obtained from reports and trial balance data transmitted to the DFAS Cleveland Center from Navy field activities; for Marine Corps data, the information was transmitted from the DFAS Kansas City Center. We did not evaluate the accuracy of data from outside sources. We evaluated the DFAS Cleveland Center's Department of the Navy-level reporting procedures for consolidating the financial data and ensuring its accuracy and completeness.

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.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DFAS Cleveland Center's management controls over the compilation of the Navy FY 1995 DBOF Consolidated Financial Statements as applicable to our audit objectives. Specifically, at the DFAS Cleveland Center's Accounting Operations Directorate, we reviewed management controls over adjustments and compilation of the financial statements.

Adequacy of Management Controls. We identified material management control weaknesses at the DFAS Cleveland Center, as defined by DoD Directive 5010.38. The draft audit report inadvertently did not make this point clear. The DFAS Cleveland Center's management controls over the compilation of the Navy's financial statements were not adequate to ensure that financial data were consistently and accurately compiled and reported. Recommendation 2., if implemented, will improve the DFAS Cleveland Center's reporting procedures for financial statements. A copy of the report is being provided to officials responsible for the DFAS Internal Management Control Program.

Adequacy of Management's Self-Evaluation. Officials at the DFAS Cleveland Center correctly identified functions of the Accounting Operations Directorate as assessable units for financial statement reporting. However, the DFAS Cleveland Center assigned a medium level of risk to the assessable units. We believe that a high level of risk should have been assigned because of previously acknowledged accounting system problems, as well as other factors. The DFAS Cleveland Center identified and reported in its annual statement of assurance some of the weaknesses identified by the audit, and is implementing procedures to correct the weaknesses. However, the planned actions will not correct all weaknesses identified by the audit because they will not ensure that the DFAS Cleveland Center accurately compiles financial data into the financial statements. The corrective actions do not specifically correct the weaknesses we identified and additional measures are needed, as recommended in this report.

Appendix B. Summary of Prior Audits and Other Reviews

Naval Audit Service

NAS Report No. 044-95, "Fiscal Year 1994 Consolidating Financial Statements of the Department of the Navy DBOF," was issued on May 30, 1995. At the request of the IG, DoD, the NAS did not issue an opinion on the Statement of Financial Position of the FY 1994 Department of the Navy DBOF Consolidating Financial Statements. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, gave the IG, DoD, overall responsibility for auditing DBOF financial statements. The NAS audit supported this requirement. The NAS found that the DFAS paying offices were inappropriately estimating collections and disbursements for nonreporting activities. In addition, DFAS improperly estimated sales for activities and ships. The DFAS Cleveland Center concurred or concurred in principle with the recommendations related to its work, and adjustments have been made.

NAS Report No. 053-H-94, "Fiscal Year 1993 Consolidating Financial Statements of the Department of the Navy DBOF," June 29, 1994. The NAS issued an adverse opinion on the financial statements because the account balances reported on the statement were materially misstated. Also, on the September 30, 1993, Statement of Financial Position, corrections had not been made on prior-year adjustments totaling a net understatement of $57,502,697 for assets and an overstatement of $263,700,000 for liabilities. NAS also noted that the totals on the FY 1992 Statement of Financial Position were not carried forward correctly on the September 30, 1993, Statement of Financial Position, but were overstated by $73,927 for total financial resources and understated by $73,929 for total nonfinancial resources. Although NAS recommended that the DFAS Cleveland Center make adjustments to correct line items on the financial statements, the manner in which the DFAS Cleveland Center consolidated the financial data from the field activities was not the reason for the adverse opinion.

Appendix C. Other Matters of Interest

General Fund Financial Statements. Because the FY 1995 General Fund financial statements were not required by the Chief Financial Officers Act of 1990, we could not determine whether the DFAS Cleveland Center had consistently and accurately compiled financial data from Navy field activities for the Navy General Fund. Although planning has begun, the DFAS Cleveland Center has not established a process or identified the procedures needed to compile and report the Navy General Fund financial statements. The DFAS Cleveland Center is responsible for compiling both the DBOF and the General Fund financial statements. During our audit of the compilation of DBOF financial data, we found management control weaknesses that could occur in the DFAS Cleveland Center's compilation and reporting of the FY 1996 Navy General Fund financial statements. The recommendations in this report should also be applied to the preparation of General Fund financial statements to ensure consistent and accurate statements.

DFAS Cleveland Center Accounting Systems. The DFAS Cleveland Center does not have an integrated, double-entry, transaction-based, general ledger accounting system. Although the CDB uses the DoD Standard General Ledger chart of accounts, the financial data that the DFAS Cleveland Center receives from Navy organizations is not in DoD Standard General Ledger format. Because the Navy uses its own chart of accounts, the CDB must convert the data into DoD Standard General Ledger format.

The DFAS Cleveland Center receives trial balances directly from the Navy field-level stock fund offices or from the business areas into the CDB. For the Marine Corps Stock Fund, the DFAS Cleveland Center also receives hard-copy trial balances and reports from the DFAS Kansas City Center. The data from the business areas comes from various non-DoD general ledger systems and is converted by the CDB into DoD Standard General Ledger format.

For the Navy Industrial Fund, the DFAS Cleveland Center receives trial balance data directly from the activity level. During posting, the CDB converts the data, which are in the Navy chart of accounts format, to the DoD Standard General Ledger format. DFAS Cleveland personnel said the data are converted by the CDB into DoD Standard General Ledger format before being crosswalked to the financial statements; however, the trial balances were in the Navy chart of accounts format. The crosswalk converted the trial balance data directly into the financial statements. As with the Stock Fund, the DFAS Cleveland Center receives data on the Marine Corps Industrial Fund in hard-copy format from the DFAS Kansas City Center. An integrated standard general ledger accounting system is required by DoD Regulation 7000.14-R, "Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," March 16, 1993.

Although the DFAS Cleveland Center's financial statements are not prepared using an integrated, double-entry, transaction-based, general ledger accounting system, we are not recommending that such a system be implemented for the Navy's financial statements. The DFAS Cleveland Center's present accounting

systems are legacy systems[1] that are being converted to standard interim migratory accounting and reporting systems. These interim migratory[2] systems should meet the requirements of DoD Regulation 7000.14-R.

[1]Refers to an existing system.

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

Appendix D. Inadequate Controls Over Adjustments to the Financial Statements

Accounts	Authorized by Navy	Initially Supported	Subsequently[1] Supported	Approved and Entered	Adjustment Amount
Statement of Financial Position					
A/R[2] Federal	N/A[3]	No	Yes	No	$1,145,525,000
A/R Non-Federal	N/A	No	Yes	No	175,247,000
A/P[4] Federal	N/A	No	Yes	No	817,312,000
A/P Non-Federal	N/A	No	Yes	No	197,371,000
Other Federal Liabilities	N/A	Yes	N/A	No	306,089,000
Other Non-Entity Assets, Other Federal Liabilities	Yes	No	Yes	No	733,297,000
A/R Non-Federal Debt	Yes	No	Yes	No	1,263,359,145
Non-Operating Change	N/A	No	Yes	No	677,559,000
Funds With Treasury, Invested Capital	No	No	Yes	No	69,598,872
Funds With Treasury, Invested Capital	Yes	Yes	N/A	No	38,827,404[5]
Statement of Operations and Changes in Net Position					
Adjustments (Prior Period)	No	No	No	No	400,497,000
Total					**$5,824,682,421**

[1] Personnel at the DFAS Cleveland Center did not initially provide supporting documentation for these adjustments. After we presented the adjustments, DFAS Cleveland personnel provided documentation that generally authorized or supported them.

[2] Accounts Receivable.

[3] Not Applicable.

[4] Accounts Payable.

[5] This adjustment affected two financial statements at the business area level, the Military Sealift Command and the Component financial statements. DFAS Cleveland personnel supported the adjustments to the Military Sealift Command's financial statements, but did not support the Navy Component financial statements.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Department of the Navy

Naval Audit Service, Arlington, VA
  Naval Audit Service, Southeast Region, Virginia Beach, VA

Other Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
  Defense Finance and Accounting Service Cleveland Center, Cleveland, OH
  Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN

Non-Defense Federal Organization

General Accounting Office, Washington, DC

Appendix F. 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 (Public Affairs)
Director, Defense Logistics Studies Information Exchange

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 Finance and Accounting Service Cleveland Center
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

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

Under Secretary of Defense (Comptroller) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

OCT 7 1996

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

SUBJECT: Draft Audit Report on Defense Finance and Accounting Service Work on the Navy Defense Business Operations Fund FY 1995 Financial Statements (Project No. 5FI-2013)

This is in response to your memorandum of July 31, 1996, that requested a response to the subject draft audit report.

This office generally concurs with the recommendations contained within the subject draft audit report. Attached are specific responses to each of the recommendations contained in the subject report.

My point of contact for this report is Mr. Jerry Williams. He may be reached at (703) 697-8283 or e-mail: williamj@ousdc.osd.mil.

Alvin Tucker
Deputy Chief Financial Officer

Attachment

DEPARTMENT OF DEFENSE INSPECTOR GENERAL
AUDIT REPORT ON THE DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE NAVY DEFENSE BUSINESS OPERATIONS FUND FY 1995 FINANCIAL STATEMENTS (PROJECT NO. 5FI-2013)

COMMENTS ON RECOMMENDATIONS

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Recommendation 1: Director, Defense Finance and Accounting Service, requires the Defense Finance and Accounting Service-Cleveland Center to establish written procedures to ensure that all adjustments to official accounting records are adequately supported, justified in writing, and properly approved; and provide an audit trail to the detailed transactions being adjusted.

OUSD(C) Response: Concur. Written procedures currently are being developed by the Defense Finance and Accounting Service (DFAS)-Cleveland Center. These procedures are intended to ensure that all adjustments to the official accounting records are adequately supported, justified in writing, and properly approved; and also will provide an audit trail to the detailed transactions being adjusted.

Recommendation 2: Director, Defense Finance and Accounting Service, requires the Defense Finance and Accounting Service-Cleveland Center to develop and implement standard operating desk procedures for use by accounting personnel in compiling and adjusting financial statements. Procedures should be reviewed annually and updated as necessary.

OUSD(C) Response: Concur. The Defense Finance and Accounting Service-Cleveland Center currently is developing Standard Operating Procedures to ensure consistency and standardization in the adjustment and consolidation of financial statements. These procedures will be reviewed annually to ensure their comprehensiveness and appropriateness.

Recommendation 3: Director, Defense Finance and Accounting Service direct the Defense Finance and Accounting Service-Cleveland Center to establish an automated process transferring financial statement data from the Central Data Base to the Mircosoft Excel spreadsheet required by the Defense Finance and Accounting Service Indianapolis Center. The automated process should ensure that the data in the Central Data Base matches the data in the financial statements.

OUSD(C) Response: Concur. A System Change Request, to provide the capability to electronically download report data to a spreadsheet application, has been submitted to, and approved by, the Defense Finance and Accounting Service-Cleveland Center. This process will better ensure data integrity between the Central Data Base and the financial statements.

Recommendation 4: Director, Defense Finance and Accounting Service direct the Defense Finance and Accounting Service-Cleveland Center to correct all crosswalk errors and establish procedures to verify that crosswalk changes are tested and proven to accurately present data in the financial statements.

OUSD(C) Response: Concur. The DFAS-Cleveland Center currently is reviewing the existing crosswalk in order to identify, and correct, any errors. In addition, the DFAS-Cleveland Center recently established procedures whereby the published crosswalk, which is prepared manually and utilized for reconciliation of financial statement data, will be reviewed by someone other than the preparer. This procedure is intended to better ensure that both the Central Data Base crosswalk and the published crosswalk are in agreement. In turn, this should better ensure the accuracy of the data while reducing the burden of the reconciliation process.

Attachment
Department of Defense Inspector General
REPORT NO. 5FI-2013
Page 2 of 2

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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