

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

COMPILATION OF FY 1995 AIR FORCE
CONSOLIDATED FINANCIAL STATEMENTS AT THE
DEFENSE FINANCE AND ACCOUNTING SERVICE
DENVER CENTER

Report No. 97-057

December 27, 1996

Department of Defense

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Acronyms

AEU	Accrued Expenditures Unpaid
AFAA	Air Force Audit Agency
CEFMS	Corps of Engineers Financial Management System
CFO	Chief Financial Officers
COARS	Command On-line Accounting and Reporting System
DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
GL/FC	General Ledger/Funds Control
IG	Inspector General
MAFR	Merged Accountability and Fund Reporting
RDT&E	Research, Development, Test, and Evaluation



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

December 27, 1996

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Audit Report on Compilation of FY 1995 Air Force Consolidated
Financial Statements at the Defense Finance and Accounting Service
Denver Center (Report No. 97-057)**

We are providing this audit report for your information and use. The audit was performed in response to the Chief Financial Officers Act of 1990. Management comments on a draft of this report were considered in preparing the final report.

Based on your comments, we revised Recommendation A.2. on required financial statement disclosures to adopt the alternative that you proposed. We also made one correction to the discussion of accounts payable in Finding A. Comments provided on a draft of this report fully conformed to the requirements of DoD Directive 7650.3, although there was one disagreement on the previous disclosure of management control weaknesses. No additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. David C. Funk, Audit Program Director, at (303) 676-7445 (DSN 926-7445) or Mr. W. Andy Cooley, Audit Project Manager, at (303) 676-7393 (DSN 926-7393). See Appendix F for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink that reads "Robert J. Lieberman".

Robert J. Lieberman
Assistant Inspector General
for Auditing

**Compilation of FY 1995 Air Force Consolidated Financial
Statements at the Defense Finance and Accounting Service
Denver Center**

Executive Summary

Introduction. The Chief Financial Officers Act of 1990 requires the Inspector General, DoD, or an appointee to audit financial statements of DoD organizations. The Inspector General, DoD, delegated the audit of the FY 1995 Air Force consolidated financial statements to the Air Force Audit Agency. Our audit focused on the compilation of the FY 1995 Air Force consolidated financial statements by the Defense Finance and Accounting Service Denver Center (Denver Center). The Denver Center maintains accounting records and prepares the financial statements for the Air Force. In its report, the Air Force Audit Agency disclaimed an opinion on those financial statements.

Audit Objectives. The primary audit objective was to determine whether the Denver Center consistently and accurately compiled financial data from field organizations and other sources for the FY 1995 Air Force consolidated financial statements.* Another audit objective was to determine whether FY 1995 ending balances reported by the Denver Center were supportable for use as beginning balances for FY 1996 financial statements. In addition, we evaluated compliance with laws and regulations and the management control program, as it related to our objectives.

Audit Results. Though still facing significant financial management challenges, the Denver Center completed corrective actions on 7 of 18 open recommendations made in prior audits by the Inspector General, DoD, to improve the process the Denver Center used in compiling the Air Force consolidated financial statements. See Appendix C, Other Matters of Interest, for details of the open recommendations. Despite the progress made, however, the Denver Center did not provide sufficient evidence that it had accurately compiled financial data from field organizations and other sources for the FY 1995 Air Force consolidated financial statements.

- o Denver Center did not report negative accounts payable of \$882.3 million and did not disclose the use of unreliable data in preparing the financial statements. As a result, we could not confirm the reliability of \$4 billion in accounts payable to non-Federal entities as reported in the financial statements. In addition, financial statement users were unaware that they could not rely on the accuracy of reported accounts payable transactions (Finding A).

- o The Command On-line Accounting and Reporting System, a major source of data for financial reports, did not provide adequate audit trails for verifying adjustments made by the Denver Center. Therefore, Denver Center managers did not have reasonable assurance that all adjustments were adequately supported, classified, coded, and recorded (Finding B).

*During the audit, the scope was reduced to exclude an evaluation of the Defense Business Operations Fund financial statements prepared by the Denver Center.

We could not determine the accuracy of the ending balances in the FY 1995 Air Force consolidated financial statements. Accordingly, we could not confirm the reliability of those ending balances for use as beginning balances for the FY 1996 financial statements.

The management control program could be improved because we identified material weaknesses related to the accuracy of reported accounts payable and the adequacy of audit trails for one automated system (Appendix A). If implemented, recommendations in this report will improve the reliability of future Air Force consolidated financial reports.

Summary of Recommendations. We recommend establishing milestones for and monitoring the progress of changes required in the automated information system used to report accounts payable, disclosing the use of unreliable data in preparing financial statements, and establishing a complete and accurate audit trail of all adjustments made by Denver Center personnel in the Command On-line Accounting and Reporting System until the Corps of Engineers Financial Management System development is completed.

Management Comments and Audit Response. The Defense Finance and Accounting Service concurred with our recommendations and proposed an acceptable alternative to one recommendation concerning disclosures on unreliable data. Management stated milestones have been established and are being closely monitored for the changes required in the automated information system used to report accounts payable. Rather than reemphasize disclosure requirements with its staff, the Denver Center will include a footnote in the FY 1996 financial statements on the reliability of the accrued expenditures unpaid data. We revised our related recommendation to adopt the alternative proposed by management. To establish an audit trail for adjustments made in one automated system, the agency will develop a system retrieval for management to use and will request that on-line transaction history files be retained longer. Management noted that an incorrect statement had been made in the discussion of accounts payable under Finding A, which we revised. Management also disagreed with the statement made in Appendix A that the material weaknesses discussed in the two findings had not been reported under the management control program. However, we verified that the agency's internal control reports for FYs 1995 and 1996 did not support management's statement. See Part I and Appendix A in Part II for our response to management's comments and Part III for the complete text of the comments.

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Part I - Audit Results

Audit Background

Audit Requirement. Public Law 101-576, the Chief Financial Officers Act of 1990 (the CFO Act), requires the Inspector General (IG), DoD, or an independent auditor appointed by the IG, DoD, to audit the financial statements of DoD organizations. The IG, DoD, delegated the audit of the FY 1995 Air Force consolidated financial statements to the Air Force Audit Agency (AFAA). To assist the AFAA, the IG, DoD, reviewed the financial statement compilation process at the Defense Finance and Accounting Service (DFAS) Denver Center (Denver Center).

Focal Point. As the CFO Act focal point for Air Force accounting and finance data, the Denver Center is responsible for providing timely, accurate, and meaningful financial information to the Air Force. The Denver Center maintains Air Force department-level records and prepares financial statements from data submitted by the Air Force and other DoD organizations. In compiling the Air Force consolidated financial statements, the Denver Center obtains data from a myriad of accounting and nonaccounting systems.

Compilation Process. As discussed in Appendix B, prior audits reported that the Denver Center did not prepare Air Force consolidated financial statements from data in a standard general ledger, as required by the DoD Financial Management Regulation. The Air Force General Funds General Ledger, a DFAS automated information system, does not capture all the information necessary to prepare the financial statements. Therefore, in preparing the FY 1995 financial statements, the Denver Center used internal systems and a number of external sources to accumulate and report financial information. The internal systems are discussed below.

- o The Status of Funds database, which is part of the Departmental On-line Accounting and Reporting System, contains budget information summarized by appropriation. Most of the Status of Funds data were received from the Command On-line Accounting and Reporting System (COARS).

- o The Air Force General Funds General Ledger, which provides some accounting information, is summarized by Air Force base and general ledger account code.

- o The Merged Accountability and Fund Reporting (MAFR) system, which includes payment and collection transactions, is summarized by appropriation.

External sources of data include reports from the Defense Logistics Agency, DFAS Columbus Center (Columbus Center), and various Air Force financial and logistics organizations. The Denver Center has little control over some of the information available, and the reliability of much of the data cannot be

confirmed at the Air Force level. For that and other reasons, the AFAA has disclaimed an opinion on the Air Force consolidated financial statements for FYs 1992, 1993, 1994, and 1995.

Planned Corrective Action. A Denver Center project was under way to develop concepts for an interim migratory accounting system* called the General Ledger/Funds Control (GL/FC) system. When completed, the GL/FC was to resolve many of the deficiencies in the existing systems and produce certifiable financial statements. However, in July 1996, the Under Secretary of Defense (Comptroller) directed DFAS to develop the Corps of Engineers Financial Management System (CEFMS) as the general accounting migratory system for the Denver Center's customers. The Denver Center is currently developing plans to implement the CEFMS.

Audit Objectives

Specific Objectives. The primary audit objective was to determine whether the Denver Center consistently and accurately compiled financial data from field organizations and other sources for the FY 1995 Air Force consolidated financial statements. We also determined whether FY 1995 ending balances reported by Denver Center were supportable for use as beginning balances for the FY 1996 financial statements. In addition, we evaluated the Denver Center's compliance with laws and regulations and its management control program, as it related to our objectives. See Appendix A for a discussion of the scope and methodology and the results of our review of the management control program. See Appendix B for prior audits and other reviews and Appendix C for other matters of interest concerning the importance of resolving issues from prior audits.

Revision of Audit Objectives. The audit did not include an evaluation of the Defense Business Operations Fund financial statements prepared by the Denver Center. For details, see the discussion of scope limitations in Appendix A.

*A migratory system is an existing or planned and approved automated information system that has been designated to support a functional process on a DoD-wide basis.

Finding A. Accuracy of Accounts Payable Data

In preparing the FY 1995 Air Force consolidated financial statements, Denver Center did not include \$882.3 million of negative Accrued Expenditures Unpaid (AEU) data reported by Columbus Center and its Albuquerque Office (now closed). In addition, accounting personnel did not disclose in the financial statements that unreliable sources were used in determining the reported accounts payable. Denver Center personnel stated they did not include all the accounts payable reported by Columbus Center and its Albuquerque Office because the data were unreliable. No disclosures on the use of unreliable accounts payable data were provided because of an oversight by accounting personnel at Denver Center. As a result, we could not confirm the accuracy of the reported accounts payable, which may be overstated by up to \$882.3 million. In addition, financial statement users were unaware that they could not rely on the accuracy of amounts reported in accounts payable transactions.

Summarizing Accounts Payable Data

Amounts Reported. The Denver Center reported \$4 billion on line 4.b.(1), Accounts Payable Transactions With Nonfederal Entities, in the FY 1995 Air Force consolidated financial statements. Personnel summarized the accounts payable information from several sources. According to Note 33, "Other Disclosures," to the financial statements, the \$4 billion of accounts payable included \$3 billion of AEUs related to procurement contracts centrally administered by Columbus Center and its Albuquerque office (see Table 1). The AEUs represent payments due on goods received or services rendered.

Denver Center's AEU Compilation Report. Air Force Regulation 177-101, "General Accounting and Finance Systems at Base Level," February 15, 1991, chapter 20, requires that Denver Center add AEU data from centrally administered contracts, other than those funded by operation and maintenance appropriations, to AEU data reported by field organizations. The Denver Center did that by summarizing in the report the data from three reports from the Columbus Center for different accounting and disbursing stations (see Appendix D for the report). Amounts received on the three reports were totaled by appropriation and fiscal year. The Denver Center included in the three reports the AEUs for five procurement appropriations:

- o Aircraft Procurement, Air Force (3010),
- o Missile Procurement, Air Force (3020),
- o Other Procurement, Air Force (3080),

Finding A. Accuracy of Accounts Payable Data

- o Military Construction, Air Force (3300), and
- o Research, Development, Test and Evaluation (RDT&E), Air Force (3600).

AEUs Reported by Albuquerque. The Denver Center also received a report with AEU data on centrally administered contracts from the Columbus Center office in Albuquerque. Denver Center added the Albuquerque data on procurement appropriations to the amounts from the Columbus Center report.

As discussed below, the Denver Center did not report all of the AEUs and did not disclose in the financial statements the use of unreliable AEU data, as required by DoD guidance on the form and content of financial statements.

Selective Use of Data

As Table 1 illustrates, accounting personnel at Denver Center reported in the Air Force consolidated financial statements about \$3 billion of AEUs for contracts centrally administered by the Columbus Center and its Albuquerque office, but did not report negative AEUs of \$882.3 million identified by the two organizations.

Table 1. Accrued Expenditures Unpaid
As of September 30, 1995

	<u>Accrued Expenditures Unpaid (in millions)</u>		
	<u>Total</u>	<u>Reported</u>	<u>Unreported</u>
Procurement AEUs identified by:			
Columbus Center (see Table 2)	\$ (333.9)	\$ 619.2	\$(953.1)
Albuquerque Office	<u>2,494.5</u>	<u>2,423.7</u>	<u>70.8</u>
Total	\$2,160.6	\$3,042.9	\$(882.3)

Accounting personnel at Denver Center included in the financial statements \$619.2 million in AEUs for contracts centrally administered by Columbus Center, but did not include \$953.1 million in negative amounts also reported by the Columbus Center. Denver Center personnel also did not report \$70.8 million (positive amount) in Air Force RDT&E AEUs reported by Albuquerque. As a result, the accounts payable in the Air Force consolidated financial statements may be overstated by as much as \$882.3 million. Denver Center's treatment of the AEUs identified by Columbus Center and its Albuquerque office is discussed in the following paragraph.

Finding A. Accuracy of Accounts Payable Data

AEUs Identified by Columbus Center. Denver Center accounting personnel did not include appropriations on the Columbus Center report if the net totals from the three reports for the different accounting and disbursing stations were negative amounts. This reporting procedure is illustrated in Table 2, which summarizes the report shown in Appendix D.

**Table 2. Summary of Denver Center's Report of
Accrued Expenditures Unpaid
As of September 1995**

<u>Appropriations</u>	<u>Accrued Expenditures Unpaid (in millions)</u>		
	<u>Total</u>	<u>Reported</u>	<u>Unreported</u>
3010 Aircraft Procurement			
FY 1989	\$(48.3)	0	\$(48.3)
FY 1990	25.7	\$ 25.7	0
FY 1991	17.9	17.9	0
FY 1992	41.0	41.0	0
FY 1993	175.2	175.2	0
FY 1994	71.3	71.3	0
FY 1995	<u>(6.7)</u>	<u>0</u>	<u>(6.7)</u>
Subtotal	\$276.1	\$331.1	\$(55.0)
3020 Missile Procurement (FYs 1989-1995)	22.7	146.3	(123.6)
3080 Other Procurement (FYs 1989-1995)	(414.8)	58.6	(473.4)
3300 Military Construction (FYs 1989-1995)	.1	.1	0
3600 RDT&E (FYs 1990-1995)	<u>(218.0)</u>	<u>83.1</u>	<u>(301.1)</u>
Total	\$(333.9)	\$619.2	\$(953.1)

As illustrated in Table 2, Denver Center did not report the \$48.3 million and \$6.7 million negative AEUs related to the FYs 1989 and 1995 Aircraft Procurement appropriations, respectively. The AEU report in Appendix D shows that the negative totals for the two appropriations (57 9 3010 and 57 5 3010) were the net of both negative and positive amounts shown for the three accounting and disbursing stations. Conversely, Denver Center reported the \$41 million AEU related to the FY 1992 Aircraft Procurement appropriation because the net total was a positive amount. Similar to the unreported AEUs for the FYs 1989 and 1995 appropriations, the total AEUs reported for the FY 1992 appropriation (57 2 3010), though positive, was also the net of both negative and positive amounts. The Denver Center used this same reporting method for 11 of the 23 amounts reported in the other four appropriations listed in the report in Appendix D.

Accounting personnel at Denver Center stated they did not report the negative totals because the AEU reports from the Columbus Center were known to be unreliable, and they believed the reported negative balances to be errors. As noted in the discussion of Financial Statement Disclosures, later in the report, an AFAA audit substantiated the fact that the AEU reports from the Columbus Center were unreliable. By definition, AEUs should normally appear as positive amounts on AEU reports received from the Columbus Center and its Albuquerque office. Thus, accounting personnel at Denver Center viewed the

Finding A. Accuracy of Accounts Payable Data

negative totals on the AEU reports as being errors. Though unusual, negative AEU's may occur because of an overpayment on the account or an error in the accounting records. The Columbus Center could not provide the information necessary to explain or correct the reported negative AEU's.

AEUs Identified by Columbus Center's Albuquerque Office. As shown in Table 1, Albuquerque identified \$2.5 billion in AEU's for centrally managed contracts. However, of the \$2.5 billion, Denver Center did not include \$70.8 million of AEU's from an Air Force RDT&E appropriation in the financial statement accounts payable data. Although sufficient unobligated authority existed, Denver Center personnel excluded the AEU's because adjusting the accounting records would have created a negative account balance for undelivered orders outstanding.

Other Data Sources. Accounting personnel at Denver Center stated that only the Columbus Center's AEU reports provided the accounting data necessary to meet the reporting requirements of the CFO Act and the appropriation data necessary to meet the reporting requirements of the U.S. Treasury. In August 1992, the Director, Denver Center, requested assistance from his counterpart at the Columbus Center to identify the composition of the AEU report totals and to certify their accuracy. The Columbus Center initiated action to correct the problem with negative account payable balances in the report; however, the system change request submitted more than 2 years ago to another Defense organization to correct the problem has not been completed. Because the AEU data provided by automated system is unreliable, the DFAS should stress the importance of making timely system changes by establishing firm milestones for the changes and by monitoring the progress in meeting the milestones.

Financial Statement Disclosures

Although aware that unreliable data were used, Denver Center personnel did not disclose the use of unreliable AEU data in the footnotes to the financial statements. Such disclosures are required by DoD "Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," October 1994. The DoD guidance on footnotes to financial statements in chapter 1, paragraph H., states:

In many cases, the underlying financial systems and operations that produce these statements were not designed to generate auditable financial statements in compliance with this form and content guidance. Consequently, diversions from generally accepted accounting principles and DoD policy exist in many of the Department's organizations. This is due largely, but not entirely, to long standing systems problems. The continuing system problems remain a serious challenge to the Department -- and realistically will require a number of years to correct. In cases where individual line items of the financial statements cannot be obtained or a substitution is made from the requirements herein, the deficiencies will be explained and the reason for noncompliance annotated. At the

Finding A. Accuracy of Accounts Payable Data

discretion of the program manager, such explanations can be included in the "Overview of the Reporting Entity," individual "Notes" to the financial statements, at Note 1 "Significant Accounting Policies," or any combination thereof.

Note 33 to the FY 1995 Air Force consolidated financial statements states that \$3 billion of the \$4 billion in Accounts Payable, Public, was based on AEU reports from Columbus Center. AFAA determined that the AEU reports from Columbus Center were not reliable, citing problems with the automated system (the Mechanization of Contract Administration Services system) used to prepare the reports, which causes the system to generate negative accounts payable balances. AFAA stated that the Columbus Center had requested that the Defense Logistics Agency, Defense Systems Design Center, Columbus, Ohio, make the necessary automated system changes. However, as of June 11, 1996, the problem had not been corrected. Details on the AFAA finding are provided in its report on Project 95053003, "Review of the Fund Control Process, FY 1995 Air Force Consolidated Financial Statements," June 27, 1996.

Denver Center managers have known of problems with the Columbus Center's AEU reports since March 1989. In response to concerns expressed by the Denver Center, the Columbus Center requested changes to the Mechanization of Contract Administration Services system in April 1994. Despite the DoD guidance on form and content, accounting personnel at Denver Center did not disclose their use of unreliable data from the Columbus Center's AEU reports in the footnotes to the FY 1995 Air Force consolidated financial statements. Accounting personnel at the Denver Center stated that they had overlooked the DoD form and content requirement to disclose the use of unreliable AEU data in the notes to financial statements. Because of the lack of disclosure, financial statement users were not aware that they should not rely on the accuracy of \$3 billion of the reported \$4 billion in accounts payable transactions.

Summary

The Denver Center and Columbus Center identified and requested changes in the automated system that should improve the reliability of the AEU reports provided by Columbus Center for reporting accounts payable transactions. However, oversight is required from DFAS to place a higher priority on completing the required system changes, which were requested more than 2 years ago. In addition, Denver Center should ensure that the use of unreliable AEU data is adequately disclosed in the financial statements.

Management Comments on the Finding and Audit Response

DFAS Comments. DFAS stated that the draft report incorrectly stated that \$70.8 million of AEUs identified by Columbus Center's Albuquerque Office were not included by Denver Center in the financial statements because ". . . funds were not available to cover all the payables." DFAS noted that more than \$150 million in unobligated authority existed. However, the accounting records were not adjusted because insufficient obligations (in the form of undelivered orders outstanding) were available to prevent creating a negative unliquidated obligation.

Audit Response. We agree and revised the finding to clearly describe why the AEUs were not reported by Denver Center.

Recommendations, Management Comments, and Audit Response

Revised Recommendation. As a result of management comments, we revised draft Recommendation A.2. to reflect the alternative recommended by DFAS. Comments on the revised recommendation are not required.

A.1. We recommend that the Director, Finance Deputate, Defense Finance and Accounting Service, coordinate with the Columbus Center to establish milestones for and monitor the progress in responding to the system change request submitted to improve the reliability of the Mechanization of Contract Administration Services system, which is used to compile and report the accrued expenditures unpaid on centrally administered contracts.

DFAS Comments. Management concurred, stating that milestones were established for reprogramming the system and the progress of the system change request was being closely monitored. Testing and implementation of the reprogrammed Accrued Expenditures Report should be completed by December 31, 1996.

A.2. We recommend that the Director, Defense Finance and Accounting Service Denver Center, include a footnote in the FY 1996 Air Force consolidated financial statements disclosing the use of unreliable data on accrued expenditures unpaid (and other departures from generally accepted accounting principles and DoD policy), as required by DoD guidance on the form and content of FY 1996 financial statements.

DFAS Comments. Management concurred, stating that data should be more reliable once the system changes discussed under Recommendation A.1. are completed. As an alternative to reemphasizing disclosure requirements to accounting personnel, by December 31, 1996, the Denver Center will prepare a

Finding A. Accuracy of Accounts Payable Data

footnote for the FY 1996 financial statements disclosing the reliability of the data on the accrued expenditures unpaid report received from the Columbus Center.

Additional comments on the management control program and our audit response are provided in Appendix A.

Audit Response. We revised our recommendation to adopt management's alternative, which was fully responsive.

Finding B. System Audit Trails

The Command On-line Accounting and Reporting System, a major source of data for Air Force financial reports, did not provide adequate audit trails for verifying all accounting adjustments originating at Denver Center. Audit trails were lacking because transaction history files were not available for use in verifying adjustments made by accountants at Denver Center to master data files. As a result, managers at Denver Center did not have reasonable assurance that all adjustments were adequately supported, classified, coded, and recorded.

Financial Management Regulation

Requirement for Audit Trails. When appropriate, Denver Center personnel adjust financial information received from field organizations to better represent the Air Force financial activity. DoD 7000.14-R, "Department of Defense Financial Management Regulation," volume 1, May 1993, states that having adequate audit trails to trace transactions is a key accounting requirement of a compliant accounting system. Volume 1 further states:

Audit trails permit tracing transactions through a system. Audit trails allow auditors or evaluators to ensure transactions are properly accumulated and correctly classified, coded and recorded in all affected accounts. Audit trails should allow a transaction to be traced from initiation through processing to final reports.

A history of COARS transactions are stored on computer tapes monthly at various Defense computer centers.

Benefits of An Audit Trail. The term "audit trail" is a misnomer because the audit trail is not solely for auditors' use; an audit trail primarily benefits management on a day-to-day basis. With an audit trail, managers can be assured that the summarized data used to make critical decisions are supported by individual transactions and documents that can be located and tested for accuracy. The creation and maintenance of adequate audit trails is part of a sound management control program.

Adjustments to Data

COARS was a major source of data for the Status of Funds system that Denver Center used in preparing the FY 1995 Air Force consolidated financial statements. However, Denver Center managers could not identify all the adjustments Denver Center accountants made to COARS data fields. The COARS allows accounting data in the master data file to be changed by Denver Center accountants without providing an audit trail of those changes. Although

Finding B. System Audit Trails

the system stores all transactions on computer tapes monthly, those tapes were not stored at Denver Center and were not in a format that management or audit could use to review departmental adjustments. For example, property and equipment valued at \$234 billion was reported on the FY 1995 Air Force Consolidated Statement of Financial Position. That amount reflected a net increase of \$10 billion from FY 1994. Denver Center accountants made adjustments affecting the property and equipment transactions reported through COARS. However, because no audit trail existed, Denver Center managers could not identify or review all adjustments made by their staff. A complete universe of transactions is necessary to verify that all adjustments can be tested for accuracy. As a result, we could not determine whether all departmental adjustments were properly classified, coded, and recorded in each affected account.

Corrective Actions Planned

The COARS system was designated an interim migratory system. Modifications were being included in the GL/FC project, which is being replaced by CEFMS. The CEFMS will include audit trails for all adjustments originating at the Denver Center. This project is estimated to be completed in December 1999.

Recommendation and Management Comments

We recommend that the Director, Defense Finance and Accounting Service Denver Center, use the transaction history files to establish a complete and accurate audit trail of all adjustments made by accounting personnel at Denver Center to data reported through the Command On-line Accounting and Reporting System, until the Corps of Engineers Financial Management System project is completed.

DFAS Comments. Management concurred, stating the Denver Center will develop a system retrieval for management to use for audit purposes and for review of specific time frames. The Denver Center will also request that on-line transaction history files be retained for at least 1 year, instead of 1 month. These changes should be completed by April 30, 1997.

Additional management comments on the management control program and our audit response are provided in Appendix A.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We reviewed the process the Denver Center used to compile financial data from Air Force field organizations and other sources for inclusion in the FY 1995 Air Force consolidated financial statements. Our audit assisted AFAA by supporting its disclaimer of opinion on the Air Force financial statements. To assess compliance with DoD accounting policies, General Accounting Office (GAO) standards, and Office of Management and Budget guidance, we reviewed documents supporting data in the FY 1995 financial statements. Those documents included the Air Force consolidated trial balance, the Report on Budget Execution, and various documents on adjustments that the Denver Center made to the September 1995 field data. We also evaluated selected line-item amounts and related adjustments on the Statement of Financial Position and the Statement of Operations, including associated footnotes. In addition, from prior IG, DoD, audits at the Denver Center, we identified recommendations that affected the compilation of data for the FY 1995 financial statements.

Limitations. We did not evaluate the accuracy of data provided by Air Force field organizations that were included in the AFAA review. In addition, in evaluating the actions taken by the Denver Center in response to prior audit recommendations (see Appendix C), we relied on the followup accomplished by the IG, DoD, Audit Followup Directorate, under DoD Directive 7650.3. Based on that followup, we did not verify or further evaluate the adequacy of actions reported by DFAS and its Denver Center as taken or planned in response to prior audit recommendations. Instead, the audit was limited to determining the impact on the current audit of the corrective actions that were still required in response to prior audit recommendations.

The objective of our audit was to evaluate whether the Denver Center fulfilled its responsibilities for preparing the Air Force financial statements. Accordingly, we did not render an opinion on the financial statements. AFAA issued a disclaimer of opinion on the Air Force financial statements in its Report No. 95053001, "Opinion on Fiscal Year 1995 Air Force Consolidated Financial Statements," March 1, 1996.

During the audit, we reduced the scope to exclude an evaluation of the Defense Business Operations Fund financial statements prepared by the Denver Center.

Use of Computer-Processed Data. To achieve the audit objectives, we extensively relied on computer-processed data in the COARS database. Our review of system controls casts doubt on the data validity. The lack of audit trails in the COARS prevented us from relying on data processed by that system. The Denver Center has initiated corrective actions through the CEFMS

implementation. However, functional changes to accounting systems, which will improve the quality of data, will not occur for several years.

Statistical Sampling Methodology. We did not use statistical sampling procedures for this audit.

Audit Period, Standards, and Locations. We performed this financial-related audit from May 1995 through March 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. See Appendix E for the organizations visited or contacted.

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 Management Control Program. We reviewed the adequacy of the internal controls over the financial statement preparation process and the Denver Center's self-evaluation of those internal controls. Specifically, we reviewed the internal controls over the COARS to determine whether the system was complete and auditable and whether adequate documentation existed to ensure data integrity.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Directive 5010.38, at the DFAS level, in the process the Denver Center used to compile financial statements. Management controls over the reporting of accounts payable data did not ensure that all accounts payable were properly reported or disclosed. Also, controls over COARS were not adequate to properly identify adjustments made to the databases and to provide a complete audit trail. Implementing Recommendation A.1. should make sure that timely automated system changes are made to improve the reliability of the Mechanization of Contract Administration Services system. Including a footnote on the reliability of data used in preparing the FY 1996 financial statements under Recommendation A.2. should help ensure that financial statement users are informed of departures from generally accepted accounting principles and DoD policy. Although management has initiated long-term corrective actions to improve COARS audit trails, implementing Recommendation B. should improve data integrity in the near-term by ensuring that transactions are properly accumulated and correctly classified, coded, and recorded in all affected accounts. A copy of the report will be provided to the senior DFAS official responsible for internal controls.

Adequacy of Management's Self-Evaluation. Denver Center officials identified the operations in COARS as a part of the Major Command

Appendix A. Scope and Methodology

Accounting and Reporting assessable unit. However, the officials had not performed a risk assessment and, therefore, had not assigned a level of risk. Denver Center officials plan to do a risk assessment during FY 1996. Because Major Command Accounting and Reporting officials did not perform the assessment, they did not identify or report the material management control weaknesses identified by the audit.

Management Comments on the Management Control Program and Audit Response

DFAS Comments on the Adequacy of Management's Self-Evaluation. Contrary to the discussion above, management stated that the two audit findings were reported as material weaknesses in the Federal Managers' Financial Integrity Act, Annual Statement of Assurance, Sections 2 and 4 reports.

Audit Response. We disagree. The Command On-line Accounting and Reporting System was reported as a noncompliant accounting system in the FY 1996 Section 4 report. However, the material weaknesses identified in Part I of this report were not included in the Section 2 reports of the FY 1995 or 1996 DFAS Annual Statement of Assurance. If management wishes to provide further clarification on this matter, we will include that information in the case file. However, this issue is not significant enough to warrant resolution procedures and no management response is required.

Appendix B. Prior Audits and Other Reviews

Since the passage of the CFO Act in 1990, the GAO; IG, DoD; and AFAA have issued numerous reports that identified weaknesses in the internal controls over the compilation of data used in the Air Force financial statements. As discussed in Appendix C, unresolved issues from prior IG, DoD, reports affected our ability to evaluate the accuracy of data reported in the FY 1995 Air Force consolidated financial statements. The IG, DoD, and other reports are listed below.

General Accounting Office

Report No. AFMD-92-12 (OSD Case No. 8376-L), "Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act," February 19, 1992. The report discusses the progress made by DoD and the Air Force in implementing the recommendations made by GAO in its audit of the FY 1988 Air Force financial statements. The report also summarizes information provided to the Air Force in 10 GAO reports on its audits of FY 1989 Air Force financial statements. The principal report findings were that financial systems were not integrated and generated unreliable information, reported costs of weapon systems were unreliable, accounting and controls over Air Logistics Command inventories were inadequate, internal accounting controls were not adequate, and short-term actions were needed to improve the quality of financial data and to ensure completion of a financial statement audit. GAO reaffirmed all 26 recommendations in its prior report (discussed below) and made additional recommendations to improve management's accountability, internal controls, and quality of financial information and to assist the Air Force in meeting the objectives of the CFO Act.

Report No. AFMD-90-23 (OSD Case No. 8193-A), "Air Force Does Not Effectively Account for Billions of Dollars of Resources," February 23, 1990. This audit focused on the GAO review of the accounts contained in the FY 1988 Air Force financial statements. The principal report findings were that financial systems did not provide reliable financial data because an integrated general ledger was not used, basic internal control weaknesses existed, full costs of weapon systems were not identified, and inventory systems did not provide accurate data. The DoD Comptroller (now Under Secretary of Defense [Comptroller]) concurred with all 26 recommendations in the report. The recommendations involved utilizing existing financial information and developing more accurate financial information (including an integrated accounting system), performing reconciliations and documenting adjustments, accounting for costs of weapon systems, achieving financial management of inventories, and developing a new accounting system. GAO followed up and reported on the status of corrective actions taken in response to the recommendations in its Report No. AFMD-92-12, as previously discussed. As

Appendix B. Prior Audits and Other Reviews

discussed in Appendix C of our current report, corrective actions taken by the Denver Center to develop an integrated accounting system, the CEFMS, are expected to be completed in December 1999.

Inspector General, DoD

Report No. 95-301, "Major Deficiencies Preventing Auditors from Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995. This report summarizes the major deficiencies impeding the ability of DoD to produce auditable general fund financial statements for FYs 1993 and 1994. Four major deficiencies were identified as having prevented auditors from rendering opinions on Army and Air Force general fund financial statements.

- o Accounting systems supporting DoD general funds did not have an integrated, double-entry, transaction-driven general ledger to compile and report reliable and auditable information.

- o Material deficiencies existed in the reporting of \$612.9 billion of assets on the FY 1994 Statements of Financial Position.

- o Auditors could not determine the reasonableness and accuracy of various accounts because the amounts were derived from unreliable disbursement and collection data.

- o Auditors could not determine the reasonableness of the amounts or disclosures made related to contingent liabilities that should have been recognized as liabilities on the FYs 1993 and 1994 Statement of Financial position.

The report also summarizes the actions taken or under way to correct the deficiencies. The report contains no recommendations. Management did not disagree with any of the facts or conclusions in the report. See Appendix C of our current report for these and other outstanding issues affecting the compilation of FY 1995 Air Force financial statements.

Report No. 95-264, "Defense Finance and Accounting Service Work on the Air Force FY 1994 Financial Statements," June 29, 1995. This report identifies material weaknesses in the security oversight provided by Denver Center to the MAFR system and in the system's audit trail for entries made at Denver Center. The report contains no recommendations because management had already initiated corrective actions to improve security and establish required audit trails in the Defense Cash Management System, which will replace MAFR. As discussed in Appendix C of the current report, Denver Center did not expect to complete the corrective actions to establish the required audit trails until January 1998.

Report No. 95-067, "Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements," December 30, 1994. This report identifies a material weakness in the oversight provided by Denver Center to U.S. Treasury clearing account balances and material errors in amounts reported in the Air Force financial statements for accounts receivable and accounts payable. The report recommends that policies and procedures be established to monitor U.S. Treasury clearing accounts and to improve the process used to compile and report amounts in the financial statements. As discussed in Appendix C of our current report, Denver Center did not expect to complete all the corrective actions to improve the oversight of the clearing accounts until April 1998.

Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994. This report states that the DFAS Denver Center did not prepare complete, accurate, and reliable FY 1992 financial statements for the Air Force. The report has four findings.

- o Denver Center did not comply with DoD accounting requirements or maintain effective procedures or controls for the accounting systems used in preparing the financial statements. Causes cited for those conditions included the lack of a transaction-driven general ledger, not verifying and reconciling MAFR system outputs to field-level data, and premature cutoff dates for military pay. As a result, the financial statements were unreliable.

- o Internal controls over budgetary data Denver Center used to prepare the financial statements were not effective. The control weaknesses were attributed to not using the DoD uniform chart of accounts, not confirming transactions with field organizations, relying on a budgetary system instead of the general ledger system, and forcing records to agree with U.S. Treasury balances.

- o Revenues on the Statement of Operations were overstated and operating expenses were misstated because personnel did not properly classify and record revenues, expenses, and losses.

- o Denver Center did not validate the accuracy of construction-in-progress data or comply with Air Force guidance on Government-furnished material and contractor-acquired material. Those conditions occurred because no procedures existed for verifying the validity, propriety, or accuracy of the amounts the DoD Components reported as construction in progress. Also, Denver Center's internal guidance was inconsistent with DoD and Air Force regulations on reporting Government-furnished material and contractor-acquired material.

Recommendations were made to establish accounting systems, issue additional regulatory guidance, ensure compliance with existing regulations, enhance internal controls, and implement formal internal control procedures. As discussed in Appendix C of the current report, Denver Center did not expect to complete the corrective actions on all the recommendations until December 1999.

Air Force Audit Agency

The AFAA issued four opinion reports in which it disclaimed an opinion on the Air Force consolidated financial statements for FYs 1992 through 1995. It disclaimed an opinion because the AFAA could not obtain sufficient evidence or apply other auditing procedures required to determine the fairness of the information presented in the financial statements. In support of its opinion reports, the AFAA issued 9 other reports on the FY 1995 Air Force consolidated financial statements, 5 reports related to FY 1994, 11 reports related to FY 1993, and 20 reports related to FY 1992. Details on the other reports are provided in the AFAA opinion reports, which are summarized below.

- o Project No. 95053001, "Opinion on Fiscal Year 1995 Air Force Consolidated Financial Statements," March 1, 1996.

- o Project No. 94053001, "Opinion on Fiscal Year 1994 Air Force Consolidated Financial Statements," March 1, 1995.

- o Project No. 94053022, "Opinion on Fiscal Year 1993 Air Force Consolidated Financial Statements," June 30, 1994.

- o Project No. 92053011, "Opinion on Fiscal Year 1992 Air Force Consolidated Financial Statements," June 29, 1993.

In its disclaimer on the FY 1995 financial statements, the AFAA stated that the primary reason preventing it from performing the audit was that financial information used to compile the FY 1995 Air Force consolidated financial statements was not reliable, and financial systems and processes and the associated internal control structure were not adequate to produce reliable financial information. The AFAA also determined that several of the conditions causing it to disclaim an opinion for FYs 1992, 1993, and 1994 still existed. No recommendations were made in the AFAA opinion report because they were included in other reports. The discussion in Appendix C of the current report does not encompass the status of corrective actions taken on the recommendations AFAA made in the audits of the Air Force consolidated financial statements.

Appendix C. Other Matters of Interest

Previously Reported Issues

Of 18 prior IG, DoD, audit recommendations open on October 1, 1994, the Denver Center completed corrective action on 7. However, despite the progress made, the DFAS and its Denver Center still faced significant financial management challenges in responding to the remaining 11 recommendations, which affected the compilation of data for the FY 1995 Air Force consolidated financial statements. Included in those issues were problems related to:

- o financial accounting systems,
- o U.S. Treasury clearing accounts,
- o MAFR internal controls, and
- o revenue and expense classifications on the Statement of Operations.

Although DFAS and Denver Center had begun corrective action on all issues, the problems still existed because most of the corrective actions would not be completed before December 1999. As a result, we could not adequately evaluate the accuracy of data included in the FY 1995 Air Force consolidated financial statements. Furthermore, future financial statement audits will be similarly affected as long as the problems exist.

Accounting System Improvements

Financial Management Operations. DoD has emphasized long-term efforts to improve and standardize its financial management operations, but many of the benefits of those efforts will not be realized for several years. To correct accounting system deficiencies and to reduce the number of DoD accounting systems, in December 1993, DFAS established the General Fund Accounting System Improvement Plan.¹ Under the improvement plan, in November 1995, the Denver Center initiated the concept exploration and development phase of a project to develop an interim migratory accounting system, known as the GL/FC system. The overall goal of the GL/FC project was to develop and implement an integrated financial accounting system that produces complete, accurate, and timely financial statements and reports. Among other objectives, the GL/FC system was expected to:

¹For details on the DFAS migratory plan, see IG, DoD, Report No. 96-180, "The General Fund Interim Migratory Accounting Strategy," June 26, 1996.

Appendix C. Other Matters of Interest

- o produce auditable financial statements;
- o provide for a transaction-driven, general ledger that complies with applicable Federal regulations;
- o incorporate the budget and accounting classification code; and
- o bring accounting systems into conformance with generally accepted accounting principles.

In July 1996, however, the Under Secretary of Defense (Comptroller) directed DFAS to develop the CEFMS as the general accounting migratory system for customers of the Denver Center. The Under Secretary's decision was based on a Denver Center determination that CEFMS presented a viable option to satisfy the general funds accounting requirements of the Denver Center's customers. Denver Center management expects the CEFMS to be completed in December 1999.

Audit Followup. Through its internal review function, the Denver Center monitors the status of corrective actions taken in response to prior IG, DoD, and other audit recommendations and issues periodic status reports to DFAS. Those reports are then used by DFAS in responding to periodic followup on the status of prior audit recommendations made by the IG, DoD, under DoD Directive 7650.3, "Followup on General Accounting Office, DoD Inspector General, and Internal Audit Reports," February 14, 1992. During the followup process, the Denver Center reported to the IG, DoD, that corrective actions had not been completed on 11 prior audit recommendations made to fix problems with accounting systems and other issues.² As discussed below, these problems affected our ability to evaluate the accuracy of data reported in the FY 1995 Air Force consolidated financial statements.

System Issues

Problems related to automated information systems the Denver Center used in compiling the FY 1992 Air Force financial statements were identified in IG, DoD, Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994 (see Appendix B). As discussed below, correcting those problems requires major changes to DFAS financial accounting systems.

Transaction-Driven General Ledger. Denver Center did not have a double-entry, transaction-driver general ledger system for use in preparing the Air Force consolidated financial statements. Without such a general ledger, the Denver Center could not prepare meaningful financial statements that met DoD accounting requirements. Recommendation A.1. in Report No. 94-073

²As stated in Appendix A, we relied on the followup made on these prior recommendations by the IG, DoD, under DoD Directive 7650.3.

recommends that the Denver Center develop and implement an integrated, double-entry, transaction-driven general ledger system for use in preparing the Air Force financial statements. According to DFAS, the CEFMS development includes an integrated, transaction-driven general ledger process that will provide financial information on general funds for the Air Force financial statements. The CEFMS is scheduled to be completed in December 1999. This issue was first reported by the GAO in FY 1990 in its audit of the FY 1988 Air Force consolidated financial statements (Appendix B), and was reported again in an FY 1992 followup report.

Uniform Chart of Accounts. The Denver Center did not use the DoD Uniform Chart of Accounts, as required by the DoD Manual 7220.9-M, "DoD Accounting Manual." Use of this chart of accounts is intended to standardize DoD accounting and meet basic reporting requirements for Federal financial statements and budgets. Instead, the Denver Center used the Air Force Chart of Accounts, which did not use the same account structure and could not be reconciled to the DoD chart of accounts. Denver Center use of the Air Force chart of accounts does not allow reconciliation of budgetary data to proprietary accounting data, which contributed to the unreliability of the data used in preparing the Air Force financial statements. Recommendation B.1. in Report No. 94-073 recommends that Denver Center implement the DoD Uniform Chart of Accounts. According to DFAS, the CEFMS should be capable of using the DoD uniform chart of account when the system is completed in December 1999.

Military Pay. Military pay data reported in the Air Force consolidated financial statements were inaccurate due to yearend timing differences. The Denver Center improperly reported military separation pay earned in one year in the next year. Also, the Summary of Military Pay Obligations system, used to report military pay activity, was cut off prematurely before the end of the fiscal year. Thus, payroll expenses that should have been reported in one year were improperly reported in the next year. Recommendation A.6. in Report No. 94-073 recommends that Denver Center establish procedures to adjust for yearend separation pay and other timing differences. Denver Center management is working to change the military pay system to provide estimates of the amounts attributable to the timing differences so accounting personnel can manually adjust the Air Force financial statements. The Denver Center also plans to revise directorate operating instructions to ensure that financial statements reflect the required adjustments. Those corrective actions are scheduled to be completed in November 1997.

Use of Budgetary Data. We could not verify accounts payable reported on the Air Force Statement of Financial Position because the Denver Center used questionable budgetary data instead of general ledger data. The budgetary data may have included duplicate amounts. Also, similar to the conditions discussed in Finding A in this report, certain negative amounts were not reported. Recommendation B.3. in Report No. 94-073 recommends that Denver Center use general ledger data instead of budgetary data to prepare the financial statements. The DFAS expects this problem to be corrected in December 1999 with the completion of the CEFMS.

Government-Furnished Material and Contractor-Acquired Material. In preparing the Air Force consolidated financial statements, the Denver Center did not properly account for Government-furnished material and contractor-acquired material. Denver Center's guidance on the reporting of those materials in the Air Force consolidated financial statements was inconsistent with DoD and Air Force regulations. Recommendation D.2. in Report No. 94-073 recommends that Denver Center develop and implement changes in internal guidance to conform to these regulations. However, Denver Center does not have a system that can differentiate between Government-furnished material and contractor-acquired material with supporting documentation. The DFAS expects this problem to be corrected with the implementation of CEFMS in December 1999.

Fund Balance with Treasury. Denver Center personnel did not reconcile differences between the U.S. Treasury account balances and Air Force base-level accounts, as required by Office of Management and Budget and DoD regulations. Office of Management and Budget Circular No. A-34 requires that Fund Balance with Treasury on the financial statements be supported by the entity's accounting records and be reconciled to the corresponding accounts reported on the Treasury's end-of-period balances. The DoD Accounting Manual requires that amounts reported by the U.S. Treasury be verified against data in the agency's records. Denver Center personnel made unsupported adjustments to the Report on Budget Execution to force agreement with the U.S. Treasury. Recommendation B.4. in Report No. 94-073 recommends that Denver Center reconcile the Air Force accounting records to Fund Balance with U.S. Treasury and limit adjustments to valid changes supported by documentation. Denver Center personnel now manually reconcile with the U.S. Treasury every month and all adjustments, except undistributed amounts, are supported by documentation. The DFAS believes this problem will be resolved with the implementation of CEFMS in December 1999.

U.S. Treasury Clearing Account Issues

Two problems with the monitoring of U.S. Treasury clearing accounts were identified in IG, DoD, Report No. 95-067, "Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements," December 30, 1994. As detailed below, Denver Center planned both short- and long-term corrective actions.

Reconciliation of Clearing Accounts. In preparing the Air Force consolidated financial statements, Denver Center did not adequately monitor U.S. Treasury clearing accounts by reconciling the differences between those account balances and Air Force base-level accounts. Also, the Denver Center did not reconcile one clearing account to the U.S. Treasury balance. Finally, Denver Center did not reconcile its own records with those maintained at the base level and by the U.S. Treasury. Recommendation A.1. in Report No. 95-067 recommends that Denver Center semiannually reconcile Air Force department-level clearing

account balances, base-level certified balances, and U.S. Treasury balances. In response, Denver Center manually reconciled those accounts, pending completion of a systemic reconciliation process in July 1997.

Old Clearing Account Balances. In preparing the Air Force financial statements, Denver Center personnel did not take sufficient action to resolve old clearing account balances at the Defense accounting offices. For example, 60 percent of the balance in one clearing account represented transactions that were 6 to 11 months old, while another 20 percent of the account balance represented transactions more than 1 year old. Recommendation A.4. in Report No. 95-067 recommends that Denver Center notify the Defense accounting offices when clearing account balances are more than 60 days old and require their resolution. To correct this situation, Denver Center requested a change to the DoD Financial Management Regulation requiring the Defense accounting offices to resolve clearing account items within 1 year. The Denver Center expects this change to be made by April 1998.

MAFR Internal Control Issues

Problems related to MAFR internal controls over reconciling account balances and maintaining an adequate audit trail were identified in IG, DoD, Reports No. 94-073 and No. 95-264, "Defense Finance and Accounting Service Work on the Air Force FY 1994 Financial Statements," June 29, 1995. As detailed below, Denver Center planned to fix those problems by February 1998.

MAFR System Reconciliations. In preparing the FY 1992 Air Force consolidated financial statements, Denver Center did not reconcile out-of-balance cash disbursements and receipts in the MAFR system. The MAFR system accounts for all cash transactions affecting the Air Force and provides consolidated cash accountability and reporting. Denver Center is required by Air Force Regulation 177-101, "General Finance and Accounting Systems at Base Level," February 15, 1991, to reconcile the cumulative dollar amounts at the department level to the monthly MAFR packages submitted by each Air Force disbursing station. If an out-of-balance condition exists, Denver Center personnel are to establish the source of the condition, require a reconciliation of data, and correct the out-of-balance condition. Recommendation A.4. in Report No. 94-073 recommends that Denver Center perform MAFR system reconciliations and make appropriate corrections. To correct this situation, Denver Center enhanced manual internal controls in MAFR and requested a system change to automate those reconciliations. The change was expected to be completed by February 1998.

MAFR Audit Trails. Though used in preparing FY 1994 Air Force financial statements, the MAFR system did not maintain an adequate audit trail or transaction histories for transactions originating at the Denver Center. As a result, Denver Center managers could not identify all the adjustments to the MAFR system database and, therefore, could not verify that such adjustments were adequately supported or properly recorded. Before the prior audit was

Appendix C. Other Matters of Interest

completed in February 1995, Denver Center included the requirement for audit trails in the specifications for the Defense Cash Management System, which was expected to replace the MAFR system in January 1998. Therefore, Report No. 95-264 made no recommendations on this matter.

Statement of Operations Issues

Revenues on the FY 1992 Air Force Statement of Operations were overstated by \$424.5 million and operating expenses were misstated. The overstatements and misstatements occurred because Denver Center did not properly classify and record revenues, expenses, and losses. Recommendation C. in Report No. 94-073 recommends that Denver Center adjust the Statement of Operations to correct revenues, expenses, extraordinary items, and prior period adjustments applicable to Air Force operations. Denver Center adjusted the financial statements to correct the misstatements. The Office of the Under Secretary of Defense (Comptroller) provided policy guidance during FY 1996 on the treatment of disbursements for financial statements.

Summary

Correcting prior audit issues is crucial to providing the means for adequately evaluating the Air Force consolidated financial statements prepared by Denver Center. However, because the Denver Center had initiated and was monitoring the status of corrective action, we are making no further recommendations.

Appendix D. Report of Accrued Expenditures Unpaid

REPORT OF ACCRUED EXPENDITURES UNPAID				
HAF-ACF9M07152(DD)				
SUMMARY OF DCMD MESSAGES				
Report Period: September 1995				
Appropriations	ADSN 8541	ADSN 8559	ADSN 8560	Totals
57 8 3010				\$ -
57 9 3010	\$ (25,503,646.39)	\$ 3,574,244.79	\$ (26,372,671.93)	\$ (48,302,073.53)
57 0 3010	\$ 14,796,137.08	\$ 7,513,825.95	\$ 3,375,705.67	\$ 25,685,668.70
57 1 3010	\$ 69,700,497.72	\$ 9,287,513.18	\$ (61,126,354.61)	\$ 17,861,656.29
57 2 3010	\$ 22,196,137.55	\$ 55,358,975.75	\$ (36,567,424.29)	\$ 40,987,689.01
57 3 3010	\$ 11,023,405.39	\$ 102,840,742.92	\$ 61,345,908.66	\$ 175,210,057.17
57 4 3010	\$ 9,008,611.99	\$ 43,692,762.23	\$ 18,584,709.63	\$ 71,286,083.85
57 5 3010	\$ (28,082,703.03)	\$ 26,950,495.64	\$ (5,585,068.08)	\$ (6,727,276.47)
57 8 3020				\$ -
57 9 3020	\$ (41,055,120.01)	\$ (3,427,610.39)	\$ (3,140,546.18)	\$ (47,623,276.58)
57 0 3020	\$ 782,729.62	\$ 490,918.54	\$ 907,331.06	\$ 2,180,979.22
57 1 3020	\$ (48,199,294.95)	\$ 1,967,635.07	\$ 7,303,192.37	\$ (38,928,467.51)
57 2 3020	\$ 56,523,893.10	\$ (127,723,380.25)	\$ 34,165,138.43	\$ (37,034,348.72)
57 3 3020	\$ 27,651,200.78	\$ 14,945,746.88	\$ 38,740,263.89	\$ 81,337,211.35
57 4 3020	\$ 25,228,680.11	\$ 5,883,762.88	\$ 21,894,636.59	\$ 53,007,079.58
57 5 3020	\$ 2,434,946.62	\$ 1,232,740.40	\$ 6,106,434.40	\$ 9,774,121.42
57 8 3080				\$ -
57 9 3080	\$ 2,821,734.87	\$ (6,378,230.02)	\$ 2,860,971.98	\$ (695,523.17)
57 0 3080	\$ (59,342,488.18)	\$ (3,520,670.83)	\$ 9,412,140.93	\$ (53,451,018.08)
57 1 3080	\$ 9,733,840.63	\$ (95,345,161.56)	\$ 8,141,435.54	\$ (77,469,885.39)
57 2 3080	\$ (57,282,424.85)	\$ (300,010,351.05)	\$ 15,508,407.97	\$ (341,784,367.93)
57 3 3080	\$ 5,474,473.50	\$ 4,471,311.59	\$ 12,077,764.43	\$ 22,023,549.52
57 4 3080	\$ 7,547,988.07	\$ 3,037,089.04	\$ 9,728,963.26	\$ 20,314,040.37
57 5 3080	\$ 3,453,759.58	\$ 3,530,453.81	\$ 9,301,552.65	\$ 16,285,766.04
57 9 3600				\$ -
57 0 3600	\$ 12,578,978.74	\$ 3,961,076.36	\$ (3,138,948.18)	\$ 13,401,106.92
57 1 3600	\$ 12,426,372.76	\$ 15,760,172.42	\$ (29,726,102.18)	\$ (1,539,557.00)
57 2 3600	\$ (29,803,881.62)	\$ 18,306,240.08	\$ (58,631,526.65)	\$ (70,129,168.19)
57 3 3600	\$ (17,173,617.17)	\$ (6,499,743.91)	\$ 13,406,569.27	\$ (10,266,791.81)
57 4 3600	\$ (1,005,708.91)	\$ 41,197,101.06	\$ (259,347,471.15)	\$ (219,156,079.00)
57 5 3600	\$ 19,683,438.38	\$ 29,103,673.02	\$ 20,944,415.89	\$ 69,731,527.29
57 9 3300	\$ 38,884.20			\$ 38,884.20
57 0 3300				\$ -
57 1 3300				\$ -
57 2 3300				\$ -
57 3 3300	\$ 89,997.66	\$ 4,697.00		\$ 94,694.66
57 4 3300		\$ 10,303.87		\$ 10,303.87
57 5 3300				\$ -

Appendix E. Organizations Visited or Contacted

Department of the Air Force

Auditor General, Department of the Air Force, Washington, DC
Assistant Auditor General, Financial and Support Audits,
March Air Force Base, CA

Other Defense Organizations

Defense Finance and Accounting Service, Washington, DC
Defense Finance and Accounting Service Denver, Denver, CO
Directorate of Departmental Accounting, Denver, CO
Internal Review Office, Denver, CO

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Director, Deputy Chief Financial Officer Support Division
Chief, Internal Management Control Division
Internal Control Officer
Director, Accounting Policy
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
Superintendent, Naval Postgraduate School, Dudley Knox Library

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

Special Projects Division, Office of the Deputy Assistant Director, Policy and Plans,
Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Deputy Director, Finance Deputate, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Denver Center
Chief, Internal Review Office
Internal Control Officer, Audit Control and Liaison, Office of the Deputy Director,
Customer Service and Support Directorate
Chief, Internal Review Office, Defense Finance and Accounting Service Columbus
Center

Other Defense Organizations (cont'd)

Assistant Inspector General for Audit, Office of the Inspector General, Defense
Intelligence Agency
Chief, Internal Review Group, Defense Logistics Agency
Inspector General, National Security Agency
Resources Management Oversight, National Security Agency

Non-Defense Federal Organizations

Special Projects Unit, Office of the Deputy Associate Director, National Security
Division, National Security and International Affairs, 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

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1831 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5281

NOV 18 1996

DFAS-HQ/AFB

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

Subject: Management Comments on DoD IG Draft Audit Report,
"Compilation of FY 1995 Air Force Consolidated
Financial Statements at the Defense Finance and
Accounting Service Denver Center,"
(Project Number 5FD-2014)

We have reviewed the subject draft audit report and are
providing the attached management comments.

Please direct any questions concerning this matter to
Mr. Charles McIntosh on (703) 607-5105.

for 
Thomas F. McCarty
Deputy Director for
Accounting

Attachment

Defense Finance and Accounting Service Comments

Final Report
Reference

Recommendation A.1: We recommend that the Director, Finance Deputate, Defense Finance and Accounting Service, coordinate with the Columbus Center to establish milestones for and monitor the progress in responding to the system change request submitted to improve the reliability of the Mechanization of Contract Administration Services system, which is used to compile and report the accrued expenditures unpaid on centrally administered contracts.

Management Comments: Concur. Our Columbus Center is aware of the problems associated with the Accrued Expenditures Report generated from the Mechanization of Contract Administration Services (MOCAS) system. In coordination with our Headquarters Finance Deputate, our Columbus Center established milestones and progress of a systems change request (SCR) which is being closely monitored. The testing and implementation of the reprogrammed Accrued Expenditures Report should be completed during the first quarter of fiscal year 1997.

Estimated completion date: December 31, 1996.

Recommendation A.2: We recommend that the Director, Defense Finance and Accounting Service Denver Center, issue a memorandum to accounting personnel, reemphasizing the need to disclose the use of unreliable data on accrued expenditure unpaid (and other departures from generally accepted accounting principles and DoD policy) in the footnotes to the Air Force consolidated financial statements, as required by DoD guidance on the form and content of FY 1996 and future financial statements.

Management Comments: Concur. Upon completion of the system change request in the Modernization of Contract Administration Services (MOCAS), at our Columbus Center, the data will more reliable. The DFAS Denver Center Chief Financial Officers Implementation Office will prepare a footnote for inclusion in the FY 1996 financial statements disclosing the reliability of the data on the accrued expenditures unpaid report received from DFAS Columbus Center.

Estimated completion date: December 31, 1996.

Recommendation B: We recommend that the Director, Defense Finance and Accounting Service Denver Center, use the transaction history files to establish a complete and accurate audit trail of all adjustments made by accounting personnel at Denver Center to data reported through the Command On-line Accounting and Reporting System, until the Corps of Engineers Financial Management System project is completed.

Management Comments: Concur. The DFAS Denver Center will prepare a systems change request to change the retention of the on-line transaction history file from one month to a minimum of one year. We will also develop a system retrieval which

Revised
A.2. to
adopt
alternative
proposed by
management.

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Correction
made on
page 7,
para. 1.

management can use for audit purposes and for reviews of specific time frames.

Estimated completion date: April 30, 1997.

Additional Management Comments: There is a misleading statement on page 7, paragraph 3, last sentence. The sentence indicates, in part, that "... funds were not available to cover all the payables." This statement is incorrect. There were more than \$150 million in unobligated authority remaining in this account at the time of the adjustment. There were not sufficient obligations (in the form of undelivered orders outstanding) available to prevent formation of a negative unliquidated obligation (NULO), so the adjustment was not made. NULOs, by definition, are not necessarily Anti-Deficiency Act violations. Valid disbursements or payables in excess of available authority, are potential Anti-Deficiency Act violations (which did not occur in this case).

Although pages 15-16 of the report indicate that the two audit findings were not reported under the Financial Managers' Financial Integrity Act (FMFIA), the areas were reported as material weaknesses in the FMFIA Annual Statement of Assurance, Section 2 (internal controls) and Section 4 (accounting systems) reports.

Audit Team Members

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

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