

**A**udit



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FUND BALANCE WITH TREASURY ACCOUNT IN THE  
FY 1996 FINANCIAL STATEMENTS OF THE  
DEFENSE BUSINESS OPERATIONS FUND

Report Number 98-100

April 2, 1998

Office of the Inspector General  
Department of Defense

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### **Acronyms**

AR	Accounting Report
CFO	Chief Financial Officer
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
FBWT	Fund Balance With Treasury
IG	Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
SMUR	System Manager and User Review
TBO/TFO	Transactions By and For Others



INSPECTOR GENERAL  
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ARLINGTON, VIRGINIA 22202

April 2, 1998

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING  
SERVICE**

**SUBJECT: Audit Report on the Fund Balance With Treasury Account in the FY 1996  
Financial Statements of the Defense Business Operations Fund  
(Report No. 98-100)**

We are providing this audit report for review and comment. We performed the audit to fulfill the requirements of the "Chief Financial Officers Act of 1990," as amended by the "Federal Financial Management Act of 1994." We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service did not comment on a draft of this report. Therefore, we request that the Director, Defense Finance and Accounting Service, provide comments on Recommendation B.2.; the Director, Defense Finance and Accounting Service Cleveland Center, provide comments on Recommendations B.3.a., B.3.b., and B.3.c.; and the Director, Defense Finance and Accounting Service Columbus Center, provide comments on Recommendations B.4.a., B.4.b., and B.4.c. by June 2, 1998.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. David F. Vincent, Audit Program Director, at (703) 604-9110 (DSN 664-9110), e-mail <DVincent@DODIG.OSD.MIL>; or Ms. Barbara A. Sauls, Audit Project Manager, at (703) 604-9129 (DSN 664-9129), e-mail <BSauls@DODIG.OSD.MIL>. See Appendix C for the report distribution. A list of audit team members is on the inside back cover.

*David K. Steensma*

David K. Steensma  
Deputy Assistant Inspector General  
for Auditing



# Office of the Inspector General, DoD

Report No. 98-100  
(Project No. 5FH-2021.01)

April 2, 1998

## Fund Balance With Treasury Account in the FY 1996 Financial Statements of the Defense Business Operations Fund

### Executive Summary

**Introduction.** This audit of the Fund Balance With Treasury Account is being performed to fulfill the requirements of the "Chief Financial Officers Act of 1990," as amended by the "Federal Financial Management Act of 1994." This is the third in a series of reports on issues related to cash management, or the Fund Balance With Treasury Account, in the financial statements of the Defense Business Operations Fund. The first report, Inspector General, DoD, Report No. 97-067, "Defense Agencies Cash Management in the Defense Business Operations Fund," January 10, 1997, and the second, Inspector General, DoD, Report No. 98-039, "Cash Management in the Defense Working Capital Funds," December 15, 1997, discussed the need for better control of cash in the Defense agencies and DoD, respectively.

The DoD Fund Balance With Treasury Account balance comprises financial data reported to the Department of the Treasury by DoD and other agencies that report for DoD. These data are recorded and summarized in the Fund Balance With Treasury Account in the general ledgers of DoD organizations. The Fund Balance With Treasury Account balance is also reported in the Defense Business Operations Fund monthly reports and the Chief Financial Officers Act financial statements. The Fund Balance With Treasury Account balance is a net balance that includes funds collected, funds disbursed, and funds with Treasury. During FY 1996, the Defense Business Operations Fund reported \$73.5 billion in funds collected, \$74.7 billion in funds disbursed, and \$5.3 billion in funds with Treasury. As of September 30, 1996, the net balance in the Fund Balance With Treasury Account for the Defense Business Operations Fund was \$4.1 billion.

On December 11, 1996, the Under Secretary of Defense (Comptroller) separated the Defense Business Operations Fund into four Defense Working Capital Funds. That realignment did not affect the issues discussed in this report.

**Audit Objectives.** The primary audit objective was to determine whether the Fund Balance With Treasury Account in the Consolidated Financial Statements of the Defense Business Operations Fund for FY 1996 was presented fairly in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We also assessed internal controls and compliance with laws and regulations related to the financial statements.

We reviewed internal controls related to the Fund Balance With Treasury Account in the FY 1996 Defense Business Operations Fund monthly reports and the financial statements. Specifically, we reviewed the amounts reported as undistributed collections and undistributed disbursements. We also analyzed the effect of the undistributed amounts on the monthly Accounting Report 1307 and the Chief Financial Officers Act financial statement reporting of the accounts receivable and accounts payable balances.

**Audit Results.** The Defense Business Operations Fund general ledgers did not support the \$4.1 billion Fund Balance With Treasury Account balance as reported in the FY 1996 monthly Accounting Report 1307 and the financial statements for the fiscal year ended September 30, 1996. As a result, DoD used the balances provided by the Department of the Treasury as the amounts reported for the Fund Balance With Treasury Account (Finding A).

The Defense Finance and Accounting Service (DFAS) Centers did not disclose the dollar amount of undistributed collections closed out to accounts receivable or the dollar amount of undistributed disbursements closed out to accounts payable in the FY 1996 financial statements for any component of the Defense Business Operations Fund. In addition, the DFAS Cleveland and Columbus Centers incorrectly reported a net total of \$335.4 million in undistributed collections and a net total of \$849.8 million in undistributed disbursements in the monthly Accounting Report 1307 for the Defense Business Operations Fund of the Defense agencies. As a result, without full disclosure, the financial statements for each Defense Business Operations Fund component did not adequately show the effect of adjustments made to accounts receivable and accounts payable due to undistributed amounts. In addition, because of the incorrect reporting of undistributed amounts, cumulative undistributed collections were overstated by \$334.6 million and cumulative undistributed disbursements were understated by \$810.8 million. The condition continued with the FY 1997 accounting reports and financial statements. If not corrected, the accounting reports and financial statements for FY 1998 and beyond will be materially misstated (Finding B).

**Summary of Recommendations.** We recommend that the Under Secretary of Defense (Comptroller) update the annual "DoD Guidance on Form and Content of Financial Statements," to include a disclosure requirement for reporting material undistributed amounts. We also recommend an update to DoD 7000.14-R, the "DoD Financial Management Regulation," to remove invalid General Ledger Account Codes and their corresponding invalid reporting lines in the monthly Accounting Report 1307.

We recommend that the Director, DFAS, issue standard operating procedures to the DFAS Centers for the reporting of undistributed balances in the monthly Accounting Report 1307. Quality assurance reviews of financial information are being performed; however, additional quality review procedures are needed to ensure the accuracy and consistent reporting of information in the financial statements. Furthermore, additional procedures are needed to research, analyze, and make necessary adjustments to negative undistributed balances before preparing the financial statements.

**Management Comments.** The Under Secretary of Defense (Comptroller) agreed to update the annual "DoD Guidance on Form and Content of Financial Statements" and omit invalid General Ledger Account Codes and invalid reporting lines in the Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information. See Part I for a discussion of management comments and Part III for the complete text of management comments. The Director, DFAS, did not respond to a draft of this report issued on November 20, 1997.

**Audit Response.** The comments from the Under Secretary of Defense (Comptroller) were responsive. We request the Director, DFAS and the Directors, DFAS Cleveland and Columbus Centers, provide comments in response to the final report by June 2, 1998.

# Table of Contents

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<b>Executive Summary</b>	i
<b>Part I - Audit Results</b>	
Introduction	2
Audit Background	2
Audit Objectives	3
Finding A. The Fund Balance With Treasury Account	4
Finding B. Reporting of Undistributed Transactions	10
<b>Part II - Additional Information</b>	
Appendix A. Audit Process	
Scope and Methodology	20
Management Control Program	20
Appendix B. Summary of Prior Coverage	22
Appendix C. Report Distribution	26
<b>Part III - Management Comments</b>	
Under Secretary of Defense (Comptroller) Comments	30



## **Part I - Audit Results**

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## **Introduction**

This audit of the Fund Balance With Treasury (FBWT) Account was performed to fulfill the requirements of the "Chief Financial Officers (CFO) Act of 1990," as amended by the "Federal Financial Management Act of 1994." This is the third in a series of reports on issues related to cash management, or the FBWT Account report in the Defense Business Operations Fund (DBOF). The first, Inspector General (IG), DoD, Report No. 97-067, "Defense Agencies Cash Management in the Defense Business Operations Fund," January 10, 1997, and the second, IG, DoD, Report No. 98-039, "Cash Management in the Defense Working Capital Funds," December 15, 1997 discussed the need for better control of cash in the Defense agencies and DoD, respectively.

## **Audit Background**

Congress established the DBOF as a revolving fund on October 1, 1991. The DBOF combined DoD and Service-owned revolving funds formerly known as stock and industrial funds. Certain Defense agencies that had formerly received appropriated funds were added. The DBOF was intended to improve financial management and to control resources with greater efficiency. Cash information for the DBOF is reported in the FBWT general ledger accounts. Each business area within the DBOF reports financial information for the FBWT Account. For DBOF cash management and reporting on the consolidated financial statements, each business area's FBWT amounts are consolidated at each of the five Component levels. The Component levels are the three Military Departments, the Corporate Account, and the Defense agencies.

The FBWT Account consists primarily of collection and disbursement transactions that are executed and reported by disbursing officers through the DoD financial network. These transactions are validated and consolidated at the Defense Finance and Accounting Service (DFAS) Centers in Cleveland and Columbus, Ohio; Denver, Colorado; Kansas City, Missouri; and Indianapolis, Indiana. For all DoD appropriations, the DFAS Cleveland Center, which also reports for the DFAS Kansas City Center; the DFAS Denver Center; and the DFAS Indianapolis Center, which also reports for the DFAS Columbus Center, transmit collection and disbursement data to the Department of the Treasury by the 8th work day of each month.

On December 11, 1996, the Under Secretary of Defense (Comptroller) separated the DBOF into four Defense Working Capital Funds. That realignment did not affect the issues discussed in this report.

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## **Audit Objectives**

The primary audit objective was to determine whether the FBWT Account on the Consolidated Financial Statements of the DBOF for FY 1996 was presented fairly in accordance with Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We also assessed internal controls and compliance with laws and regulations related to the financial statements.

We reviewed internal controls related to the FBWT Account on the DBOF monthly Accounting Report 1307 (AR 1307); the AR 1307 Statement of Cash Flows, Supplemental Disclosure of Cash Information (Supplemental Information); and the DBOF CFO Act financial statements. Specifically, we reviewed undistributed collections and undistributed disbursements reported in the DBOF monthly AR 1307 and the DBOF CFO Act financial statements. In addition, we analyzed the effect of undistributed amounts on the monthly and annual reporting of accounts receivable and accounts payable for the DBOF. See Appendix A for a discussion of the audit scope and methodology. Appendix B summarizes prior audit coverage.

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## **Finding A. The Fund Balance With Treasury Account**

The DBOF general ledgers did not support the \$73.5 billion in funds collected, \$74.7 billion in funds disbursed, \$5.3 billion in funds with Treasury, or the net \$4.1 billion FBWT Account balance as reported in the monthly AR 1307 and the DBOF financial statements for the fiscal year ended September 30, 1996. This occurred because previously reported deficiencies in DoD accounting and reporting systems, such as general ledger controls and the DoD collection and payment process, remained uncorrected. Consequently, DoD had no method of determining reliable FBWT amounts and used the monthly and annual Department of the Treasury (the Treasury) FBWT Account balances as the reported amounts in the FY 1996 DBOF monthly AR 1307 and the FY 1996 DBOF financial statements. The same problems existed for the FY 1997 Working Capital Fund financial statements. If these problems are not corrected, the accounting reports and financial statements for FY 1998 and beyond will be materially misstated.

### **The Fund Balance With Treasury Account Balance**

The DoD FBWT Account balance comprises financial data reported to the Treasury by DoD and other agencies that report for DoD. Through the Military Department financial networks, DoD reports transactions for all DoD appropriations to the Treasury on a monthly basis. Other agencies, such as the Department of State and the General Services Administration, use their own systems to report DoD financial data to the Treasury. The Treasury tracks all collections, disbursements, and transfers made by and to Federal agencies. Each month, the financial network data reported to the Treasury are reconciled to the financial data accepted by the Treasury from all sources.

The differences in the FBWT Account balances as shown in the DoD financial networks and the Treasury have at least two causes, the accounting and reporting systems and the DoD collection and payment process. The financial network data that should be posted to the DBOF general ledgers were not always available because DoD did not have a centralized accounting and reporting system. Therefore, DoD was unable to compute the status of its own appropriation balances. In addition, the DoD collection and payment process caused timing problems in posting collection and disbursement transactions to DoD general ledgers. Consequently, DoD had no method of determining reliable FBWT amounts and used the monthly and annual Treasury FBWT Account balances as the reported amounts in the FY 1996 DBOF monthly AR 1307 and the FY 1996 DBOF financial statements.

## **DoD Accounting and Reporting Systems**

The accounting and reporting systems at the DFAS Centers provide various financial information to DoD managers. These systems use and consolidate operational data for preparing departmental reports; interface cross-disbursing and interfund data from other DFAS Centers; control and reconcile cash to Treasury balances; and develop financial management information for monthly and annual financial statement reporting. However, a number of deficiencies and material weaknesses in these systems have been identified in the DFAS FY 1996 annual statement of assurance and the DBOF FY 1996 management representation letter. In addition, the current systems do not comply with the requirements of OMB Circular No. A-127, "Financial Management Systems," July 23, 1993. These deficiencies and material weaknesses contribute to the inability of DoD to capture all transactional data in the DBOF general ledgers.

**Compliance With OMB Circular No. A-127.** In its FY 1996 annual statement of assurance, DFAS evaluated its financial management systems, which included departmental accounting and reporting systems. These evaluations were conducted to determine compliance with the requirements for financial management systems outlined in OMB Circular No. A-127. OMB Circular No. A-127 is implemented through DoD 7000.14-R, the "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," chapter 3, "Accounting Systems Conformance, Evaluation, and Reporting," May 1993. This guidance requires that systems managers and users complete an annual self-assessment of operating accounting systems, and that an independent, detailed evaluation also be completed on a cyclical basis. These self-assessments and independent detailed evaluations should form the basis for determining the compliance of existing accounting systems. DFAS performed these reviews and took action to correct the deficiencies found.

**Assessment Results.** In FY 1996, the DFAS Centers used an automated evaluation document referred to as a "System Manager and User Review" (SMUR) guide to evaluate their financial management systems. The SMUR guides outlined key accounting requirements and showed the status of the DFAS systems. We reviewed SMUR guides for the Defense Business Management System at the DFAS Columbus Center, for the Merged Accountability and Fund Reporting System at the DFAS Denver Center, and for the Headquarters Accounting and Reporting System at the DFAS Indianapolis Center. These systems captured and reported the transactional data for each activity. Each of the SMUR guides reported deficiencies that represent nonconformance with the principles, standards, and requirements of the General Accounting Office, the OMB, and DoD.

The DFAS Columbus Center reported as noncompliant 2 out of 13 key accounting requirements for the Defense Business Management System, a mixed multifunctional system. The DFAS Denver Center reported as noncompliant 6 out of 13 key accounting requirements for the Merged Accountability and Fund Reporting System, a departmental accounting and reporting system. In addition, the DFAS Indianapolis Center reported as noncompliant 2 out of

**Finding A. The Fund Balance With Treasury Account**

13 key accounting requirements for the Headquarters Accounting and Reporting System, another departmental accounting and reporting system. Table 1 details the noncompliance of these systems with key accounting requirements.

<u>Key Accounting Requirements</u>	<u>Accounting Systems</u>		
	<u>HOARS</u> <sup>1</sup>	<u>MAFR</u> <sup>2</sup>	<u>DBMS</u> <sup>3</sup>
1. General Ledger Control and Financial Reporting	X <sup>4</sup>	X	X
2. Property and Inventory Accounting	-- <sup>5</sup>	--	--
3. Accounting for Receivables Including Advances	--	--	--
4. Cost Accounting	--	--	--
5. Accrual Accounting	--	--	--
6. Military and Civilian Payroll Procedures	--	--	--
7. System Controls	--	X	--
8. Audit Trails	--	--	X
9. Cash Procedures and Accounts Payable	--	X	--
10. System Documentation	X	X	--
11. System Operations	--	X	--
12. User Information Needs	--	X	--
13. Budgetary Accounting	--	--	--

<sup>1</sup>Headquarters Accounting and Reporting System.

<sup>2</sup>Merged Accountability and Fund Reporting System.

<sup>3</sup>Defense Business Management System.

<sup>4</sup>X means the system was noncompliant.

<sup>5</sup>-- means the system was compliant or the requirement was not applicable.

IG, DoD, Report No. 97-006, "Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995," October 15, 1996, stated that the internal control structure of existing accounting systems is so weak that reliable and auditable financial statements will probably not be available until the turn of the century, after DBOF has converted from legacy systems to interim migratory systems.

**DFAS Actions.** DFAS has begun taking steps to resolve some of the reported deficiencies. Specifically, Headquarters, DFAS contracted with Arthur Andersen, a consulting firm, to study DoD accounting and cash accountability functions and to determine the benefits of performing these functions differently. The "Departmental Accounting and Cash Accountability Study" was completed in July 1996. Although we did not validate the results, the study concluded that more efficiency could be realized by reducing the

## **Finding A. The Fund Balance With Treasury Account**

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number of systems that provide accounting data, standardizing general ledger processes and data elements, editing accounting data at the source, and establishing a single system to perform each function.

The study by Arthur Andersen was followed by another DFAS initiative, "Defense Finance and Accounting Service, Accounting Systems Strategic Plan for the Department of Defense," February 13, 1997. In this plan, DFAS outlined a target architecture and migration strategy that analyzed alternatives to migrating to a single departmental accounting system and a single cash accountability system. This strategy incorporated the recommendations of the study by Arthur Andersen.

### **DoD Collection and Payment Process**

The DBOF general ledgers did not support the \$73.5 billion in funds collected, \$74.7 billion in funds disbursed, the \$5.3 billion in funds with Treasury, or the net \$4.1 billion FBWT Account balance as reported in the monthly AR 1307 and the CFO Act financial statements for the fiscal year ended September 30, 1996. This occurred because previously reported deficiencies in the DoD collection and payment process remained uncorrected. Timing differences between the recording of financial data by the Treasury and the posting of the financial data in the DoD general ledgers contributed to the unsupported financial statements. DoD has no method of determining reliable FBWT amounts and uses the monthly and annual Treasury FBWT Account balances as the reported amounts in the FY 1996 DBOF monthly AR 1307 and the FY 1996 DBOF CFO Act financial statements.

The DoD collection and payment process typically involves collection and payment transactions made by one DoD activity on behalf of another DoD activity. These transactions are referred to as transactions by or for others (TBO/TFO). TBO/TFOs may take place between two elements of a DoD Component (intra-Service) or between one DoD Component and another DoD Component or Government activity (cross-disbursing). Interfund transactions, which are transactions between buyers and sellers of DBOF supplies and appropriated fund supplies, are another aspect of the DoD collection and payment process. Each DFAS Center and its subordinate Operating Locations or Defense Accounting Offices participate in the DoD collection and payment process by originating and reporting transactions for the other DFAS Centers, which are responsible for recording the reported transactions in the general ledgers of the DoD activity affected.

The DFAS Center involved in the collection and payment process may be the paying or the receiving center. The paying center reviews data received from the disbursing stations; reports collection and disbursement data to the Treasury; and sends vouchers, supporting documentation, summary information, and Treasury reports to the accountable receiving center. The receiving center passes the vouchers and supporting documentation to its subordinate Operating Locations or Defense Accounting Offices that are responsible for recording transactions in the general ledgers of the business activity. Transferring documents among the various financial activities creates problems, such as

## **Finding A. The Fund Balance With Treasury Account**

misplaced documents and timing differences in posting transactions to DoD general ledgers. The timing differences help to create the differences between the DoD general ledgers and the Treasury balances for the FBWT account. This problem has been reported in prior audit reports and candidly acknowledged in feeder reports for the DFAS FY 1996 annual statement of assurance.

**Collection and Disbursement Issues.** The DoD audit community and the Directors of the DFAS Centers have reported numerous problems with the DoD collection and payment process. Some significant problems identified by the Military Departments or DFAS Centers are discussed below.

**Navy Issues.** The Naval Audit Service, in Report No. 035-96, "Fiscal Year 1995 Consolidated Financial Statements of the Department of the Navy Defense Business Operations Fund," May 31, 1996, stated that even after cash reconciliation, Navy DBOF cash amounts reported as collected and disbursed did not agree with individual Navy DBOF activities' records. As of September 30, 1995, collections reported by the Navy DBOF activities exceeded the amounts reported in the Navy DBOF Consolidated Financial Statements by \$1.3 billion, and disbursements reported by the Navy DBOF activities' exceeded the financial statements by \$1 billion. The differences occurred because the Navy DBOF Consolidated Financial Statements used amounts reported through the Navy financial network, and the Navy DBOF activities used amounts not processed through that network. Differences identified during cash reconciliations were not reported in the Navy DBOF activities' records, and DFAS did not provide the Navy DBOF activities with all data processed through the Navy financial network.

**DFAS Cleveland Center Issues.** The DFAS Cleveland Center reported a material weakness in its feeder report to Headquarters, DFAS, for the FY 1996 annual statement of assurance. The weakness was a lack of controls that inhibited the elimination of undistributed and unmatched disbursements. In-transit or undistributed disbursements are defined as disbursements or collections that have been registered to the Treasury and charged or credited to an appropriation, but not yet distributed to the responsible accounting station. Therefore, the general ledgers of the activities affected will not equal collection and disbursement amounts reported by the Treasury. In-transit disbursements are reported and tracked by the DFAS as problem disbursements when those transactions are not cleared within 180 days. As of August 31, 1996, in-transit problem disbursements amounted to a net value of \$3.6 billion for all Navy appropriations, including the Navy DBOF. As of September 30, 1996, the in-transit problem disbursements reported by the DFAS Cleveland Center totaled \$5.1 billion for the Navy.

**Air Force Issues.** We reviewed the Air Force DBOF collection and disbursement reconciliation with the Treasury for May 1996 and determined that the Air Force identified reconciliation differences of \$4.3 million caused by duplicate transactions, suspense transactions, unidentified adjustments, and accounting errors. Personnel at the DFAS Denver Center who provide accounting services for the Air Force stated that reconciling differences such as these occur each month.

**DFAS Denver Center Issues.** The DFAS Denver Center reported a material weakness in reconciling the clearing accounts in its feeder report to

## **Finding A. The Fund Balance With Treasury Account**

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Headquarters, DFAS for the FY 1996 annual statement of assurance. The required monthly reconciliation of collection and disbursement transactions by the Air Force to Treasury balances was inaccurate. The DFAS Denver Center reported that as a result of this material weakness, financial statement amounts may not be accurate, and fraud could go undetected.

**DFAS Indianapolis Center Issues.** The DFAS Indianapolis Center also reported a material weakness for problem disbursements. In its feeder report to Headquarters, DFAS for the FY 1996 annual statement of assurance, the DFAS Indianapolis Center stated that the primary causes of problem disbursements were nonintegration between systems and errors or delays in posting collections and disbursements to the accounting records. No dollar values for problem disbursements were given in the report. However, as of September 30, 1996, problem disbursements reported by the DFAS Indianapolis Center to Headquarters, DFAS totaled \$3.1 billion for all categories of problem disbursements, including \$2.3 billion for in-transit disbursements.

**Summary Reporting Issues.** All of the examples noted above contributed to the inability of DoD to calculate the FBWT Account balances. The "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996, states that when individual line items cannot be obtained, the deficiencies will be explained and the reasons for noncompliance annotated. The DoD financial statements do not explain the deficiencies in the FBWT Account because the reported amounts were provided by the Treasury.

In spite of the deficiencies noted, DFAS is continuing to take corrective actions. For example, in the "Chief Financial Officer, Financial Management 5-Year Plan," August 1996, DFAS detailed the steps that DoD is taking to develop financial management systems that comply with OMB Circular No. A-127.

## **Summary**

The DoD general ledgers do not provide support for the \$73.5 billion in funds collected, \$74.7 billion in funds disbursed, \$5.3 billion in funds with Treasury, or the net \$4.1 billion FBWT Account balances. Therefore, DoD has relied on the Treasury to provide FBWT Account balances as reported amounts in the monthly AR 1307 and the CFO Act financial statements for the fiscal years ended September 30, 1996 and 1997. Until changes are implemented to DoD accounting and reporting systems and DoD payment and collection processes, DoD will not be in compliance with the DoD 7000.14-R. In addition, if these problems are not corrected, the monthly accounting reports and the financial statements for FY 1998 and beyond will be materially misstated. We are not making recommendations because the issues discussed in our report have been previously reported in other audit reports and in feeder reports for the DFAS annual statement of assurance.

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## **Finding B. Reporting of Undistributed Transactions**

The DFAS Centers did not disclose the dollar amounts of undistributed collections and disbursements closed out to accounts receivable and accounts payable for any DBOF component in the DBOF financial statements for FY 1996. In addition, the DFAS Cleveland and Columbus Centers incorrectly reported net totals of \$335.4 million in undistributed collections and \$849.8 million in undistributed disbursements in the monthly Supplemental Information for the DBOF Defense agencies. This occurred because annual financial statement guidance from the OMB and DoD did not require the disclosure of adjustments made to accounts receivable and accounts payable by undistributed amounts. In addition, DoD policy instructions were unclear concerning the reporting of undistributed amounts in the monthly Supplemental Information. Further, the DFAS quality reviews did not uncover deficiencies in the reporting of undistributed amounts. As a result, the DBOF financial statements for FY 1996 did not adequately disclose material adjustments made to accounts receivable and accounts payable because of undistributed amounts. Because of the incorrect reporting of the FY 1996 monthly Supplemental Information, cumulative undistributed collections were overstated by \$334.6 million and cumulative undistributed disbursements were understated by \$810.8 million for the DBOF Defense agencies. The condition continued with the FY 1997 accounting reports and financial statements. If these problems are not corrected, the accounting reports and financial statements for FY 1998 and beyond will be materially misstated.

### **Undistributed Transactions**

Undistributed collection and disbursement transactions represent financial data reported to the Treasury that were not accepted and posted to the general ledgers of DoD organizations. The financial networks at the DFAS Cleveland, Denver, and Indianapolis Centers report financial data on collections and disbursements monthly to the Treasury. These networks used the financial data provided to the Treasury for FBWT Account reporting in the FY 1996 DBOF monthly AR 1307 and the FY 1996 DBOF financial statements. The differences between the amounts reported to the Treasury and the amounts officially recorded by DoD activities represent undistributed transactions.

Undistributed transactions affect the DBOF monthly AR 1307 and the DBOF financial statements because cumulative (since the inception of DBOF) undistributed transactions are applied to the accounts receivable and accounts payable general ledger accounts. Therefore, if errors are recorded in

## Finding B. Reporting of Undistributed Transactions

undistributed transactions, the balances in the DBOF accounts receivable and accounts payable accounts will reflect the same errors.

Table 2 illustrates the reporting of undistributed amounts as of September 30, 1996, for the DBOF Defense agencies. The "reported" column details the amounts shown on the monthly Supplemental Information. The "required" column details the actual adjustments made for reporting purposes to accounts receivable and accounts payable on the monthly AR 1307 and financial statements for the DBOF Defense agencies during the period ended September 30, 1996. The "difference" column reflects the errors in reporting made in the monthly Supplemental Information, as well as errors in the accounts receivable and accounts payable balances reported in the FY 1996 financial statements for the DBOF Defense agencies.

**Table 2. Reporting of Undistributed Collections and Disbursements on AR 1307 as of September 30, 1996 (millions)**

	<u>Required</u>		<u>Reported</u>		<u>Difference</u>	
	<u>Collections</u>	<u>Disbursements</u>	<u>Collections</u>	<u>Disbursements</u>	<u>Collections</u>	<u>Disbursements</u>
<b><u>Defense Agencies</u></b>						
DECA <sup>1</sup> Operations	\$(105.2)	\$ (14.2)	\$ 0	\$ 0	\$ (105.2)	\$ (14.2)
DFAS	(14.2)	254.5	0	0	(14.2)	254.5
DLA <sup>2</sup>	308.6	829.0	338.4	869.1	(29.8)	(40.1)
DLA <sup>3</sup>	(256.2)	114.6	(3.6)	(7.1)	(252.6)	121.7
DMCs <sup>4</sup>	67.8	476.7	.6	(12.2)	67.2	488.9
JLSC <sup>5</sup>	0	187.7	0	187.7	0	0
USTRANSCOM <sup>6</sup>	<u>58.0</u>	<u>167.3</u>	<u>58.0</u>	<u>167.3</u>	<u>0</u>	<u>0</u>
<b>Totals</b>	<b>\$ 58.8</b>	<b>\$2,015.6</b>	<b>\$ 393.4</b>	<b>\$ 1,204.8</b>	<b>\$ (334.6)</b>	<b>\$810.8</b>

<sup>1</sup>DeCA - Defense Commissary Agency.

<sup>2</sup>Represents DLA business area Supply Management.

<sup>3</sup>Includes all DLA business areas except Supply Management.

<sup>4</sup>DMCs - Defense Megacenters.

<sup>5</sup>JLSC - Joint Logistics Service Center reported \$(3,000) in undistributed collections.

<sup>6</sup>USTRANSCOM - United States Transportation Command.

Table 2 shows that cumulative undistributed collections were overstated by \$334.6 million and cumulative undistributed disbursements were understated by \$810.8 million for the DBOF Defense agencies.

For reporting purposes, the normal effect of posting undistributed transactions would be to decrease accounts receivable and accounts payable. However, when undistributed amounts reflect negative amounts, which is termed an abnormal condition, accounts receivable and accounts payable are abnormally increased. Table 2 shows negative undistributed amounts reported for the

## **Finding B. Reporting of Undistributed Transactions**

FY 1996 DBOF Defense agencies. Therefore, accounts receivable and accounts payable were abnormally increased for reporting purposes in every month and at the end of every fiscal year when negative undistributed amounts were included in undistributed balances. For reporting purposes, adjustments made to accounts receivable and accounts payable by undistributed amounts are normally reversed at the start of each reporting period.

### **Disclosing Undistributed Amounts**

The reporting guidance for DoD financial statements is based on OMB guidance, which does not require the disclosure of financial data on undistributed amounts in the footnotes to the financial statements. However, OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, states, "The notes to the principal statements are an integral part of the principal statements." The OMB guidance also states that the notes to the principal statements "shall provide additional disclosures necessary to make the principal statements fully informative and not misleading." In contrast, the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" provides for the disclosure of any other information related to accounts receivable and other liabilities; however, it does not specifically require the disclosure of financial data on undistributed amounts.

The DFAS Centers did not disclose \$58.8 million in undistributed amounts closed out to accounts receivable and \$2 billion in undistributed amounts closed out to accounts payable in the DBOF Defense agencies' component of the FY 1996 Consolidated Financial Statements. The footnotes to those financial statements disclosed that adjustments were made to accounts receivable and accounts payable because of financial data on undistributed amounts. However, the footnotes did not disclose the dollar value of those financial data. The DoD guidance should be updated to require that the footnotes to the financial statements disclose material undistributed amounts used to adjust the accounts receivable and accounts payable balances.

### **Reporting Undistributed Amounts**

Because of unclear DoD policy instructions, the DFAS Columbus and Cleveland Centers incorrectly reported a net total of \$335.4 million in undistributed collections and \$849.8 million in undistributed disbursements on the September 30, 1996, Supplemental Information for the DBOF Defense agencies. As a result, the September 30, 1996, Supplemental Information overstated cumulative undistributed collections by \$334.6 million and understated cumulative undistributed disbursements by \$810.8 million.

**DoD Policy Instructions.** DoD policy instructions are found in DoD 7000.14-R, volume 11B, "Reimbursable Operations, Policy and Procedures--

## **Finding B. Reporting of Undistributed Transactions**

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Defense Business Operations Fund," chapter 70, "Defense Business Operations Fund Accounting Report 1307," December 1994. However, chapter 70 provides both correct and incorrect guidance.

The correct guidance directs that undistributed amounts be reported in the Supplemental Information. The undistributed amounts represent cumulative undistributed amounts. DoD 7000.14-R gives examples showing that undistributed amounts that are applied to accounts receivable and accounts payable should be reported in the Supplemental Information on reporting lines 33 and 34. Reporting lines 33 and 34 provide for undistributed collection and disbursement amounts that should have been recorded in DoD General Ledger Account Codes 1014 (Undistributed Collections) and 1015 (Undistributed Disbursements).

DoD 7000.14-R gives incorrect guidance on the citing of General Ledger Account Codes 1011.3 (Funds Collected-Undistributed) and 1012.3 (Funds Disbursed-Undistributed). According to personnel at Headquarters, DFAS, General Ledger Account Codes 1011.3 and 1012.3 are invalid because they no longer exist in the DoD Chart of Accounts. These invalid General Ledger Account Codes have corresponding invalid reporting lines in the Supplemental Information (lines 29c and 30c). By including the invalid General Ledger Account Codes 1011.3 and 1012.3 and the associated invalid reporting lines 29c and 30c in the Supplemental Information, DoD 7000.14-R contributed to the incorrect reporting of undistributed amounts in the Supplemental Information. The Under Secretary of Defense (Comptroller) should update DoD 7000.14-R to remove the invalid General Ledger Account Codes 1011.3 and 1012.3 from chapter 70. The invalid reporting lines 29c and 30c in the Supplemental Information should also be removed from chapter 70.

**DFAS Center Reporting.** The DFAS Cleveland, Columbus, and Denver Centers were responsible for reporting undistributed amounts in the monthly Supplemental Information for the DBOF Defense agencies. The monthly Supplemental Information for September 30, 1996, showed that the DFAS Cleveland and Columbus Centers incorrectly reported a net total of \$335.4 million in undistributed collections and \$849.8 million in undistributed disbursements in the September 30, 1996, Supplemental Information for the DBOF Defense agencies.

**DFAS Cleveland Center Reporting.** The DFAS Cleveland Center incorrectly reported \$67.2 million in cumulative undistributed collections and \$488.9 million in cumulative undistributed disbursements for the Defense Information Systems Agency's Defense Megacenters business area in the monthly Supplemental Information for the period ended September 30, 1996. Specifically, the DFAS Cleveland Center reported partial undistributed amounts (\$0.6 million in undistributed collections and a negative \$12.2 million in undistributed disbursements) for the Defense Megacenters business area. However, those portions of the undistributed amounts were reported on the correct reporting lines 33 and 34 in the monthly Supplemental Information.

**DFAS Columbus Center Reporting.** The DFAS Columbus Center incorrectly reported undistributed amounts for the DFAS business areas, the Defense Commissary Agency Operations business area, and part of the Defense Logistics Agency (DLA) business areas on invalid reporting lines 29c and 30c. Although the amounts reported were incorrect for the DLA Supply Management

## **Finding B. Reporting of Undistributed Transactions**

business area (\$338.4 million in undistributed collections and \$869.1 million in undistributed disbursements), the DLA Materiel portion of the Supply Management business area was reported correctly on lines 33 and 34.

In addition, the DFAS Columbus Center was not able to calculate cumulative undistributed amounts for the Defense Commissary Agency's Resale business area because of systematic problems with the posting of undistributed transactions in the DFAS Columbus Center's accounting system. Therefore, the FY 1996 financial statements for the Defense Commissary Agency showed incorrect amounts for accounts receivable and accounts payable that were not adjusted because of unavailable data on undistributed amounts. The DFAS Columbus Center is currently working with the Defense Commissary Agency and Headquarters, DFAS, to correct the problem.

**DFAS Denver Center Reporting.** In contrast, the DFAS Denver Center correctly reported undistributed amounts (\$58 million in undistributed collections and \$355 million in undistributed disbursements) in the Supplemental Information for the U. S. Transportation Command and the Joint Logistics Service Center for the period ended September 30, 1996. In addition, the undistributed amounts were correctly reported on lines 33 and 34 in the monthly Supplemental Information.

## **Quality Assurance Review**

Headquarters, DFAS and the DFAS Columbus, Cleveland, and Indianapolis Centers have quality review procedures; however, the DFAS Centers did not effectively review the undistributed amounts reported in the monthly AR 1307 before certification. The ineffective quality review checks resulted in reporting deficiencies, such as inaccurate and incorrectly reported amounts and negative undistributed amounts, in the monthly Supplemental Information. The ineffective quality review checks represent an internal control weakness; additional procedures need to be established to ensure the accuracy of the undistributed amounts reported. As a result, the AR 1307 did not disclose the actual amounts closed out to accounts receivable (\$58.8 million) and accounts payable (\$2 billion) in FY 1996 monthly Supplemental Information for the DBOF Defense agencies.

**Reporting Negative Undistributed Amounts.** The "Required" column in Table 2 illustrates negative undistributed amounts. Specifically, Table 2 shows that the Defense Commissary Agency Operations business area had \$105.2 million in negative undistributed collections, the DFAS business areas had \$14.2 million, and the DLA business areas had \$256.2 million. Table 2 also shows that the Defense Commissary Agency Operations business area had \$14.2 million in negative undistributed disbursements.

Negative undistributed amounts that represent abnormal balances should not exist in DoD reporting. Collection and disbursement amounts recorded in DoD general ledgers should not exceed the amounts that are reported in the same period to the Treasury. Negative undistributed amounts, when closed out for reporting purposes to accounts receivable and accounts payable, increase those

## **Finding B. Reporting of Undistributed Transactions**

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accounts. The increase caused the accounts receivable and accounts payable amounts in the FY 1996 DBOF financial statements to be misstated.

The General Accounting Office, in its Report No. GAO/AIMD 96-54 (OSD Case No. 1109), "Defense Business Operations Fund: DoD is Experiencing Difficulty in Managing the Fund's Cash," April 10, 1996, also identified the reporting of negative undistributed amounts and the resulting improper effect on accounts receivable and accounts payable.

**Management Control Weakness.** The quality review checks performed by DFAS did not disclose the inaccurate reporting of undistributed amounts in the FY 1996 monthly Supplemental Information for the DBOF Defense agencies. The monthly Supplemental information should have listed the exact undistributed amounts that were closed out for reporting purposes to accounts receivable and accounts payable, but did not. The ineffective quality review of the monthly Supplemental Information represents an internal control weakness.

### **Summary**

The financial statement reporting for undistributed amounts in the DBOF was not disclosed in the FY 1996 financial statements because guidance from OMB and the USD(C) did not specifically require the disclosure of undistributed amounts. In addition, undistributed amounts totaling \$335.4 million in undistributed collections and \$849.3 million in undistributed disbursements were incorrectly reported in the monthly Supplemental Information for the DBOF Defense agencies. This occurred because DoD policy instructions were unclear concerning the reporting of undistributed amounts. Because of errors in the DoD policy instructions, DoD 7000.14-R required the use of invalid General Ledger Account Codes 1011.3 and 1012.3 and the corresponding invalid reporting lines 29c and 30c in the monthly Supplemental Information.

DFAS quality review procedures did not identify errors in the undistributed data reported in the monthly Supplemental Information. As a result, the September 30, 1996, Supplemental Information overstated cumulative undistributed collections by \$334.6 million and understated cumulative undistributed disbursements by \$810.8 million. The condition continued with the FY 1997 accounting reports and financial statements. If these problems are not corrected, the accounting reports and financial statements for FY 1998 and beyond will be materially misstated.

## **Recommendations and Requirements for Management Comments**

### **B.1. We recommend that the Under Secretary of Defense (Comptroller):**

**a. Update the annual “DoD Guidance on Form and Content of Financial Statements” to require the reporting of material undistributed amounts that are applied to accounts receivable and accounts payable in all financial reporting for the Defense Working Capital Funds.**

**Management Comments.** The Under Secretary of Defense (Comptroller) concurred and will require disclosure of material amounts of undistributed collections and disbursements.

**b. Update DoD 7000.14-R to omit invalid General Ledger Account Codes 1011.3 and 1012.3 from the instructions for the monthly Accounting Report 1307.**

**Management Comments.** The Under Secretary of Defense (Comptroller) concurred and will update the DoD-7000.14R and omit invalid General Ledger Account Codes

**c. Update DoD 7000.14-R to omit invalid reporting lines in the Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information.**

**Management Comments.** The Under Secretary of Defense (Comptroller) concurred and will update the DoD-7000.14R to omit invalid reporting lines.

**B.2. We recommend that the Director, Defense Finance and Accounting Service, issue standard operating procedures to the Defense Finance and Accounting Service Centers for the reporting of undistributed balances in the monthly Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosures of Cash Information.**

The Director, Defense Finance and Accounting Service, did not comment on a draft of this report. We request the Director provide comments on this report.

**B.3. We recommend that the Director, Defense Finance and Accounting Service Cleveland Center:**

**a. Establish procedures to implement DoD 7000.14-R for reporting undistributed balances on the monthly Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information, for the Defense Working Capital Funds.**

**b. Establish procedures to supplement existing quality assurance reviews of financial information before certification of the financial statements to ensure that undistributed balances are correctly reported in the monthly Accounting Report 1307, Statement of Cash Flows,**

## **Finding B. Reporting of Undistributed Transactions**

### **Supplemental Disclosure of Cash Information, for the Defense Working Capital Funds.**

**c. Establish procedures to reconcile undistributed amounts and to research and determine the basis for the reporting of negative undistributed balances for the Defense Working Capital Funds and make the necessary corrections before certification of the financial statements to ensure that undistributed balances are correctly reported.**

The Director, Defense Finance and Accounting Service Cleveland Center, did not comment on a draft of this report. We request the Director provide comments on this report.

### **B.4. We recommend that the Director, Defense Finance and Accounting Service Columbus Center:**

**a. Establish procedures to implement DoD 7000.14-R for the reporting of undistributed balances on the monthly Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information, for the Defense Working Capital Funds.**

**b. Establish procedures to supplement existing quality assurance reviews of financial information before certification of the financial statements to ensure that undistributed balances are correctly reported in the monthly Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information, for the Defense Working Capital Funds.**

**c. Establish procedures to reconcile undistributed amounts and to research and determine the basis for the reporting of negative undistributed balances for the Defense Working Capital Funds and make the necessary corrections before certification of the financial statements to ensure that undistributed balances are correctly reported.**

The Director, Defense Finance and Accounting Service Columbus Center, did not comment on a draft of this report. We request the Director provide comments on this report.



## **Part II - Additional Information**

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## Appendix A. Audit Process

### Scope and Methodology

We performed our work at Headquarters, DFAS, and at the DFAS Cleveland, Columbus, Denver, and Indianapolis Centers. We reviewed the DFAS process for reconciling the DBOF FBWT Account and for disclosing undistributed amounts on the FY 1996 DBOF financial statements. We also reviewed the DFAS process for reporting and closing out undistributed amounts in the monthly AR 1307 for the DBOF Defense agencies. As of September 30, 1996, DoD reported \$73.5 billion in collections, \$74.7 billion in disbursements, \$5.1 billion in funds with Treasury, and a net balance of \$4.1 billion, in the DBOF FBWT Account. Of those totals, the DBOF Defense agencies reported \$27.4 billion in funds collected, \$29 billion in funds disbursed, \$2.8 billion in funds with Treasury, and a net balance of \$1.2 billion in FBWT as of September 30, 1996.

**Use of Computer-Processed Data.** To achieve our audit objective, we relied on computer-processed data without testing the general and application controls. We compared the data on the monthly Supplemental Information to financial data provided by the DoD financial networks and the Treasury. Although we did not confirm the reliability of the data, the inaccuracies in the data, as reported in Finding B, did not materially affect the results of our audit.

**Audit Period and Standards.** We performed this financial-related audit from August 1996 through June 1997 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary.

**Contacts During the Audit.** We visited or contacted individuals and organizations within the DoD. Further details are available on request.

### Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, 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 management controls over the reporting of the FBWT Account in the FY 1996 monthly AR 1307 and in the FY 1996 DBOF financial statements for the DBOF Defense agencies. Specifically, we reviewed the management controls over the reporting of undistributed collection and undistributed disbursement amounts in the FY 1996 monthly DBOF AR 1307 and the FY 1996 DBOF financial statements. Because we did not identify a material weakness, we did not assess management's self-evaluation.

**Adequacy of Management Controls.** Management controls over the reporting of FBWT Account balances in the FY 1996 DBOF monthly AR 1307 and the FY 1996 DBOF financial statements were adequate; we identified no material management control weaknesses.

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## Appendix B. Summary of Prior Coverage

### General Accounting Office

**Report No. AIMD-96-54 (OSD Case No. 1109), "Defense Business Operations Fund: DoD is Experiencing Difficulty in Managing the Fund's Cash," April 10, 1996.** This report stated that DBOF managers did not have timely, accurate, and complete data on cash balances for individual business areas. In addition, DBOF monthly financial reports did not fully disclose \$5.4 billion in adjustments that were made to its accounts receivable and payable balances for undistributed disbursements and collections. The GAO recommended that the Under Secretary of Defense (Comptroller) identify the cash balance for each business area in the DBOF monthly AR 1307 financial reports and fully disclose the amount of adjustments made to the accounts receivable and payable balances for undistributed collections and disbursements. The DFAS responded that it had developed reporting procedures so that fund balances for each area could be reported monthly. On November 26, 1996, Headquarters, DFAS, issued a memorandum to the Directors of the DFAS Centers entitled, "Footnotes for the Defense Business Operations Fund (DBOF) Financial Reports." The memorandum explained how undistributed disbursements and collections should be disclosed on financial reports.

**Report No. AIMD-95-79 (OSD Case No. 9859), "Defense Business Operations Fund: Management Issues Challenge Fund Implementation," March 1, 1995.** This report stated that DoD still had problems preparing accurate DBOF financial reports. DFAS revised the DBOF monthly AR 1307, Statement of Operations, but some officials in charge of the revision believed the report could not be properly prepared. Because the financial systems did not contain or accumulate all the necessary data, some DFAS Centers had to obtain the data manually. The officials stated that because different sources were used to obtain data manually, the AR 1307 data were not consistent, and therefore not comparable, between similar business areas. The report made no recommendations.

**Report No. AIMD-94-80 (OSD Case No. 9339-D), "Status of the Defense Business Operations Fund," March 9, 1994.** This report stated that at least \$4.7 billion in DBOF disbursements had not been matched to the corresponding obligations as of September 30, 1993. A major cause of unmatched disbursements is the time that elapses between making payments, transmitting disbursement data to various DoD activities, and recording the disbursement data against the proper obligations. DoD also acknowledged that DBOF financial systems were inadequate. DBOF had 80 disparate, unlinked financial

systems and approximately 200 ancillary systems that provided financial data. Consequently, data often were not complete, timely, or useful. The report made no recommendations.

## **Inspector General, DoD**

**Report No. 97-006, "Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995," October 15, 1996.** This report identified significant accounting and management control deficiencies that prevented the timely development and reliable presentation of the DBOF financial statements. The report listed DBOF accounting systems as a major category of management control structures. Significant management control weaknesses existed in the DBOF accounting systems. The report concluded that the management control structure of existing accounting systems was so weak that reliable and auditable financial statements probably would not be available until at least FY 2002, after DBOF has converted from legacy systems to interim migratory systems. DoD senior management acknowledged the presence of severe control flaws in the DBOF accounting systems and took action to upgrade the systems and eliminate the weaknesses. The report contained no recommendations because numerous recommendations addressing these issues were made in previous audit reports.

**Report No. 94-159, "Fund Balances With The Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund," June 30, 1994.** This report concluded that the DLA business areas' FBWT Accounts were not prepared in accordance with generally accepted accounting principles. This occurred because DoD policy guidance defined FBWT Accounts inadequately; DFAS procedures did not require that adequate audit trails be maintained and adjustments be matched to their proper periods; reconciliations were not completed for FY 1993 between two sets of financial records; and disclosures on the statement of cash flows and footnotes to the financial statements were inadequate. The report recommended that FBWT guidance be rescinded because it was not in accordance with generally accepted accounting principles; that procedures and controls be issued to establish adequate audit trails, reconciliations, and controls over appropriation limits; that limits be established for business areas; and that discrepancies be disclosed in the FY 1993 statement of cash flows and accompanying footnotes. DLA concurred with the recommendation to establish appropriate limits for business areas, and partially concurred with the recommendation to disclose discrepancies in the FY 1993 statement of cash flows and accompanying footnotes. DLA stated that the footnote disclosures in the FY 1993 financial statements were adequate.

**Report No. 94-082, "Financial Management of the Defense Business Operations Fund - FY 1992," April 11, 1994.** This report stated that cash transactions were not accurately recorded on the financial statements because the Comptroller, DoD (now the Under Secretary of Defense [Comptroller]), had not issued written guidance on cash management of the DBOF and had not established oversight to ensure that accounting policies were followed. In addition, the various automated accounting systems in use by the DFAS Centers were not uniform and did not provide consistency in financial reporting or comparability of operations for the DBOF. The Deputy Comptroller, DoD, was tasked with developing comprehensive policies and procedures for cash management. The report recommended internal reconciliation procedures for disbursements and collections, adequate documentation to support accounting adjustments, and improved audit trails. Management concurred with the recommendations.

**Report No. 94-048, "Uncleared Transactions by and for Others," March 2, 1994.** This report concluded that DFAS management was not exercising the oversight needed to eliminate excessive delays in clearing transactions and to reduce undistributed disbursements and collections with a net value of \$34.6 billion as of January 31, 1993. The procedures used to solve problems with disbursement and collection transactions were less than effective, and were not always followed. Without matching disbursements and collections to obligations, DoD incurs the risk that cumulative disbursements may exceed appropriation and other limits, and that fraudulent and erroneous payments could be made. The report recommended that the Comptroller, DoD, include detailed guidance for clearing transactions and reducing undistributed disbursements in DoD 7000.14-R. Management concurred with the recommendation.

**Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund," June 30, 1993.** This report stated that controls over cash were inadequate, a material discrepancy existed between the DBOF cash balance and Department of the Treasury records, and weekly flash cash reports were inaccurate. The report made no recommendations. Management generally concurred with the material weaknesses identified in the report.

## **Naval Audit Service**

**Report No. 035-96, "Fiscal Year 1995 Consolidating Financial Statements of the Department of the Navy Defense Business Operations Fund," May 31, 1996.** This report stated that the amounts reported as collected and disbursed in the FY 1995 Navy DBOF Consolidating Financial Statements did not agree with activities' records after cash reconciliations. Collections reported by activities exceeded those used to prepare the FY 1995 Navy DBOF Consolidating Financial Statements by \$1.3 billion, and disbursements reported

## **Appendix B. Summary of Prior Coverage**

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by activities exceeded those used to prepare the statements by \$1 billion. The differences occurred because financial statement preparers relied only on information processed by the Navy finance network, although activities included transactions not processed through that network. Differences noted by activities during cash reconciliations were not reported in the activities' records; and DFAS did not provide activities with all data processed through the Navy finance network. DoD guidance states that cash transactions occur only when the finance network recognizes them. The report recommended that the Director, DFAS, provide Navy DBOF activities with data on all collections and disbursements reported in the finance network and require, in forthcoming directives on cash reconciliation, all subordinate activities, in conjunction with Navy DBOF activities, to reconcile collection and disbursement data to data reported in the finance network and post these reconciling items to the records. DFAS concurred with the recommendations and initiated corrective actions.

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

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

### **Unified Command**

Commander, U.S. Transportation Command

### **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 Finance and Accounting Service  
Director, Defense Finance and Accounting Service Cleveland Center  
Director, Defense Finance and Accounting Service Columbus Center  
Director, Defense Finance and Accounting Service Denver Center  
Director, Defense Finance and Accounting Service Indianapolis Center  
Director, Defense Finance and Accounting Service Kansas City Center  
Director, Joint Logistics Service Center

## **Non-Defense Federal Organizations and Individuals**

Office of Management and Budget  
Technical Information Center, National Security and International Affairs Division,  
General Accounting Office  
Inspector General, U.S. Department of Education

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 Government Management, Information, and Technology,  
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



COMPTROLLER

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



FEB 18 1998

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

SUBJECT: Draft Audit Report on the "Fund Balance With Treasury Account in the  
FY 1996 Financial Statements of the Defense Business Operations Fund,"  
(Project No. 5FH-2021.01)

This is the Office of the Under Secretary of Defense (Comptroller) response to the subject  
draft report.

This office concurs with recommendations B.1. (a), (b), and (c). Attached are detailed  
comments regarding those recommendations.

We appreciate the opportunity to comment on the draft report.

The point of contact for this matter is Mr. Thomas Short. He may be reached by e-mail:  
short@ousdc.osd.mil or by telephone at (703) 697-6875.

William J. Lynn

Attachment

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
COMMENTS ON AN OFFICE OF THE INSPECTOR GENERAL DRAFT AUDIT REPORT  
"FUND BALANCE WITH TREASURY ACCOUNT IN THE FY 1996 FINANCIAL  
STATEMENTS OF THE DEFENSE BUSINESS OPERATIONS FUND"  
DATED NOVEMBER 20, 1997  
(PROJECT NO. 5FH-2021.01)

\*\*\*\*\*

**Recommendation B.1.a.** We [OIG] recommend that the Under Secretary of Defense (Comptroller) update the annual "DoD Guidance on Form and Content of Financial Statements" to require the reporting of material undistributed amounts that are applied to accounts receivable and accounts payable in all financial reporting for the Defense Working Capital Funds.

**OUSD(C) Comment.** Concur. The DoD Guidance on Form and Content for FY 1998 Financial Statements will require that the footnotes to the financial statements disclose the amount of undistributed collections and disbursements used to offset accounts receivable and accounts payable balances when such amounts are material.

**Recommendation B.1.b.** We [OIG] recommend that the Under Secretary of Defense (Comptroller) update DoD 7000.14-R to omit invalid General Ledger Account Codes 1011.3 and 1012.3 from the instructions for the monthly Accounting Report 1307.

**OUSD(C) Comment.** Concur. Volume 11B, Chapter 70, of DoD 7000.14-R will be revised to omit General Ledger Account Codes 1011.3 and 1012.3 from the instructions for the monthly Accounting Report 1307.

**Recommendation B.1.c.** We [OIG] recommend that the Under Secretary of Defense (Comptroller) update DoD 7000.14-R to omit invalid reporting lines in the Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information.

**OUSD(C) Comment.** Concur. Volume 11B, Chapter 70, of DoD 7000.14-R will be revised to omit report lines 29c and 30c from the monthly Accounting Report 1307, Statement of Cash Flows, Supplemental Disclosure of Cash Information.

Attachment

## **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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