

Audit



Report

COMPILATION OF THE FY 1997 ARMY GENERAL FUND
FINANCIAL STATEMENTS AT THE DEFENSE FINANCE AND
ACCOUNTING SERVICE INDIANAPOLIS CENTER

Report No. 98-212

September 24, 1998

Office of the Inspector General
Department of Defense

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Acronyms

AAA	Army Audit Agency
CFO	Chief Financial Officers
DBARS	Departmental Budgetary Accounting and Reporting System
DFAS	Defense Finance and Accounting Service
GL	General Ledger
HQARS	Headquarters Accounting and Reporting System



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202

September 24, 1998

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on the Compilation of the FY 1997 Army General Fund
Financial Statements at the Defense Finance and Accounting Service
Indianapolis Center (Report No. 98-212)

We are providing this report for review and comment. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Director, Defense Finance and Accounting Service did not comment on a draft of this report. Accordingly, we request that the Director, Defense Finance and Accounting Service provide comments on the final report by October 26, 1998.

Management comments should indicate concurrence or nonconcurrence with each finding and recommendation. Comments should describe actions taken or planned in response to agreed-upon recommendations and should designate the completion dates of the actions. State specific reasons for any nonconcurrence and propose alternate actions, if appropriate. Defense Finance and Accounting Service management should also comment on the material control weakness identified in Appendix A.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird at (703) 604-9175 (DSN 664-9175) or e-mail rbird@dodig.osd.mil, or Mr. John J. Vietor at (317) 510-3855 (DSN 699-3855) or e-mail jvietore@dodig.osd.mil. See Appendix D for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in cursive script that reads "David K. Steensma".

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-212

(Project No. 7FI-2031.02)

September 24, 1998

Compilation of the FY 1997 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center

Executive Summary

Introduction. The Defense Finance and Accounting Service (DFAS) Indianapolis Center maintains the Army departmental accounting records and compiles the Army General Fund financial statements. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with applicable generally accepted Government auditing standards, but allows the delegation of the audit work. The Inspector General, DoD, delegated the audit of the FY 1997 Army General Fund financial statements to the Army Audit Agency. The Inspector General, DoD, assisted the Army Audit Agency by performing the required audit work at the DFAS Indianapolis Center. The Army Audit Agency disclaimed an opinion on the FY 1997 Army General Fund financial statements and we concurred with the disclaimer. The FY 1997 Army General Fund financial statements included the Statement of Financial Position and the Statement of Operations and Changes in Net Position, along with the supporting footnotes, supplementary schedules, and a management overview. The FY 1997 Statement of Financial Position reported total assets of \$215.3 billion and total liabilities of \$36.4 billion as of September 30, 1997. The Statement of Operations and Changes in Net Position reported total revenues of \$64.7 billion and total expenses of \$65.4 billion for the fiscal year ended September 30, 1997.

Audit Objective. Our audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data from field activities and other sources for the financial statements of Army General Fund. We reviewed management controls and compliance with laws and regulations related to the objective.

Audit Results. The DFAS Indianapolis Center compilation of financial data from field entities and other sources into the FY 1997 Army General Fund financial statements was not in compliance with applicable laws and regulations. The use of status of appropriations data and expenditure data is an unacceptable interim method for compiling the Army General Fund financial statements. This interim compilation process has been in place for over six years. The Army General Fund financial statements, taken as a whole, will not be auditable until a transaction-driven, integrated accounting system based on general ledger accounting is implemented Army-wide. Procedures and internal controls were needed in the following areas.

- The DFAS Indianapolis Center made about \$350 billion of unsupported general ledger adjustments while compiling the FY 1997 Army General Fund financial statements. The adjustments were part of an interim compilation process in use since

FY 1991 and were made to force general ledger data to agree with data on the status of appropriations. As a result, the Army General Fund financial statements were not auditable. (Finding A).

- The DFAS Indianapolis Center did not have an effective procedure for monitoring unresolved discrepancies between Treasury records and disbursing station statements of accountability for checks issued. These check issue discrepancies were about \$4.4 billion as of September 30, 1997, of which about \$1 billion were more than eight months old. As a result, there was no assurance that existing discrepancies would be corrected or that future discrepancies will be resolved. The existence of significant check issue discrepancies was one reason why auditors rendered a disclaimer of opinion on the FY 1997 Army General Fund financial statements (Finding B).

- Footnote disclosure in the FY 1997 Army General Fund financial statements needed improvement. Footnotes did not fully explain the causes for large variances in financial statement line items from year to year and necessary disclosures concerning check issue discrepancies and nonoperating changes were incomplete. As a result, the usefulness of the FY 1997 Army General Fund financial statements was reduced (Finding C).

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center establish an action plan with specific target dates for deploying a transaction-driven, integrated accounting system based on general ledger accounting for compiling the Army General Fund financial statements. We recommend that the Director, DFAS Indianapolis Center establish a permanent monitoring program so that previously reported check issue discrepancies can be resolved and future discrepancies may be avoided. We also recommend that the Director, DFAS Indianapolis Center request the U. S. Treasury to provide the monthly check issue discrepancy report in automated form and provide copies of Advice of Check Issue Discrepancy Notices to the DFAS Indianapolis Center. We recommend that the Director, DFAS establish procedures to ensure that all material and relevant financial data is disclosed in the financial statement footnotes in accordance with applicable guidance.

Management Comments. The Director, DFAS did not respond to a draft of this report. We request that the Director, DFAS provide comments on the report by October 26, 1998.

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Part I - Audit Results

Audit Background

Chief Financial Officers Act. This audit was performed in response to the Chief Financial Officers Act (the CFO Act) of 1990, as amended by the Government Management Reform Act of 1994. The CFO Act requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments and agencies, as well as Government corporations. The CFO Act also requires the Inspectors General, or appointed external auditors, to audit financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget.

Role of the DFAS Indianapolis Center. The DFAS Indianapolis Center provides finance and accounting support to all DoD organizations, but especially to the U.S. Army and the Defense Agencies. Support includes maintaining departmental accounting records and preparing financial statements from general ledger trial balances and financial data on the status of appropriations, submitted by DoD field accounting entities and other sources. However, the compilation process is complicated because financial data submitted to the DFAS Indianapolis Center were not generated by integrated, transaction-driven general ledger systems.

Audit of the FY 1997 Army General Fund Financial Statements. The Inspector General, DoD, delegated the FY 1997 audit of the Army General Fund financial statements to the Army Audit Agency (AAA). The Inspector General, DoD, assisted the AAA by performing the required audit work at the DFAS Indianapolis Center, including examining the processes used to prepare the Army General Fund financial statements.

FY 1997 Army General Fund Financial Statements. The Army FY 1997 financial statements consisted of the Statement of Financial Position and the Statement of Operations and Changes in Net Position, along with the supporting footnotes, supplementary schedules, and a management overview. The FY 1997 Statement of Financial Position reported total assets of \$215.3 billion and total liabilities of \$36.4 billion as of September 30, 1997. The Statement of Operations and Changes in Net Position reported total revenues of \$64.7 billion and total expenses of \$65.4 billion for the fiscal year ended September 30, 1997.

Audit Objective

The audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data from field activities and other sources for the financial statements of the Army General Fund. We reviewed internal controls and compliance with laws and regulations related to the objectives.

See Appendix A for a discussion of the audit process, and the DFAS Indianapolis Center management control program. See Appendix B for a summary of prior audit coverage at the DFAS Indianapolis Center related to the audit objectives.

Finding A. General Ledger Adjustments

The DFAS Indianapolis Center made about \$350 billion of unsupported general ledger adjustments while compiling the FY 1997 Army General Fund financial statements. The adjustments were part of an interim compilation process in use since FY 1991 and were made to force general ledger data to agree with data on the status of appropriations. These adjustments were made because the DFAS Indianapolis Center Headquarters Accounting and Reporting System and its supporting accounting subsystems do not conform to the general ledger method of accounting. Further DFAS Indianapolis Center personnel believed data on the status of appropriations was more accurate. As a result, the Army General Fund financial statements were not auditable. The Army General Fund financial statements, taken as a whole, will not be auditable until a transaction-driven, integrated accounting system based on general ledger accounting is implemented Army-wide.

The Compilation Process

Since FY 1991, The DFAS Indianapolis Center has used a complex interim process to combine financial information from many accounting subsystems and compile the Army financial statements.

Data on the Status of Appropriations. Data on the status of appropriations recorded by the DFAS Indianapolis Center during the fiscal year are adjusted to match year-end reports on the status of appropriations certified by responsible officials. The adjusted status of appropriations data are referred to as certified status of appropriations data. The certified status of appropriations data are then reconciled to the net expenditures recorded by the U.S. Treasury and departmental adjustments are made. These adjustments allow for adjusting status of appropriations data to show the effect of in-transit and unmatched transactions on accounts payable and accounts receivable, correcting bulk errors caused by deficiencies in accounting systems, meeting special reporting requirements, and adding department-level information not available to or accounted for by the field accounting systems.

General Ledger Data. Each month field accounting entities supported by the DFAS Indianapolis Center submit a general ledger trial balance directly to the departmental general ledger module of the Headquarters Accounting and Reporting System (HQARS). At year-end, the general ledger data are consolidated into a microcomputer database, the Source File, used to prepare the Army General Fund financial statements. General ledger adjustments are then made directly to the Source File. Adjustments are made for many reasons, including changing general ledger accounts to match certified status of appropriations data, recording auditor's adjustments, and recording ammunition assets.

Preparation of the Financial Statements. After the general ledger adjustments have been made, the DFAS Indianapolis Center uses a microcomputer program known as the Comprehensive Reporting System to convert the Source File into the Army General Fund financial statements. The DFAS Indianapolis Center adds footnotes and supplementary schedules, and the Assistant Secretary of the Army (Financial Management and Comptroller) adds an overview section to the financial statements to create the Army CFO annual report.

Responsibilities. The Departmental Support Team Two of the DFAS Indianapolis Center's Directorate for Departmental Accounting is responsible for compiling the Army General Fund financial statements.

Adjustments to the General Ledger

The DFAS Indianapolis Center prepared 252 general ledger adjustments valued at about \$749 billion while compiling the FY 1997 Army General Fund financial statements. About \$350 billion of the adjustments were made to force general ledger data to agree with status of appropriations data. Table 1 summarizes the adjustments the DFAS Indianapolis Center made to the general ledger for FY 1997 and FY 1996.

Purpose of Adjustments	FY 1997	FY 1996
Forcing general ledger accounts to match certified status of appropriations data	\$350.0	\$127.8
Recording appropriated capital used	57.0	55.2
Recording auditors' adjustments	17.2	31.2
Recognizing contingent liabilities	31.5	14.6
Recording prior period adjustments	129.3	13.5
Making intra-agency eliminations	12.1	11.9
Recording ammunition assets	2.2	10.4
All others	149.5	34.3
Total	\$ 748.8	\$ 298.9

DFAS Indianapolis Center personnel made the adjustment to force the general ledger data to agree with status of appropriations data because the accounting systems used to compile the Army General Fund financial statements did not conform to the general ledger method of accounting and status of appropriations data was believed to be more accurate. The General Accounting Office stated in its report on the Army Financial Statements for FY 1992 and FY 1991, "there can be no assurance that either data source is accurate because discrepancies between them are not investigated." Since DFAS Indianapolis Center personnel make the adjustment to force the general ledger data to agree with status of appropriation data without attempting to reconcile the differences between the two data sources or determine which is correct, we consider the adjustment to be unsupported.

Accounting Systems

The DFAS Indianapolis Center HQARS and its supporting accounting subsystems do not conform to the general ledger method of accounting required by the Federal Financial Management Improvement Act of 1996, Office of Management and Budget Circular A-127 - Revised, or the DoD Financial Management Regulation.

- The Federal Financial Management Improvement Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level.
- Office of Management and Budget Circular A-127-Revised, “Financial Management Systems,” July 23, 1993, requires that “The design of the financial management systems shall reflect an agency-wide financial information classification structure that is consistent with the U.S. Standard General Ledger.”
- The DoD Financial Management Regulation, Volume 1, Chapter 3, “Accounting Systems Conformance, Evaluation, and Reporting,” states that “The system must have general ledger control and maintain an appropriate account structure approved by DoD. The general ledger account structure must follow the general ledger accounts for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources.”

Headquarters Accounting and Reporting System. The DFAS Indianapolis Center used its HQARS to prepare the FY 1997 Army General Fund financial statements. However, this accounting system does not meet accounting system requirements. The DFAS Indianapolis Center Chief Financial Officer Financial Management 5-Year Plan, September 1997, states that “departures [from key accounting requirements] in the Headquarters Accounting and Reporting System general ledger control and reporting and system documentation impede progress in achieving auditable CFO Financial Statements.” The 5-Year Plan further states that the departures in key accounting requirements were first identified in FY 1983 and that full elimination of the departures depends on receiving reliable financial information from accounting subsystems. The 5-Year plan does not give a date for completion of the goal to eliminate departures from the key accounting requirements.

Supporting Accounting Subsystems. The HQARS receives general funds accounting support from seven accounting subsystems, including the Standard Finance System and the Standard Operation and Maintenance Army Research and Development System. The 5-Year plan says that “General ledger control and reporting, . . . [key accounting requirements] departures impede achieving reliable CFO Financial Statements.” The 5-Year Plan further states that the departures in key accounting requirements were first identified in FY 1983 but does not give a date for elimination of the key accounting requirement departures.

The DFAS Indianapolis Center should establish an action plan with specific target dates for deploying a transaction-driven, integrated accounting system based on general ledger accounting for compiling the Army General Fund financial statements.

The Use of Status of Appropriations Data

The DFAS Indianapolis Center believed status of appropriations data to be more accurate than general ledger data because responsible officials certify status of appropriations data to be correct. However, significant differences existed between the general ledger and status of appropriation data. While compiling the FY 1997 Army General Fund financial statements, the DFAS Indianapolis Center made adjustments of about \$350 billion to force general ledger accounts to match status of appropriations data. However, these adjustments are only the symptom of the underlying material internal control weakness—specifically, the lack of an integrated transaction-driven double-entry general ledger accounting system to prepare the Army General Fund financial statements. Without this accounting system, for over six years DFAS Indianapolis Center personnel have relied on status of appropriation data to prepare a significant portion of the financial statements. Table 2 illustrates the significance of the departmental adjustments made by DFAS Indianapolis Center personnel to force general ledger accounts to match status of appropriations data on the FY 1997 Army General Fund financial statements.

Financial Statement Line	Unadjusted Balance	Status/GL Adjustments	Other Adjustments	Adjusted Balance
Fund Balance With Treasury	\$190.3	(133.2)	(26.5)	30.6
Accounts Payable, Governmental	30.2	(26.6)	(2.8)	.8
Unexpended Appropriations	380.2	(296.3)	(56.6)	27.3
Cost of Goods Sold to the Public	\$4.5	(4.0)	0	.5
Nonoperating Changes	222.8	(108.8)	(110.2)	3.8

Unsupported adjustments of the magnitude noted in Table 2 call into question the validity of both the general ledger data and the status of appropriations data. As a result, the Army General Fund financial statements were not auditable.

Finding A. General Ledger Adjustments

Conclusion

The DFAS Indianapolis Center was not in compliance with requirements to use an integrated standard general ledger accounting system to produce the FY 1997 Army General Fund financial statements. This nonconformance to the general ledger method of accounting has existed for over six years. The lack of an integrated, double-entry, transaction-based general ledger accounting system has been reported as a major reason for a disclaimer of opinion since the General Accounting Office first audited the Army financial statements in 1991. The General Accounting Office, in Report No. AFMD-92-83 (OSD Case No. 8674), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991," August 7, 1992, concluded that much of the information needed for the financial statements was not produced by a general ledger-controlled accounting system because the DFAS Indianapolis Center determined that the general ledger data were so unreliable that it was necessary to use an alternative source, the status of appropriations data, for preparing the Army's financial statements. In its audit of the FY 1993 Army General Fund financial statements, the Inspector General, DoD, stated that the DFAS Indianapolis Center recognized the problem that the Army General Fund financial statements were compiled from systems not conforming to the general ledger method of accounting. Therefore, the Inspector General, DoD, did not recommend that an integrated, double entry, transaction-based general ledger system be developed for compiling the Army General Fund financial statements. At that time, the DFAS Indianapolis Center stated that the problem would be corrected by September 1997. As reported in the September 1997 DFAS Indianapolis Center 5-Year Financial Management Plan, the DFAS Indianapolis Center does not have a date for correcting the accounting system problem. The DFAS Indianapolis Center should establish an action plan with specific target dates for deploying a transaction-driven, integrated accounting system based on general ledger accounting for compiling the Army General Fund financial statements. The Army General Fund financial statements, taken as a whole, will not be auditable until a transaction-driven, integrated accounting system based on general ledger accounting is implemented Army-wide.

Recommendation for Corrective Action

A. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center establish an action plan with specific target dates for deploying a transaction-driven, integrated accounting system based on general ledger accounting for compiling the Army General Fund financial statements.

Management Comments Required

The Director, DFAS did not comment on a draft of this report. We request that the Director, DFAS provide comments on the final report.

Finding B. Check Issue Discrepancies

The DFAS Indianapolis Center did not have an effective procedure for monitoring unresolved discrepancies between Treasury records and disbursing station statements of accountability for checks issued. These check issue discrepancies were about \$4.4 billion as of September 30, 1997, of which about \$1 billion were more than eight months old. This occurred because although the DFAS Indianapolis Center acted to eliminate some discrepancies in existence as of September 30, 1996, no permanent program to monitor and correct subsequent or future discrepancies was established. As a result, there was no assurance that existing discrepancies would be corrected or that future discrepancies will be resolved. The existence of significant check issue discrepancies was one reason why auditors rendered a disclaimer of opinion on the FY 1997 Army General Fund financial statements.

Check Issue Discrepancies

Check issue discrepancies occur when Treasury records of checks issued do not agree with disbursing station accountability reports. Check issue discrepancies may happen for several reasons.

- **Timing.** Check issue discrepancies often indicate differences between disbursing station monthly summary reports of expenditures and detailed reports on checks issued. This type of check issue discrepancy may occur because the summary expenditure reports cover slightly shorter accounting periods than detailed check issue reports. For example, the summary report may only cover the first 26 days of a given month, while the detailed reports cover the entire month. Disbursing stations elect to use a shorter accounting period for the summary reports to meet reporting requirements. In some cases, accounting system deficiencies or the location of the disbursing station delay the submission of detailed check issue reports until after the end of the Treasury accounting period. These discrepancies because of timing differences are normally resolved within three months. For example, about \$1.8 billion of the \$2 billion, or about 89 percent, of the check issue discrepancies that originated in December 1997 were resolved before the end of March 1998.
- **Corrections.** Check issue discrepancies may also occur because corrections of timing discrepancies or other errors are reported for the current month instead of for the month when the discrepancy occurred. As a result, discrepancies and the adjustments intended to correct them are included in separate reporting months, and the adjustments become new discrepancies. Unless disbursing stations research and correct these errors, the check issue discrepancies will remain indefinitely.
- **Cashed Checks.** Check issue discrepancies may occur when the amount of a check actually cashed by the Federal Reserve Bank

Finding B. Check Issue Discrepancies

disagrees with the amount of the same check reported on detailed listings submitted by disbursing stations. The Treasury reports this type of check issue discrepancies to the disbursing stations on an Advice of Check Issue Discrepancy notice. The amount of this type of discrepancy reported to Army disbursing stations for FY 1997 was about \$33 million or about 1 percent of the \$3,209.9 million in discrepancies reported during FY 1997 and still in existence as of December 31, 1997. Although these discrepancy amounts are of limited materiality, disbursing stations should research and correct them because they represent potential fraud and loss of funds.

Guidance. On June 20, 1996, the DFAS Indianapolis Center Deputy Director for Accounting Operations issued a desk top procedure covering check issue reporting and check issue discrepancies to all disbursing stations.

Resolving Check Issue Discrepancies

The DFAS Indianapolis Center did not have an effective procedure for monitoring unresolved check issue discrepancies. These check issue discrepancies were about \$4.4 billion as of September 30, 1997, of which about \$1 billion were more than eight months old. About \$1.5 billion of the total discrepancies were in the Treasury's favor and about \$2.9 billion were in the Army's favor, or an unresolved net difference of about \$1.4 billion. Some of the discrepancies date back as early as 1985 and many are related to inactive disbursing stations. There were 19 disbursing stations with outstanding discrepancies of \$122 million that had been inactive so long that they no longer appeared on the rosters of disbursing stations from which reports were expected.

DFAS Indianapolis Center Action. Although the DFAS Indianapolis Center acted to eliminate some discrepancies in existence as of September 30, 1996, no permanent program to monitor and correct subsequent or future discrepancies was established. On July 28, 1997, the Office of the Assistant Secretary of the Army (Financial Management and Comptroller) requested that the DFAS Indianapolis Center assist Army disbursing stations in resolving check issue discrepancies identified by the U.S. Treasury as at least eight months old as of May 31, 1997. On September 18, 1997, the DFAS Indianapolis Center issued a memorandum to all Army disbursing stations. The letter provided each disbursing station with a summary of its outstanding aged check issue discrepancies, established a target date of March 1998 for resolving all discrepancies, and required bi-monthly reports. The DFAS Indianapolis Center also reported the existence of check issue discrepancies as a material management control weakness. However, the DFAS Indianapolis Center effort was directed at the elimination of the check issue discrepancies identified by the Treasury. The DFAS Indianapolis Center did not establish a permanent program to monitor the disbursing stations to ensure that all aged and current check issue discrepancies were resolved and to reduce future check issue discrepancies.

Effects of Action Taken. As of December 31, 1997, the DFAS Indianapolis Center had made some progress in eliminating the check issue discrepancies identified by the Treasury. Table 3 shows discrepancy balances at key months.

Month	From 2/85 to 9/96 ¹	Over 8 Months Old	4 to 8 Months Old	1 to 3 Months Old	Total
July 1997	\$936.6	\$939.1	\$354.6	\$2,655.3	\$3,949.0
September 1997	944.8	952.3	748.7	2,723.9	4,424.9
December 1997	931.7	948.2	344.3	2,846.7	4,139.2
March 1998	743.2	975.8	558.8	2,029.8	3,564.4

¹Included in the amount shown as over eight months old.

As explained in the discussion of check issue discrepancies, about 89 percent of the discrepancies which are one to three months old can be expected to be due to timing and easily resolved. The DFAS Indianapolis Center has reduced the check issue discrepancies for the period February 1985 through September 1996 by about 20 percent. However, further resolution of these discrepancies will be difficult because the records required to research them are often no longer available. Generally, the older discrepancies get, the harder they are to successfully research and resolve. For this reason, it is critical that those discrepancies not due to timing be identified, researched, and resolved as soon as possible.

Resources Needed to Monitor, Research, and Resolve Discrepancies

The U.S. Treasury did not provide the DFAS Indianapolis Center the resources necessary to monitor, research, and resolve check issue discrepancies effectively.

The Detail Report. The U.S. Treasury did not provide the DFAS Indianapolis Center information on the number and extent of check issue discrepancies until August 1997. Starting in that month, the U.S. Treasury's Financial Management Service began sending out a monthly report (the Comparison of Checks Issued—Detail Report) on check issue discrepancies. The Detail Report includes all check issue discrepancies for Army disbursing stations, active and inactive, that were still unresolved at the end of the reporting month. However, the U.S. Treasury provides the DFAS Indianapolis center only a single paper copy of the 100-page Detail Report each month. As a result, the data contained in the Detail Report cannot be readily sorted, distributed, or analyzed. The DFAS Indianapolis Center should request the U.S. Treasury to provide the Detail Reports in automated form.

Advice of Check Issue Discrepancy Notice. The U.S. Treasury provides copies of Advice of Check Issue Discrepancy Notices to the disbursing stations but not to the DFAS Indianapolis Center. Also, the Detail Report summarizes all check issue discrepancies that occur at a disbursing station during a month into a single number. As a result, the DFAS Indianapolis Center cannot easily identify check

Finding B. Check Issue Discrepancies

issue discrepancies that resulted from cashed checks. The DFAS Indianapolis Center should request the U.S. Treasury to provide copies of the FMS forms 5206 directly to it as well as to the disbursing station.

Conclusion

Check issue discrepancies are an uncertainty affecting the amount reported for Fund Balance With Treasury, and represent a material internal control issue that must be resolved. In its FY 1997 audit report on the Army General Fund financial statements, the AAA stated that “We weren’t able to attest to the reasonableness of the reported total for Fund Balance With Treasury (about \$30.6 billion as of 30 September 1997). Treasury reports showed about \$4.4 billion of unresolved discrepancies between Treasury records and disbursing officer statements of accountability for checks issued.” About \$1 billion had existed for eight or more months and could not readily be resolved. The inability to explain these discrepancies is one of the many reasons auditors rendered a disclaimer of opinion on the FY 1997 Army General Fund financial statements. Until the DFAS Indianapolis Center establishes a permanent program for monitoring and resolving check issue discrepancies, there will be no assurance that previously reported discrepancies will be resolved and future discrepancies will be avoided. Check issue discrepancies will remain a reason for a disclaimer of opinion on the Army General Fund financial statements.

Recommendations for Corrective Action

B. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center:

1. Establish a permanent program to monitor and eliminate previously reported discrepancies and avoid future discrepancies.
2. Request the U.S. Treasury to provide the monthly check issue discrepancy report to the DFAS Indianapolis Center in automated form.
3. Request that the U.S. Treasury provide copies of Advice of Check Issue Discrepancy Notices to the DFAS Indianapolis Center.

Management Comments Required

The Director, DFAS did not comment on a draft of this report. We request that the Director, DFAS provide comments on the final report.

Finding C. Footnote Disclosure

Footnote disclosure in the FY 1997 Army General Fund financial statements needed improvement. Footnotes did not fully explain the causes for large variances in financial statement line items from year to year, and necessary disclosures concerning check issue discrepancies, nonoperating changes, and presentation of comparative data between fiscal years were incomplete. This condition occurred because the DFAS Indianapolis Center did not implement existing policy regarding footnote disclosure. Also, the DFAS Indianapolis Center had not developed formal procedures to verify that all material relevant financial data was fully disclosed in financial statement footnotes. As a result, the usefulness of the FY 1997 Army General Fund financial statements was reduced.

Criteria and Responsibilities

Criteria. The American Institute of Certified Public Accountants Statement on Auditing Standards No. 32, "Adequacy of Disclosure in Financial Statements," October 1980, states that "The presentation of financial statements in conformity with generally accepted accounting principles includes adequate disclosure of material matters." Office of Management and Budget Bulletin 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, states that "the notes to principal statements, which are an integral part of the principal statements, shall provide additional disclosures necessary to make the principal statements fully informative and not misleading." The Federal Accounting Standards Advisory Board Concept Statement No. 2, "Entity and Display," April 20, 1995, states in paragraph 68 that "Financial information is also conveyed with accompanying footnotes, which are an integral part of the financial statements. Footnotes typically provide additional disclosures that are necessary to make the financial statements more informative and not misleading." The DoD Financial Management Regulation, volume 6, chapter 6, "Form and Content of Audited Financial Statements," January 1998, establishes specific requirements for footnotes to principal financial statements. As a result of a prior audit recommendation, the DFAS Indianapolis Center established policy that material year-to-year variances not resulting from normal operations should be explained in the financial statement footnotes.

Responsibilities. DFAS Indianapolis Center Departmental Support Team Two of the Deputy Director for Accounting Operations, Directorate for Departmental Accounting is responsible for developing the footnotes to the Army General Fund financial statements.

Footnote Disclosure

Footnote disclosure in the FY 1997 Army General Fund financial statements needed improvement. As required by Statement on Auditing Standards No. 32, "Adequacy of Disclosure in Financial Statements," we examined the footnotes prepared by the DFAS Indianapolis Center for the FY 1997 Army General Fund financial statements. We determined that the footnotes could have better

Finding C. Footnote Disclosure

explained the causes for large variances in financial statement line items from year to year. Also, other necessary disclosures concerning check issue discrepancies and nonoperating changes were incomplete. This happened because the DFAS Indianapolis Center did not implement existing policy regarding footnote disclosure. Also, while the DFAS Indianapolis Center had several Standing Operating Procedures that discussed various aspects of financial statement presentation, none of the procedures addressed the preparation of the footnotes for the CFO financial statements.

Footnote Disclosure of Year-To-Year Variances in Financial Statement Line Item Balances. Footnote disclosures could have better explained the causes for large variances in financial statement line items from year to year. We determined that the FY 1997 Army General Fund financial statements contained 11 lines that had large variances from the prior year (see Appendix D, “Year-To-Year Variances”). Three of the 11 lines should have been better explained in the footnotes.

- **Other Non-Federal Liabilities.** Line 5.b.5 of the FY 1997 Army General Fund Statement of Financial Position showed a FY 1997 balance for unfunded non-Federal liabilities of \$27.7 billion, a 71.7 percent increase from the FY 1996 balance. This difference was because of first-time recognition of certain types of environmental liabilities. In Footnote 17 - Other Liabilities, DFAS Indianapolis Center personnel mentioned that the environmental liabilities were being recognized for the first time, but did not explain how this circumstance affected the financial statements.
- **Cumulative Results of Operations.** Line 7.c of the FY 1997 Army General Fund Statement of Financial Position showed a FY 1997 balance for cumulative results of operations of negative \$401.5 million, a 75.9 percent increase from the FY 1996 balance. The DFAS Indianapolis Center did not explain this difference.
- **Future Funding Requirements.** Line 7.e of the FY 1997 Army General Fund Statement of Financial Position showed a FY 1997 balance for future funding requirements of negative \$29.6 billion, a 62.8 percent increase from the FY 1996 balance. The DFAS Indianapolis Center did not explain this difference.

If material year-to-year changes are not fully explained in the footnotes, the meaning of large variances in line item balances may not be properly understood. Incomplete explanations reduce the usefulness of the financial statements.

Other Necessary Disclosures. The DFAS Indianapolis Center did not disclose all information necessary for a complete understanding of the FY 1997 Army General Fund financial statements, especially with regards to check issue discrepancies, Non-Entity Fund Balance With Treasury, nonoperating changes, and comparative data between fiscal years.

- **Check Issue Discrepancies.** Footnote 2, Fund Balances with Treasury, did not disclose the amount of unresolved check issue discrepancies between the records of the Treasury and the Army. DFAS Indianapolis Center personnel disclosed the existence of “an indeterminate amount” of check issue discrepancies. Treasury had

determined this amount to be \$1.4 billion, but DFAS Indianapolis Center personnel were not willing to disclose the \$1.4 billion because they believed the Treasury amount was unreliable. DFAS Indianapolis Center personnel should have disclosed the Treasury determined amount for check issue discrepancies.

- **Non-Entity Fund Balance With Treasury.** DFAS Indianapolis Center personnel explained in Footnote 17 - Other Liabilities that line 4.a.4 of the FY 1997 Army General Fund Statement of Financial Position was significantly higher for FY 1997 than for FY 1996 because of the effects of an “abnormal balance” reported in FY 1996. However, DFAS Indianapolis Center personnel did not disclose that the abnormal balance was the inaccurate balance reported for the FY 1996 Non-Entity Assets Fund Balance With Treasury. Further, the DFAS Indianapolis Center did not disclose that the correct balance was not determined. This information should have been disclosed in Footnote 2 - Fund Balances With Treasury.
- **Nonoperating Changes.** DFAS Indianapolis Center personnel did not explain the actual meaning of the Transfers In and Transfers Out included in Footnote 28, Non-Operating Changes. The U.S. Government Standard General Ledger defines Transfers In as the value of assets received from others without reimbursement and Transfers Out as the value of assets transferred to others without reimbursement. Note 28 reports Transfers In of \$34.6 billion and Transfers Out of \$21.1 billion. However, these amounts do not represent actual transfers of assets to and from the Army. Rather, they are the results of departmental general ledger adjustments made while preparing the financial statements. This should be explained in Footnote 28.
- **Comparative Data.** Most footnotes to the FY 1997 Army General Fund financial statements that presented detailed information on the FY 1997 financial data did not present comparative detailed information for FY 1996. Of the 16 footnotes that contained detailed information on FY 1997 financial data, only 5 also included corresponding detailed information for FY 1996. If a footnote does not contain comparative data, the potential usefulness of the footnotes is reduced.

The DFAS Indianapolis Center could have prepared better footnotes for the FY 1997 Army General Fund financial statements. All necessary disclosures should be made. These enhancements to the footnotes would improve the potential usefulness of the financial statements.

Recommendation for Corrective Action

C. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center establish procedures to verify that all material and relevant financial data is adequately disclosed in the financial statement footnotes.

Management Comments Required

The Director, DFAS did not comment on a draft of this report. We request that the Director, DFAS provide comments on the final report.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. Our review of the compilation of the Army FY 1997 General Fund financial statements covered the DFAS Indianapolis Center processes, procedures, and related management controls for consolidating financial data from field activities and other sources. These data were used to prepare the version of the Army financial statements submitted to the auditors on January 26, 1998. Our examination included a review of the following processes:

- establishing beginning account balances;
- establishing the Fund Balance With Treasury line item balance for the Army General Fund, including:
 - controls over the reconciliation of outstanding discrepancies between Army reports of deposits and payments and Treasury records,
 - reconciliation of outstanding discrepancies between Army records of checks issued and Treasury records,
 - reconciliation of Army status of appropriations records to the Treasury trial balance, and
 - reconciliation of Army status of appropriations reports to the Army statements;
- making departmental adjustments to status of appropriations data;
- making departmental adjustments to the general ledger; and
- producing the Department of the Army Annual Financial Report for FY 1997, including the Army statements, footnotes, and supplementary schedules.

Limitations to Audit Scope. We did not examine the accuracy of data submitted by DoD field accounting entities or other sources, or attempt to reconcile the data with subsidiary records. However, we did compare the Fund Balance With Treasury recorded by the U.S. Treasury for the Army General Fund to the Fund Balance With Treasury reported in the Army General Fund financial statements. We also reviewed the closing positions for Army General Fund appropriations for deficit balances, and general ledger trial balances for reasonableness. In addition, we did not examine the Management Overview section of the financial statements.

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of

Defense has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This audit report pertains to achievement of the following objective and goal.

Objective: Fundamentally reengineer the Department of Defense and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Objective: Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High Risk Area. The General Accounting Office has identified several high risk areas in the DoD. This report provides coverage of the Defense Financial Management high risk area.

Use of Computer-Processed Data. To achieve the audit objective, we relied primarily on computer-processed data in the Departmental Budgetary Accounting and Reporting System (DBARS) and the General Ledger Database. We accomplished a limited assessment of the reliability of this data using the General Accounting Office systems audit approach designed for generalists. Our limited review determined that the controls reviewed were adequate. We also conducted sufficient tests of the data and concluded that the computer-processed data were sufficiently reliable to be used in fulfilling the audit objective. However, field-level systems were not included in the review. Therefore, we can comment only on the reliability of data processed after receipt by the DFAS Indianapolis Center.

Audit Type, Dates, and Standards. We performed this financial-related audit at the DFAS Indianapolis Center from October 1997 through May 1998. The audit was made in compliance with auditing standards established by the Comptroller General, as implemented by the Inspector General, DoD, and with Office of Management and Budget guidance; however, we limited our scope as noted above. The audit included such tests of management controls and management's compliance with laws and regulations as we 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 Review

DoD Directive 5010.38, "Internal Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of internal controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We evaluated management controls over the DFAS Indianapolis Center processes and

Appendix A. Audit Process

procedures for consolidating financial data from field activities and other sources for preparation of the Army financial statements. We did not assess the adequacy of management's self-evaluation of these controls, because the review of the DFAS Indianapolis Center management control program, as it relates to the compilation of the Army financial statements, is covered in a related audit report, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," Project 7FI-2034.02.

Adequacy of Management Controls. A material management control weakness existed in the DFAS Indianapolis Center processes and procedures for monitoring and resolving discrepancies between the amount or other information on checks reported by a disbursing office and the amount or other information actually printed on the check, as defined by DoD Directive 5010.38. The DFAS Indianapolis Center management controls were not adequate to monitor discrepancies between disbursements and collections reported by the Army and Treasury records. This weakness was identified by the DFAS Indianapolis Center during its annual management control review and reported in the DFAS Indianapolis Center FY 1997 Annual Assurance Statement. The control weakness identified and our recommendations for improvements are discussed in Part I. Recommendations B.1, B.2, and B.3, if implemented, will improve controls over monitoring discrepancies between disbursements and collections reported by the Army and Treasury records. A copy of the report will be provided to the senior official responsible for management controls at the DFAS Indianapolis Center.

Appendix B. Summary of Prior Coverage

U. S. General Accounting Office Report No. AFMD-92-83 (OSD Case No. 8674), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991," August 7, 1992.

U. S. General Accounting Office Report No. AIMD-93-1 (OSD Case No. 9276-E), "Financial Audit: Examination of the Army's Financial Statements for Fiscal Years 1992 and 1991," June 30, 1993.

Inspector General, DoD, Report No. 98-120, "Compilation of the FY 1996 Army Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," April 23, 1998.

Inspector General, DoD, Report No. 96-161, "Compilation of the FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service, Indianapolis Center," June 13, 1996.

Inspector General, DoD, Report No. 94-168, "Defense Finance and Accounting Service Work on the Army's FY 1993 Financial Statements," July 6, 1994.

Appendix C. Year-To-Year Variances

The FY 1997 Army General Fund financial statements contained 11 lines with large variances (the change from FY 1996 to FY 1997 was greater than \$500 million and at least 25 percent). The 11 lines are listed in the table below.

FY 1997 Material Year-to-Year Variances (Dollars in Millions)				
Statement of Financial Position				
	Line	FY 1997	FY 1996	Change (percent)
	Advances and Prepayments (Non-Federal)	\$ 2,536.8	\$ 424.2	+498
	War Reserves	46,760.4	35,769.9	+31
	Other Entity Assets	0	5,476.7	-100
	Accounts Payable (Federal)	1,495.7	2,069.1	-28
	Other Federal Liabilities (Funded)	1,499.7	725.3	+107
	Accounts Payable (Non-Federal)	795.7	1,789.2	-56
X	Other Non-Federal Liabilities (Unfunded)	27,712.2	16,138.9	+72
X	Cumulative Results of Operations	-401.5	-1,667.7	+76
X	Future Funding Requirements	-29,655.9	-18,221.9	+63
Statement of Operations (and Changes in Net Position)				
	Line	FY 1997	FY 1996	Change (percent)
	Other Expenses	\$1,885.0	\$ 735.1	+156
	Nonoperating Changes	3,821.6	-33,089.9	-1112
"X" indicates lines that required additional footnote explanation.				

Appendix D. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service, Indianapolis Center
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

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

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

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

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