

Audit



Report

COMPILATION OF THE FY 1998 ARMY WORKING CAPITAL
FUND FINANCIAL STATEMENTS

Report Number 99-258

September 23, 1999

Office of the Inspector General
Department of Defense

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Acronyms

AAA	Army Audit Agency
AR	Accounting Report
CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
HQARS	Headquarters Accounting and Reporting System
WCF	Working Capital Fund



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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September 23, 1999

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Compilation of the FY 1998 Army Working Capital Fund
Financial Statements (Report No. 99-258)

We are providing this report for your information and use. We performed this audit as part of our audit of the FY 1998 DoD Agency-Wide Consolidated financial statements, in response to 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 when preparing the final report.

Management comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Richard B. Bird at (703) 604-9159 (DSN 664-9159) (rbird@dodig.osd.mil) or Mr. Jack L. Armstrong at (317) 510-3846 (DSN 699-3846) (jarmstrong@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover of this report.

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Report No. 99-258
(Project No. 8FI-2027.01)

September 23, 1999

Compilation of the FY 1998 Army Working Capital Fund Financial Statements

Executive Summary

Introduction. This is the second in a series of audit reports relating to the audit of the FY 1998 Army Working Capital Fund financial statements. The first report was on our oversight of the Army Audit Agency audit of the FY 1998 Army Working Capital Fund financial statements. We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires that DoD provide audited financial statements to the Office of Management and Budget. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. The Inspector General, DoD, delegated the audit of the FY 1998 Army Working Capital Fund financial statements to the Army Audit Agency. The Inspector General, DoD, and the Army Audit Agency jointly performed audit work at the Defense Finance and Accounting Service (DFAS) Indianapolis Center. The Army Audit Agency disclaimed an opinion on the FY 1998 Army Working Capital Fund financial statements, and we endorsed the disclaimer. The FY 1998 Army Working Capital Fund financial statements reported total assets of \$14.2 billion and total liabilities of \$1.3 billion. Net program costs for the Army Working Capital Fund were \$938 million.

Objectives. The overall audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data from field organizations and other sources for the financial statements of the Army Working Capital Fund. Specifically, we worked with the Army Audit Agency to evaluate whether the compilation of financial information for the FY 1998 financial statements was complete and materially correct. We reviewed management controls and compliance with laws and regulations as they related to the audit objective. We also evaluated the management control program for the compilation of the FY 1998 Army Working Capital Fund financial statements.

Results. The DFAS Indianapolis Center made material accounting adjustments that were not adequately supported. Specifically,

- DFAS Indianapolis Center made \$208 billion in adjustments to the Accounting Report 1307 database without adequate support or audit trail from the Accounting Report 1307 database to the journal vouchers. The Army Audit Agency was able to reconstruct an audit trail and perform a detailed review of \$72.9 billion of the \$208 billion. It was able to locate

supporting documentation for \$48.4 billion in adjustments; however, \$24.5 billion of adjustments were made without adequate supporting documentation.

- DFAS Indianapolis Center did not adequately support \$7 billion in adjustments made to the Source File database.

As a result, the FY 1998 Army Working Capital Fund financial statements contained material amounts of unsupported adjustments that rendered the financial statements unauditible. The details are discussed in the Finding section in this report.

Summary of Recommendations. We recommend that the Director, DFAS Indianapolis Center, require that the procedures contained in the “Standard Operating Procedures for Journal Vouchers” be followed in making all accounting adjustments. Also, we recommend requiring certification and maintenance of journal vouchers.

Management Comments. The Director for Accounting, DFAS, generally disagreed with auditor assertions of inadequately supported accounting adjustments, but he concurred with both recommendations and stated that corrective action would be completed by September 30, 1999. A discussion of management comments and audit response is in the Finding section of this report, and the complete text of the comments is in the Management Comments section.

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Background

This is the second in a series of audit reports on the FY 1998 Army Working Capital Fund (WCF) financial statements. The first report was on our oversight of the Army Audit Agency (AAA) audit of the FY 1998 Army WCF financial statements. This report summarizes the compilation process at the Defense Finance and Accounting Service (DFAS) Indianapolis Center and reflects the audit work jointly performed by the Inspector General, DoD, and AAA.

Chief Financial Officers Act. The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD and other Government agencies to prepare financial statements covering substantial commercial functions, revolving funds, and trust funds. Agency-wide financial statements are audited and submitted to the Director, Office of Management and Budget, beginning in FY 1996 and in each succeeding year. The CFO Act also requires the Inspector General, or an appointed external auditor, to audit financial statements in accordance with generally accepted Government auditing standards and other criteria established by the Office of Management and Budget.

Roles and Responsibilities. The Under Secretary of Defense (Comptroller) as the Chief Financial Officer, DoD, is responsible for overseeing the preparation of agency-wide financial statements. The Under Secretary of Defense (Comptroller) is also responsible for providing accounting policy and procedures to DoD. The DFAS centers perform accounting functions and prepare financial statements for DoD entities.

Role of the DFAS Indianapolis Center. Each month, field accounting entities supported by the DFAS Indianapolis Center submit a general ledger trial balance directly to the Federal Financial System, a general ledger module of the Headquarters Accounting and Reporting System (HQARS). They also submit monthly financial data on the status of appropriations to the DFAS Indianapolis Center. Two teams within the Departmental Accounting Directorate at the DFAS Indianapolis Center prepare the Army WCF financial statements. The WCF Team prepares the monthly and year-end Defense WCF Accounting Report (AR) 1307 for the consolidated business areas as well as the Army entity levels, and the Team maintains departmental accounting records. The CFO Reporting and Support Team prepares the Army WCF financial statements.

Data on the Status of Appropriations. During the fiscal year, the DFAS Indianapolis Center records the data on the status of the Army WCF appropriation. Responsible officials are required to fax, mail, or electronically submit copies of their monthly status reports to the DFAS Indianapolis Center for the reconciliation process. If necessary, adjustments are made so that status-of-appropriations data agree with the beginning balances certified from the prior year and ending balances submitted for the current reporting period. The certified status-of-appropriations data are then reconciled to the net expenditures recorded by the Department of the Treasury. Status data are used to compile

the Status of Reimbursements (SF 112) report, the Status of Approved Resources (SF 218) report, and the Report on Budget Execution (SF 133). The status-of-appropriations data are also reconciled with the AR 1307. If the two reports differ, the AR 1307 is adjusted to agree with the status-of-appropriations data, which have been certified and are considered to be the most correct.

Preparation of Accounting Reports. The WCF Team prepares the monthly AR 1307 for each field accounting entity. Most accounting entities' general ledgers are transaction-driven; however, some financial data submitted to the DFAS Indianapolis Center are not generated by an integrated transaction-driven general ledger system. The general ledger data are supplemented with information from other sources, such as AR 1302, the Cost Accounting Budget general ledger, Reports on Budget Execution, and the Army WCF Cash Management Report. The WCF Team adjusts the data to agree with certified data on the status of appropriations, to record field accounting adjustments, to revalue inventory, to record undistributed collections and disbursements, to reconcile with the Department of the Treasury's records, and to record assets. After the general ledger is balanced, the general ledger data are used to prepare the monthly AR 1307. Each field accounting entity reviews its AR 1307 for accuracy and completeness, and certifies it. At the end of the fiscal year, the WCF Team produces the year-end AR 1307.

Preparation of the Financial Statements. The HQARS data are downloaded to another microcomputer system that prepares the Army WCF financial statements. The year-end AR 1307 becomes the Source File for the Army WCF financial statements. The DFAS Indianapolis Center then makes additional adjustments directly to the Source File in the microcomputer system. Adjustments are made for many reasons, including recording auditors' adjustments, making intra-agency eliminations, and meeting special reporting requirements. 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.

Army WCF Financial Statements. The FY 1998 Army WCF financial statements consist of the consolidated and consolidating balance sheets; consolidated and consolidating Statement of Financing; consolidated and consolidating Statement of Changes in Net Position; consolidated and consolidating Statement of Net Costs; consolidated and consolidating Statement of Budgetary Resources, along with the supporting footnotes; and the management overview on the Army WCF financial statements. The FY 1998 Army WCF Consolidated Balance Sheet reported total assets of \$14.2 billion and total liabilities of \$1.3 billion, and the consolidated Statement of Net Costs reported net program costs of \$938 million.

Objectives

The overall audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data received from field organizations and other sources for the financial statements of the Army WCF. Specifically, we worked with AAA to evaluate whether the compilation of financial information for the FY 1998 financial statements was complete and materially correct. We reviewed management controls and compliance with laws and regulations as they related to the audit objective. We also evaluated the management control program for the compilation of the FY 1998 Army WCF financial statements. 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 related to the audit objectives at the DFAS Indianapolis Center.

Accounting Adjustments

The DFAS Indianapolis Center made material accounting adjustments that were not adequately supported.

- DFAS Indianapolis Center made \$208 billion* in adjustments to the AR 1307 database without adequate support or audit trail from the AR 1307 database to the journal vouchers. The Army Audit Agency was able to reconstruct an audit trail for \$72.9 billion of the \$208 billion. It performed a detailed review of the \$72.9 billion and was able to locate supporting documentation for \$48.4 billion in adjustments. However, \$24.5 billion of adjustments were made without adequate supporting documentation.
- DFAS Indianapolis Center did not adequately support \$7 billion in adjustments made to the Source File database.

Adjustments were not adequately supported because accounting personnel did not use voucher numbers to identify adjustments made to the AR 1307 database. Adequate management controls were not in place to ensure the validity of the adjustments. Unsupported adjustments to the Source File database were made because the DFAS Indianapolis Center HQARS and its supporting accounting subsystems did not conform to the general ledger method of accounting. As a result, the FY 1998 Army WCF financial statements contained material amounts of unsupported adjustments that rendered the financial statements unauditible.

Guidance for Compilation

Federal Financial Management Improvement Act of 1996. 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 requirements for systems, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

Office of Management and Budget Guidance. Office of Management and Budget Circular No. A-127 Revised, "Financial Management Systems," July 23, 1993, states, "The design of the financial management systems shall reflect an agency-wide financial information classification structure that is consistent with the U.S. Government Standard General Ledger."

* Unless otherwise indicated, dollar values referenced in this report reflect the absolute value of adjustments.

DoD Financial Management Regulation 7000.14-R. DoD Financial Management Regulation 7000.14-R, volume 1, chapter 3, "Accounting Systems Conformance, Evaluation, and Reporting," states, "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." DoD Financial Management Regulation 7000.14-R, volume 6, "Reporting Policy and Procedures," February 12, 1996, includes the DFAS responsibilities for the preparation of the financial statements. The regulation requires DFAS to establish procedures to ensure that the preparation of financial statements is timely and auditable and that controls are in place to provide accurate and complete statements. The regulation states, "... the DFAS shall support adequately and justify in writing any adjustment to the official accounting records." The regulation also states that the documentation of adjustments should be detailed enough to provide an audit trail. The regulation requires that the DoD Components review all financial statements prepared by DFAS to ensure that the amounts are consistent and reconcilable with the data in their management reports.

Adjustments to the AR 1307 Database

DFAS Indianapolis Center prepared 50 journal vouchers to adjust the general ledger data in the AR 1307 database. The adjustments consisted of more than 9,100 journal entries, valued at \$208 billion. None of the adjustments had an adequate audit trail back to supporting journal vouchers. Management control procedures were inadequate. For example, management control weaknesses identified by AAA included the following:

- adequate supporting documentation was not attached to all the journal vouchers,
- journal voucher numbers were not identified in the AR 1307 database, and
- journal vouchers were prepared after the adjustments were made to the AR 1307 database.

In addition, the WCF Team used an informal control log to post journal vouchers; however, it was not kept current and accurate. AAA found that some journal vouchers were prepared that were not recorded in the control log. Also, DFAS Indianapolis Center had no separate management control check to ensure that all journal vouchers were properly prepared, supported, and recorded. Specifically, AAA found adjustments in the AR 1307 database that could not be traced to the journal vouchers and adjustments on the vouchers that could not be traced to the AR 1307 database. As a result, journal voucher adjustments could

not be located without searching through 50 journal vouchers with more than 9,100 entries and trying to match dollar values or reason reference codes to the AR 1307 database adjustment transactions.

Management Control Procedures. Beginning in FY 1999, the WCF Team was reassigned to the Departmental Accounting Directorate. Before FY 1999, the WCF Team was assigned to the Defense Accounting Directorate at the DFAS Indianapolis Center. The WCF Team did not have written management control procedures for processing accounting adjustments to the FY 1998 Army WCF financial statements. However, the Departmental Accounting Directorate had written procedures that could be adapted for the WCF Team. On September 19, 1997, the Departmental Accounting Directorate issued "Standard Operating Procedures for Journal Vouchers." The purpose of the procedures was to ensure adequate audit trails, the validity of the journal vouchers, the separation of duties to avoid erroneous input, and proper approval of journal vouchers. That purpose was to be accomplished by the Internal Control and Development Support Team of the Departmental Accounting Directorate through the use of a formal control log and by maintaining the official journal vouchers. To preclude future management control weaknesses, the WCF Team should follow the "Standard Operating Procedures for Journal Vouchers" of the Departmental Accounting Directorate.

Supporting Documentation. Because AAA could not trace the adjustments from the AR 1307 database to the journal voucher, the auditors attempted to reconstruct an audit trail. The reconstruction process involved searching through the 50 journal vouchers and 9,100 entries at DFAS Indianapolis Center to match the adjustment. When the appropriate journal voucher was found, the journal voucher was provided to the auditors at the field organizations to identify supporting evidence. The auditors were able to find journal vouchers for \$72.9 billion of the \$208 billion in adjustments that were reviewed. The auditors were also able to find support for \$48.4 billion of the \$72.9 billion but were unable to locate adequate support for \$24.5 billion of the adjustments. Because of the extensive effort involved, and the lack of documentation, verifying the remaining \$135.1 billion of the \$208 billion in accounting adjustments would have been impractical.

The AAA addressed the supporting documentation issue in its Audit Report No. AA 99-37, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Accounting Support," November 25, 1998, and made recommendations for corrective actions. The AAA addressed the audit trail issue in Audit Report No. AA 99-161, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998: Report on Internal Controls and Compliance With Laws and Regulations," February 12, 1999. Also, AAA is preparing an audit report that presents additional details and will make recommendations to correct the audit trail deficiency. Although AAA has addressed two of the issues, the actions will not correct all of the management control deficiencies.

Adjustments to the Source File Database

DFAS Indianapolis Center prepared 126 journal vouchers, resulting in \$16.2 billion in adjustments to the Source File. However, sufficient evidence was not provided for 19 journal vouchers, valued at \$6.98 billion, to determine whether the adjustments were adequately supported. The data in the Source File were used to compile the Army WCF financial statements.

Similarly, Inspector General, DoD, Audit Report No. 98-216, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements," September 29, 1998, states that material accounting adjustments made to the Source File were not adequately supported or were in error. Specifically, 15 adjustments for \$2.1 billion were made to the Source File to bring the data into agreement with the AR 1307. The condition existed because DFAS Indianapolis Center did not follow the DoD procedures and policy. DFAS Indianapolis Center did not review and verify that manual adjustments made to the financial statements were correct. The report recommended that the DFAS Indianapolis Center reconcile transactions that were incorrectly transmitted to the Source File database. For preparation of the FY 1998 Army WCF financial statements, the DFAS Indianapolis Center prepared listings from the databases and performed the reconciliations.

The report also recommended that adjustments be documented in accordance with the "DoD Financial Management Regulation," and the Director concurred with the recommendation. For the FY 1998 financial statements, DFAS Indianapolis Center made journal vouchers for the adjustments made to the Source File database; however, the supporting documentation was inadequate for the 19 journal vouchers. The "Standard Operating Procedures for Journal Vouchers" requires that adjustments be explained, reasons for their need given, and methods for calculating the amounts shown. The journal voucher should be supported with documentation stating the purpose for the accounting adjustment. The documented purpose should describe what caused the error, the reason for the adjustment, rationale, and effects if not corrected. Documents accompanying the journal voucher must reference the adjustment and support the amounts. The following table shows the documentation deficiencies.

Journal Voucher Documentation Deficiencies		
	<u>Number of Vouchers</u>	<u>Value of Vouchers (Millions)</u>
The journal voucher did not adequately explain what caused the error, why the adjustment was required, and how the amounts were determined.	13	\$6,570
The reason or justification for the adjustment was not documented, and attached documentation did not justify the journal voucher.	4	354
The journal voucher was not supported by adequate documentation for the amounts or justification.	2	64
Total	19	\$6,988

We are not making any additional recommendations to address the deficiencies in documentation. The recommendation made in Inspector General, DoD, Audit Report No. 98-216, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements," September 29, 1998, was adequate. In comments to the report, the Director, DFAS, stated that action had been taken to ensure that accounting adjustments were adequately supported. Also, DFAS Indianapolis Center was taking action to improve the documentation of accounting adjustments made to the Source File.

Accounting Systems

The adjustment process used at the time of this audit to compile the Army WCF financial statements was an unacceptable interim compilation process because of inadequate accounting systems. The DFAS Indianapolis Center HQARS and its supporting accounting subsystems did 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 No. A-127 Revised, or the DoD Financial Management Regulation 7000.14-R.

Headquarters Accounting and Reporting System. The DFAS Indianapolis Center used its HQARS to prepare the FY 1998 Army WCF financial statements. However, HQARS did not meet accounting system requirements. The DFAS Indianapolis Center reported the failure of the HQARS to meet accounting system requirements in its September 1997 Chief Financial Officers Financial Management 5-Year Plan (5-Year Plan). The 5-Year Plan 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 1993 and that full compliance with key accounting requirements depends on receiving reliable financial information from accounting subsystems. The 5-Year Plan did not give a date for completion of corrective actions to bring about full compliance with the key accounting requirements.

National Defense Act. The National Defense Authorization Act of 1998 directed DoD to create a Biennial Financial Management Improvement Plan (Biennial Plan) and submit the plan to Congress no later than September 30 of each even-numbered year. The first Biennial Plan was completed in September 1998. Because the Biennial Plan addresses almost all aspects of DoD financial management operations, it covers many of the financial reporting requirements specified in other regulatory legislation, including the reporting requirements for the 5-Year Plan. As a result, the 5-Year Plan will no longer be published. The September 1998 Biennial Plan lists HQARS in the inventory of accounting systems. However, the Biennial Plan does not include any details on the inability of HQARS to meet accounting system requirements. As a result, until HQARS is replaced, the basic problems with adjustments will continue to exist.

Summary

The DFAS Indianapolis Center’s process for compiling the Army WCF financial statements needs improvement in management controls to ensure that the financial statements are more complete and accurate, and that sufficient audit trails exist to trace the adjustments back to supporting documentation. The process should also ensure that supporting documentation is complete and adequate. Specifically, adjustments made by the WCF Team should be reviewed and certified in accordance with the same standards as the adjustments made to the Source File by the CFO Reporting and Support Team. Those conditions exist because the WCF Team did not have written procedures for processing and logging adjustment journal vouchers. In addition, the Departmental Accounting Directorate did not require that adjustment journal vouchers processed by the WCF Team be controlled by the Internal Control and

Development Support Team, which maintains control of the journal vouchers processed by the CFO Reporting and Support Team. As a result, the FY 1998 Army WCF financial statements were unreliable.

Management Comments on the Finding and Audit Response

Management Comments. The Director for Accounting, DFAS, generally disagreed with the auditors' assertions that the DFAS Indianapolis Center made material accounting journal vouchers without adequate supporting documentation. The Director requested that the auditors provide specific concerns with the quality of the documentation so that DFAS could properly evaluate the need to address improvements required to adequately support the journal vouchers. The Director commented that the report implied a lack of documentation for AR 1307 database journal vouchers and stated that was not the case. Further, not preparing journal vouchers immediately after the corrections are made to the AR 1307 database was not an internal control weakness. The Director stated that procedures will be changed to ensure each journal voucher in the AR 1307 database contains a voucher number.

Audit Response. We agree that DFAS Indianapolis Center is attempting to fully and completely document all journal vouchers, however, it still needs improvements in the documentation process. Also, DFAS Indianapolis Center personnel had information on the accounting adjustments that the auditors questioned. For example, in this report, the table titled, "Journal Voucher Documentation Deficiencies" shows instances in which the documentation did not adequately support the adjustments or did not contain the reasons for the adjustments. Each of the 19 journal vouchers was discussed with DFAS Indianapolis Center personnel, who stated that they would improve journal voucher justification and support. The statement that the AR 1307 database would include a number to identify the journal voucher further supports the DFAS commitment to improve documentation. The inclusion in the database was the result of auditors bringing the issue to the attention of DFAS Indianapolis Center personnel. We have and will continue to work closely with DFAS Indianapolis Center personnel to improve the financial statement compilation process.

We do not agree with the Director's comment that the report implied a lack of documentation for AR 1307 database journal vouchers and that was not the case. The report states that adjustments did not have adequate support or audit trail. The adjustments did not have an audit trail from the AR 1307 database to the supporting journal vouchers. Because the adjustments that the Army WCF team made did not have journal voucher numbers entered into the database, we could not trace the adjustment amounts in the database directly to the journal vouchers. We disagree with the Director for Accounting that untimely preparation of journal vouchers is not an internal control weakness. Journal vouchers should be prepared and approved before making manual corrections and immediately after making automated corrections to the database. If adequately supported journal vouchers are not prepared in a timely manner, it

reduces the creditability for the justification for the adjustment. We also believe that it reduces the ability of the person making the adjustment to determine why the adjustment was needed and its validity. We question whether or not a journal voucher would have been prepared if the auditors had not identified the transactions. For example, a monthly journal voucher for \$13.8 billion was prepared more than 2 months after year-end. The voucher number was not in the AR 1307 database, and the journal voucher contained no reference codes. Although the reference codes were not recorded in the journal voucher, DFAS Indianapolis Center personnel believed that the voucher contained five reference codes; however, the auditors were able to find only three reference codes in the AR 1307 database. The reference code identifies the source of the 35 adjustments made on the voucher. In addition, for three adjustments, the general ledger code in the database did not track to the journal voucher. Even though three reference codes were found, we cannot be sure that the adjustments were the same because journal voucher numbers were not in the database.

Recommendations and Management Comments

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

1. Require that the Working Capital Fund Team use guidance in the “Standard Operating Procedures for Journal Vouchers,” used by the Chief Financial Officers Reporting and Support Team for processing and documenting adjustment journal vouchers.

Management Comments. DFAS management concurred and stated that the WCF Team has been directed to follow the procedures implemented by the CFO Reporting and Support Team for processing and documenting journal vouchers. DFAS estimates that implementation will be completed by September 30, 1999.

2. Require the Internal Control and Development Support Team to certify and maintain adjustment journal vouchers processed by the Working Capital Fund Team.

Management Comments. DFAS management concurred and stated that the Internal Control and Development Support Team will certify and maintain journal vouchers processed by the WCF Team and the CFO Reporting and Support Team. DFAS estimates that it will complete those actions by September 30, 1999.

Appendix A. Audit Process

Scope

Our audit work was limited to an examination of the DFAS Indianapolis Center's processes, procedures, and management controls for compiling financial data from field organizations and other sources into the FY 1998 Army WCF Financial Statements. The data that we reviewed were used to prepare the FY 1998 Army WCF financial statements. The FY 1998 Army WCF financial statements reported total assets of \$14.2 billion and total liabilities of \$1.3 billion. Net program costs for the Army WCF were \$938 million.

Limitations to Audit Scope. We did not examine the accuracy of data submitted by Army field entities or other sources, nor did we attempt to reconcile the data with subsidiary records because of the lack of audit trails and support for accounting adjustments. We compared the Fund Balance With Treasury, recorded by the Department of the Treasury for the Army WCF, to the Fund Balance With Treasury reported in the Army WCF financial statements.

Audit of the FY 1998 Army WCF Financial Statements. The Inspector General, DoD, delegated the audit of FY 1998 Army WCF financial statements to AAA. The AAA performed work at the Army field entities, where they examined accounting adjustments between the Army field entities' records and the AR 1307. The Inspector General, DoD, and the AAA auditors jointly performed audit work on adjustments made to the AR 1307 and the Source File used by the Departmental Accounting Directorate to prepare the financial statements. The AAA disclaimed an opinion on the FY 1998 Army WCF financial statements, and we endorsed the disclaimer.

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 report pertains to achievement of the following objectives and goals.

Objective: Fundamentally reengineer DoD 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 objectives and goals.

-
- **Financial Management Functional Area. Objective:** Consolidate finance and accounting operations. **Goal:** Consolidate and standardize financial systems. (FM-2.1)
 - **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goals:** Improve compliance with the Federal Managers' Financial Integrity Act of 1982. (FM-5.3)

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

Methodology

Audit Work Performed. Our review of the compilation of the FY 1998 Army WCF financial statements covered the processes, procedures, and management controls at the DFAS Indianapolis Center for consolidating financial data from field organizations and other sources. The data were used to prepare the FY 1998 Army WCF financial statements. We oversaw the AAA review of the following processes:

- establishing beginning account balances;
- establishing the Fund Balance With Treasury line item balance for the Army WCF, 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, and
 - reconciliation of Army status of appropriations records to the Treasury trial balance;
- making adjustments to status of appropriations data; and
- producing the Army WCF Financial Statement for FY 1998, excluding the Army overview.

Our audit focused on the process that the DFAS Indianapolis Center used to make adjustments to accounting data. We reviewed the journal voucher control log, the journal voucher cover sheets, and the journal vouchers to determine whether the proper separation of duties existed. We ascertained that the preparer, approving official, and certifier were separate individuals. We compared the computer program used to extract the financial information for the

FY 1998 financial statements to paper copies of the FY 1998 financial statements. In addition, we interviewed personnel at the DFAS Indianapolis Center about the compilation of the financial statements.

Use of Computer-Processed Data. We did not rely on the computer-processed data used to prepare the FY 1998 Army WCF financial statements because DoD accounting and related systems were unreliable. The unreliable computer-processed data used in preparing the financial statements and this report were the only financial data available. We reviewed the computer-processed transaction journal voucher adjustments, totaling \$112.1 billion, made by the Departmental Accounting Directorate. The adjustments included \$104 billion made to the AR 1307 database by the WCF Team and \$8.1 billion made to the Source File by the CFO Reporting and Support Team.

Audit Period and Standard. We performed this financial-related audit from August 27, 1998, through April 1, 1999. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls 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 FY 1998 Army WCF financial statements. Specifically, we reviewed the management controls over the adequacy of consolidating the status of appropriations data and the general ledger data for the preparation of the Army WCF financial statements. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. Management controls did not ensure that information on the financial statements was accurate and reliable. We identified material management control weaknesses, as defined by DoD Directive 5010.38, in the compilation of data for preparation of the Army WCF financial statements. Lack of an integrated general ledger system made the financial statements less reliable, particularly for the proprietary accounts. The WCF Team did not have written management control procedures for processing accounting adjustments to the FY 1998 Army WCF financial statements. Also, accounting adjustments to the financial statements were not always supported with audit trails to the documented transactions. The recommendations in this report, if implemented, will improve management controls for supporting

documentation and audit trails. A copy of this report will be provided to the senior official responsible for management controls for the DFAS Indianapolis Center.

Adequacy of Management's Self-Evaluation. We reviewed management controls within the Departmental Accounting Directorate. Personnel at the DFAS Indianapolis Center identified assessable units and performed a self-evaluation of management controls. However, management did not perform a self-evaluation of the branch that consolidates the financial statements. The management control coordinator stated that the branch did not perform a self-evaluation because it had recently been reorganized. As a result, the Annual Statement of Assurance for FY 1998 did not identify accounting adjustments as a material weakness on the Army WCF financial statements.

Appendix B. Summary of Prior Coverage

Inspector General, DoD

Inspector General, DoD, Report No. 98-216, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements," September 29, 1998

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

Army Audit Agency

Army Audit Agency Report No. AA 99-161, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998: Report on Internal Controls and Compliance With Laws and Regulations," February 12, 1999

Army Audit Agency Report No. AA 99-37, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Accounting Support," November 25, 1998

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
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 Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

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 Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International
Relations, Committee on Government Reform

Defense Finance and Accounting Service Comments



DFAS-HQ/ASF

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

JUN 28 1998

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

SUBJECT: Audit Report on the Compilation of the FY 1998 Army Working Capital Fund
Financial Statements (Project No 8F1-2027 01)

Our response to the subject audit is attached. The primary point of contact (POC) is
Mr Wayne Ebaugh, (703) 607-2857 or DSN 327-2857, and the secondary POC is Mr Mike
Bryant, (703) 607-1562 or DSN 327-1562

Handwritten signature of Edward A. Harris in black ink.

Edward A. Harris
Director for Accounting

Attachment:
As stated

cc:
DFAS-HQ/PO
DFAS-IN/P

**DFAS Comments on Department of Defense Inspector General Audit Report on the
Compilation of the FY 1998 Army Working Capital Fund Financial Statements
(Project No. 8FI-2027.01)**

General Comments

We disagree with the auditors' assertions that the Defense Finance and Accounting Service Indianapolis Center (DFAS-IN) made material accounting journal vouchers without adequate supporting documentation. The DFAS-IN attempts to fully and completely document all journal vouchers and assess the need to improve its documentation process. We would appreciate the auditors providing us with their specific concerns with the quality of the documentation so that we can properly evaluate the need to address improvements required to adequately support the journal vouchers.

Specific Comments

Executive Summary, Results, first bullet: "\$208 billion absolute value in adjustments were made to Accounting Report 1307 without adequate support or audit trail "

This statement implies a lack of documentation for all journal vouchers; this is clearly not the case. The amount referenced is the total value of all journal vouchers made for the Accounting Report 1307 (AR 1307), and all journal vouchers had supporting documentation in various forms including reports, spreadsheets, or other hard-copy documentation. In addition, the DFAS-IN provided copies of the software application that was used, as well as files containing a detailed description of the referenced journal vouchers. During the FY 1998 audit, the auditors requested DFAS-IN to include the name of the application that was used for all vouchers. We complied with their request without exception.

Page 5, Adjustments to the AR 1307 Database, second bullet: "journal voucher numbers were not identified in the AR 1307 database "

The DFAS-IN has updated its procedures to ensure each journal voucher to the AR 1307 database contains a voucher number.

Page 5, Adjustments to the AR 1307 Database, third bullet: "journal vouchers were prepared after the adjustments were made to the AR 1307 database "

We agree with the auditors' statement that journal vouchers were prepared after the corrections were made to the AR 1307 database, we disagree that this is an internal control weakness. An automated process generates the majority of our journal vouchers, and the journal vouchers cannot be created until the data has been processed. We run the process once to calculate the journal voucher amounts, we validate the system created accounts and then prepare the journal voucher. Running the process again to post the amounts to the AR 1307 does not improve internal controls. Our draft standard operating procedures for processing journal

vouchers addresses this issue and directs preparers to complete the voucher immediately after the report is prepared

Responses to Recommendations

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

Recommendation 1. Require that the guidance in the "Standard Operating Procedures for Journal Vouchers", used by the CFO Reporting and Support Team for processing and documenting adjustment journal vouchers, also be used by the Working Capital Fund Team

DFAS Management Comments: Concur The Working Capital Fund Team has been directed to follow the procedures implemented by the CFO Reporting and Support Team for processing and documenting journal vouchers.

Estimated Completion Date: September 30, 1999

Recommendation 2. Require the Internal Control and Development Support Team to certify and maintain adjustment journal vouchers processed by the Working Capital Fund Team

DFAS Management Comments: Concur. The Internal Control and Development Support Team will certify and maintain journal vouchers processed by the Working Capital Fund Team and the CFO Reporting and Support Team

Estimated Completion Date: September 30, 1999

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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