Audit Report

ACCOUNTING AND DISCLOSING
INTRAGOVERNMENTAL TRANSACTIONS ON THE
DOD AGENCY-WIDE FINANCIAL STATEMENTS

Report No. D-2001-042 January 31, 2001

Office of the Inspector General
Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
OMB	Office of Management and Budget
USD (Comptroller)	Under Secretary of Defense (Comptroller)

INSPECTOR GENERAL
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January 31, 2001

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Audit Report on Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statements (Report No. D-2001-042)

We are providing this report for review and comment. We conducted the audit 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.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Under Secretary of Defense (Comptroller) comments were partially responsive. We request additional comments on Recommendation 2. We request that the Under Secretary of Defense (Comptroller) provide comments by April 2, 2001.

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 E for the report distribution. The audit team members are listed inside the back cover.

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Report No. D-2001-042 **January 31, 2001**
(Project No. D2000FI-0063.005)

Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statements

Executive Summary

Introduction. This report is the fourth in a series of audit reports related to the FY 1999 DoD Agency-wide financial statements. The first report discusses the internal controls and compliance with laws and regulations for DoD. The second report discusses the reporting of performance goal information in the DoD financial statements. The third report discusses journal voucher entries made to accounting data used to prepare the DoD financial statements. This report discusses the annual process of accounting and disclosing of intragovernmental transactions on the DoD Agency-wide financial statements.

Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 7, 2000, requires the balance sheet and Statement of Net Cost to be prepared on a consolidated basis. When statements are prepared on a consolidated basis, intra-agency transactions must be eliminated to remove the double accounting effect. Intragovernmental transactions with other Federal agencies are to be reported as required supplemental information as part of the agency's financial statements. The required supplemental information is used to prepare the Federal consolidating statements. Reporting entities are encouraged to reconcile intragovernmental amounts with their trading partners.

The DoD Agency-wide balance sheet, the Statement of Net Cost, and the Statement of Changes in Net Position were prepared on a consolidated basis. When the Defense Finance and Accounting Service prepares the DoD Agency-wide financial statements on a consolidated basis, it should eliminate the double accounting effects of financial transactions among its components. If the double accounting effects are not eliminated, then the amounts reported in the financial statements would be overstated. In financial statements for the consolidated entity, the revenues, expenses, assets, and liabilities should be reported based on transactions with outside parties. The DoD Agency-wide Statement of Net Cost for FY 1999 identified total program costs of $410.3 billion and total earned revenue of $32.5 billion for a total net cost-of-operations of $377.8 billion. In addition, the DoD Agency-wide balance sheet reported total assets of $599 billion and total liabilities of $999 billion.

Objectives. Our overall audit objective was to determine whether the DoD Agency-wide financial statements were prepared in accordance with OMB Bulletin No. 97-01, 1996, as amended January 7, 2000. As part of the objective, we reviewed the preparation of the DoD Agency-wide financial statements and the accounting and disclosing of intragovernmental transactions that should be eliminated on the DoD Agency-wide financial statements or reported as required supplemental information. We also reviewed the management control program as it related to the overall objective.

Results. Since FY 1996, DoD made little progress in accounting for and disclosing amounts of eliminating entries. Similarly, the Department has been slow to initiate

improvements that are needed to ensure that all of the intragovernmental transactions were captured and the amounts were accurate. In response to prior Inspector General, DoD, audit reports, DoD indicated that it could not perform the critical checks because many of the DoD accounting systems did not capture all the data necessary to reconcile with partners or to accurately identify elimination transactions and balances.

The FY 1999 DoD Agency-wide financial statements reflected $229.4 billion in intragovernmental transactions between buyers and sellers that were not reliable and were not adequately supported. DoD reported $236.7 billion in eliminating entries that were not reconciled with intragovernmental accounts and buyer and seller transactions. The Defense Finance and Accounting Service made $298.8 billion (absolute value) in accounting entries to intragovernmental and public accounts that were not adequately reconciled. In addition, the elimination of intra-agency transactions on the Statement of Net Cost were made to the total program cost and revenue lines and not by the specific programs that made up the totals. As a result, the DoD Agency-wide financial statements continue to contain material misstatements, the amounts reported for intragovernmental line items are unreliable, and unless corrected, will continue to contain material misstatements for FY 2000 and beyond.

See the Finding section for details on the audit results and Appendix A for details on our review of the management control program.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) correct abnormal account balances; establish a working group with the Defense Finance and Accounting Service and the DoD Components to re-execute the implementation strategy to improve eliminations; modify DoD Regulation 7000.14-R, "Financial Management Regulation," to require Defense Finance and Accounting Service and DoD Components to reconcile buyer side and seller side information and disclose any unreconciled amounts in the footnotes of the financial statements, and to require that DoD entities disclose elimination amounts for each program category on the DoD Agency-wide consolidating Statement of Net Cost; and issue revisions to DoD Regulation 7000.14-R, "Financial Management Regulation," in time to prepare the FY 2000 financial statements.

Management Comments. The Under Secretary of Defense (Comptroller) stated that it has taken action to implement all the recommendations except for establishing a working group to re-execute the implementation strategy. Instead the Under Secretary of Defense (Comptroller) stated that the Defense Finance and Accounting Service was attempting to identify alternative ways to develop electronic files at the transaction level. See the Finding section for a discussion of management comments and the Management Comments section for the complete text.

Audit Response. The Under Secretary of Defense (Comptroller) comments were responsive in part. We request that the Under Secretary of Defense (Comptroller) provide additional details on how the alternative ways of developing electronic files at the transaction level will achieve the goals set forth for the implementation strategy for eliminations. We request that comments on the final report be provided by April 2, 2001.

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Background

This report is the fourth in a series of audit reports related to the FY 1999 DoD Agency-wide financial statements. The first report discusses the internal controls and compliance with laws and regulations for DoD. The second report discusses the reporting of performance goal information in the DoD financial statements. The third report discusses journal voucher entries made to accounting data used to prepare the DoD financial statements. This report discusses the annual process of accounting for and disclosing intragovernmental transactions on the DoD Agency-wide financial statements.

Reporting Requirements. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to prepare annual audited financial statements. Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, establishes the requirements for audits of Federal financial statements.

Accounting Functions and Responsibilities. The Under Secretary of Defense (Comptroller) (USD [Comptroller]), as the Chief Financial Officer, is responsible for overseeing all financial management activities related to the programs and operations of DoD. As such, the USD (Comptroller) is responsible for compliance with laws and regulations applicable to the DoD Agency-wide financial statements. The compliance includes whether those financial statements are prepared in accordance with Federal accounting standards and other reporting guidance.

The Defense Finance and Accounting Service (DFAS) performs accounting functions and prepares financial statements for DoD. DFAS operates under the control and direction of the USD (Comptroller). DFAS is responsible for entering information from DoD entities into finance and accounting systems, operating and maintaining the finance and accounting systems, and ensuring the continued integrity of the information entered. The DoD reporting entities are responsible for providing accurate financial information to DFAS through the data feeder systems. The data feeder systems contain the day-to-day operating information to be translated into financial information and processed in finance and accounting systems to be useful for financial managers.

DoD Agency-Wide Financial Statements. The DoD Agency-wide financial statements consist of five parts: overview, principal statements, required supplementary stewardship information, required supplemental information, and other accompanying information. The principal statements consist of six financial statements and related footnotes. The financial statements are the balance sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, the Statement of Financing, and the Statement of Custodial Activity.

For FY 1999, DFAS prepared financial statements for nine reporting entities: DoD Agency-wide; Army, Navy, and Air Force General Funds; Army, Navy, and Air Force Working Capital Funds; Army Corps of Engineers; and the DoD Military Retirement Fund. In addition, DFAS prepared trial balance data for other Defense organizations.

Transactions Requiring Elimination. The balance sheet, the Statement of Net Cost, and the Statement of Changes in Net Position were prepared on a consolidated basis. When DFAS prepares the DoD Agency-wide financial statements on a consolidated basis, it should eliminate the duplicate accounting effects of financial transactions among its components. If the double accounting effects are not eliminated, then the amounts reported in the financial statements are overstated. In financial statements for the consolidated entity, the revenues, expenses, assets, and liabilities should be reported based on transactions with outside parties.

An intragovernmental sales transaction has two sides. Reimbursable sales, or seller side information, affect at least four general ledger accounts: revenues, unearned revenues, receivables, and collections. Reimbursable purchases, or buyer side information, affect expenses, advances, payables, and disbursements. Eliminating entries should be made on consolidating financial statements, which include a column for each entity, a column for eliminating entries, and a total column. Table 1 shows that DoD reports three levels of transaction eliminations.

Table 1. Elimination Levels

Level	Reporting Entity	Description
1	Federal-wide eliminations	The financial statements include receivables, revenue, and unearned lines for transactions with Federal (intragovernmental) entities. The level 1 transactions should be eliminated from the consolidated financial statements of the United States. DoD disclosed level 1 elimination amounts as required supplemental information.
2	DoD Agency-wide eliminations	Transactions that should be eliminated from DoD financial statements are reimbursable sale and purchase transactions between DoD Components (or intra-agency). The level 2 elimination amounts were disclosed on the consolidating statements of the DoD Agency-wide financial statements.
3	Entity eliminations	Transactions within the same DoD appropriation, account, or entity (intra-entity) should be eliminated. The level 3 eliminations were disclosed on the consolidating statements of the DoD Component financial statements or trial balance data.

Objectives

Our overall audit objective was to determine whether the DoD Agency-wide financial statements were prepared in accordance with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 7, 2000. As part of the objective, we reviewed the preparation of the DoD Agency-wide financial statements and the accounting for and disclosing of intragovernmental transactions that should be eliminated on the DoD Agency-wide financial statements, or reported as required supplemental information. We also reviewed the management control program as it related to the overall objective. Appendix A discusses the scope and methodology related to the audit objectives, the management control program, and prior audit coverage.

Intragovernmental Transactions

The FY 1999 DoD Agency-wide financial statements reflected $229.4 billion in intragovernmental transactions between buyers and sellers that were not reliable and were not adequately supported. DoD reported eliminating entries of $236.7 billion that were not reconciled with intragovernmental accounts for buyer and seller transactions. DFAS made $298.8 billion (absolute value) in accounting entries to intragovernmental and public accounts that were not adequately reconciled. In addition, DFAS Centers made the elimination of intra-agency transactions on the Statement of Net Cost to the total program cost and revenue lines and not by the specific programs that made up the totals. The intragovernmental transaction amounts were incorrectly accounted for and disclosed because of the following:

- DoD did not issue adequate and timely guidance for making eliminating entries,
- DoD did not follow existing requirements for making accounting entries to intragovernmental accounts,
- DoD form and content guidance for preparing the Statement of Net Cost was not in accordance with OMB Bulletin No. 97-01, and
- DoD did not fully execute the implementation strategy to collect and analyze both buyer and seller side intragovernmental transactions.

As a result, the DoD Agency-wide financial statements continued to contain material misstatements, and the intragovernmental line items were unreliable. The inability of DoD to properly account for and disclose intragovernmental transactions and report trader partner eliminations is a major impediment in obtaining a favorable audit opinion on its financial statements for FY 2000 and beyond.

Guidance for Accounting and Disclosing Intragovernmental Transactions

The guidance and requirements for Federal agencies to account for and disclose intragovernmental transactions and for making accounting entries are contained in legislation, Statements of Federal Financial Accounting Standards, Federal Financial Accounting System Requirements, General Accounting Office guidance, and OMB publications. Specifically, the Federal Financial Management Improvement Act of 1996 requires that Federal agencies follow Statement of Federal Financial Accounting Standards and the Joint Financial Management Improvement Program publications on accounting systems. The

General Accounting Office and OMB reinforced those requirements in their guidance for Federal agencies. Appendix B contains more details on the accounting and disclosure requirements for DoD.

The guidance requires DoD to establish and to implement internal accounting and administrative controls that provide reasonable assurance that revenue and expenditures are recorded and accounted for properly. The controls are also to ensure reliable accounts and financial and statistical reports and to maintain accountability of the assets. As part of the requirement, DoD must account for and disclose intragovernmental transactions and eliminate the effects of double accounting when preparing consolidating financial statements. The documentation, recording, and reconciling of intragovernmental transactions must follow specific procedures. The procedures also require fully supported accounting entries to the intragovernmental accounts. The reconciliation of intragovernmental accounts, specifically the eliminating entries and accounting entries made to adjust DoD accounts, is a major internal control function. In addition, management is responsible for ensuring adequate management controls over the accounting and reporting of intragovernmental transactions.

Reliability of Intragovernmental Transactions

The FY 1999 DoD Agency-wide financial statements reflected $229.4 billion in transactions between buyers and sellers that were not reliable and were not adequately supported. Table 2 shows the amounts of intragovernmental transactions that were disclosed in the DoD Agency-wide financial statements for FY 1999.

Table 2. Intragovernmental Amounts for Trading Partners Reported in the DoD Agency-Wide Financial Statements

Financial Statement Line	Total Amounts (billions)
Accounts Receivable	$ 5.8
Other Assets	1.4
Accounts Payable	4.1
Other Liabilities	8.9
Intragovernmental Costs	101.0
Earned Revenue	108.2
Total	**$229.4**

The sum of the eliminating entries (levels 1 and 2) should equal the total intragovernmental transactions reported in the DoD Agency-wide financial statements, after properly reconciling buyer and seller transaction amounts and making appropriate supported accounting entries to the intragovernmental accounts. However, DoD reported elimination amounts and made accounting entries to intragovernmental and public accounts that were neither properly reconciled between the seller and buyer nor adequately supported. Reconciliation of eliminating and accounting entries is an internal control function required by various legal and regulatory requirements. As a result, DoD could not provide reasonable assurance that revenue and expenditures applicable to agency operations were recorded and accounted for properly. Also, DoD was unable to maintain accounts and reliable financial and statistical reports and maintain accountability of its assets.

Reconciliation of Eliminating Entries. DoD reported $236.7 billion in eliminating entries that were not properly reconciled between the buyer and seller. The $236.7 billion consisted of elimination amounts equal to the $229.4 billion in intragovernmental amounts and an additional $7.3 billion in elimination amounts reported as required supplemental information but not included in the Statement of Net Cost. We compared the levels 1 and 2 eliminating entries for revenue, accounts receivable, unearned revenue, intragovernmental costs, accounts payable, and advances that DFAS trial balance data provided with the intragovernmental transaction amounts reported in the DoD Agency-wide balance sheet, Statement of Net Cost, and required supplemental information. The Statement of Net Cost and intragovernmental costs reported on the required supplemental information reflected $22.1 billion (absolute value) in differences between intragovernmental costs by program category. In addition, the trial balance data used to compile earned revenue amounts contained $791 million in abnormal balances. We did not find any differences for accounts payable, unearned revenue, accounts receivable, and advances because DFAS had adjusted the accounts to agree.

The reconciliation process should include a complete review of all material variances to determine the correct amounts to be reported and eliminated on the DoD Agency-wide and Federal-wide financial statements. However, DoD did not perform critical checks such as performing adequate reconciliation and research of buyer and seller transactions. The lack of checks partially results from DoD not having the accounting systems to provide the required information and in part results from inadequate accounting policies and procedures. DFAS procedures required the centers to use seller side information such as reimbursement information and revenue, accounts receivable, and unearned revenue to estimate buyer side information such as expenses, accounts payable, and advances. As a result, the intra-agency elimination amounts for $89.4 billion in expenses, $4 billion in accounts payable, and $880 million in advances were assumed to be equal to the seller side information without verifying them by reconciliation.

Intragovernmental Program Costs. The trial balance cost information for eliminating entries did not agree with the intragovernmental cost by a net value of $3 billion. The absolute value of the total difference is $17.8 billion.

Table 3 shows the differences between the amount of intragovernmental costs reported on the FY 1999 DoD Agency-wide Statement of Net Cost and the amount of trial balance elimination data.

Table 3. Comparison of DoD Reported Intragovernmental Costs With Trial Balance Eliminating Entries by Program
(dollars in millions)

Program	DoD Agency-Wide	Trial Balance Eliminations	Differences
Military Personnel	$ 7,411	$ 5,840	$ 1,571
Operation and Maintenance	43,565	42,650	915
Procurement	5,213	3,927	1,286
Research, Development, Test, and Evaluation	3,384	1,174	2,210
Military Construction/Family Housing	1,558	155	1,403
U.S. Army Corps of Engineers Civil Works	781	782	(1)
Working Capital Funds	20,197	23,193	(2,996)
Other Programs	18,854	26,239	(7,385)
Total program costs (net difference)			**$(2,997)**
Absolute value of differences			**$17,767**

Required Supplemental Information. In addition, the amount of costs reported on the required supplemental information was $4.3 billion more than the trial balance data provided. The trial balance data reported $14.5 billion, and the required supplemental information reported $18.8 billion in costs. The difference existed because DFAS forced the amount of expenses to agree with the amount of earned revenues. However, no reconciliation took place between the buyer and seller transactions to determine whether the cost or earned revenue trial balance data were correct. If the trial balance cost data had agreed with the required supplemental information, the intragovernmental costs on the Statement of Net Cost would have been misstated by an additional $4.3 billion, for a total $7.3 billion net difference, or $22.1 billion absolute value.

Earned Revenues. The earned revenues reported on the Statement of Net Cost consisted of revenue accounts that contained $791 million in abnormal balances. Intragovernmental and public revenue trial balance data should equal the total earned revenue reported on the Statement of Net Cost. Although the trial balance data equaled the reported amount, the earned revenue trial balance data contained abnormal balances that DoD entities provided, which understated total earned revenues. DFAS should have researched the cause of the abnormal balances and made corrections; however, DFAS did not provide information that the abnormal balances were addressed. As shown in Table 4, $762.1 million of the $791 million in abnormal balances were material to the earned revenue amounts for three of the program categories.

Table 4. Earned Revenue Abnormal Balances by Program
(dollars in millions)

Program	Earned Revenue Before Eliminations	Abnormal Balance Amounts	Percent
Military Personnel	$ 480.4	$114.8	23.9
Research, Development, Test, and Evaluation	1,704.9	388.9	22.8
Military Construction/Family Housing	1,331.4	258.4	19.4
Total	**$3,516.7**	**$762.1**	21.7

Seller Side Information. DFAS made the entries because the seller side information was more reliable than the buyer side information; however, DoD was unable to adequately support its position that seller side information was sufficiently reliable to force buyer side information into agreement. DoD did not provide sufficient or reliable information for us to evaluate management's assertions or verify amounts. Because internal control weaknesses, compilation problems, lack of audit trails, and financial management system deficiencies continued to exist, Inspector General, DoD, and Military Department auditors were not able to verify amounts reported for material line items on the financial statements. Not only is the buyer side information unreliable, but Inspector General, DoD, and Military Department auditors have determined that the seller side information was often incorrect or unverifiable. Appendix C discusses examples of unreliable seller side information in the supporting FY 1999 financial statements.

The internal control and accounting deficiencies associated with eliminating entries are continuing problems that have been reported since the first DoD consolidated financial statements were published for FY 1996. Until DoD can ensure that both buyer and seller information is reliable and that the information is reconciled and differences are researched by DFAS and DoD Components, forcing buyer side information to agree with seller side information will be nothing more than an unsupported adjustment. Making unsupported eliminating entries without proper reconciliation and research remains a major impediment in DoD achieving a favorable audit opinion on the DoD Agency-wide financial statements for FY 2000 and beyond.

Reconciling Accounting Entries. DoD made eliminating entries that were not adequately reconciled and researched. In addition, DoD made $298.8 billion (absolute value, total debit and credit entries) in accounting entries to provide sufficient amounts to make the intragovernmental eliminations. Of the $298.8 billion (absolute value) accounting entries:

- $288.8 billion (absolute value), or 96.7 percent, was unsupported;
- $6.7 billion (absolute value), or 2.2 percent, was to correct errors and adjust previous unsupported accounting entries; and
- $3.3 billion (absolute value), or 1.1 percent, was based on estimates.

The $288.8 billion (absolute value) in adjustments was unsupported because we did not find adequate supporting documentation for the journal vouchers used to make the accounting entries. DoD did not follow existing requirements for properly reconciling and supporting accounting entries to intragovernmental accounts. However, the USD (Comptroller) and DFAS instructed that its centers make buyer side data transaction amounts agree with seller side information.

The $298.8 billion (absolute value) in accounting entries was made without performing adequate reconciliations as required by OMB, General Accounting Office, and DoD procedures. Although the accounting entries were precipitated by the exchange of buyer and seller data between the reporting entities, the accounting entries were generally just a reclassification (moving amounts from one account to another) of transaction amounts between general ledger accounts. Some reclassifications were an attempt to increase intragovernmental accounts and bring them into agreement with the amount of eliminating entries, and other reclassifications reduced intragovernmental accounts. The accounting entries were made to both intragovernmental accounts and to accounts for transactions with the public. Accounting entries were not only made to the buyer side accounts such as accounts payable and expenses, but were also made to the seller side accounts, such as earned revenues and accounts receivable. The following buyer and seller discussions address accounting entries made to expenses, accounts payable, earned revenues, and accounts receivable, which are $243.6 billion, or 81.5 percent, of the $298.8 billion in accounting entries.

Buyer Side Accounts. The DFAS Centers made $223.7 billion (absolute value) in adjustments to buyer side accounts, $211.1 billion (absolute value) in expenses and costs and $12.6 billion (absolute value) in accounts payable. Table 5 shows examples in which DFAS Cleveland, Denver, and Indianapolis Centers made accounting entries to increase the amount of intragovernmental accounts payable and expenses by reclassifying amounts from expenses and accounts payable with the public or other accounts. The increases to intragovernmental expenses were made to ensure that sufficient amounts were available to make eliminating entries.

Table 5. Increases to Buyer Side Accounts

DoD Entity	Summary of the Transactions
Army General Fund	Intragovernmental expenses increased by a net $21.3 billion, and expenses with the public decreased by a net $21.3 billion.
Army Working Capital Fund	Intragovernmental expenses increased by a net $1.1 billion, and expenses with the public decreased by a net $1.1 billion.
Navy General Fund	Intragovernmental accounts payable increased by a net $1.8 billion. Canceled accounts payable decreased by $1.8 billion.
Air Force General Fund	Intragovernmental expenses (debit balance) increased by $914 million while intragovernmental accounts payable (credit balance) increased by a net $914 million.
Other Defense Organization General Funds	Intragovernmental expenses increased by $8.3 billion, and expenses with the public decreased by $8.3 billion.
Other Defense Organization Working Capital Funds	Intragovernmental expenses increased by $1.8 billion, and expenses with the public decreased by $1.8 billion.

In addition, DFAS Cleveland and Indianapolis Centers made accounting entries to reclassify amounts from intragovernmental to public expenses. The decreases were made to ensure that intragovernmental expenses and payables would be at zero after the level 1 and 2 eliminations were made. However, as shown in Table 3, DoD was not successful at ensuring that intragovernmental expenses would be at zero after eliminations. The accounting entries reducing intragovernmental amounts on the buyer side demonstrate an inconsistency in the centers' applying DFAS policy. Table 6 shows examples of reclassified transaction amounts.

Table 6. Decreases to Buyer Side Accounts

DoD Entity	Summary of the Transactions
Navy Working Capital Fund	Intragovernmental expenses decreased by $11.7 billion, and expenses with the public increased by $10.9 billion and the budget accounts increased by $0.8 billion.
Navy Working Capital Fund	Intragovernmental accounts payable decreased by $230.6 million, and undelivered orders unpaid increased by $230.6 million.
Air Force Working Capital Fund	Intragovernmental expenses decreased by $2.7 billion, and expenses with the public increased by $2.7 billion.
Other Defense Organization Working Capital Funds	Intragovernmental accounts payable decreased by $719.9 million, and intragovernmental expenses decreased by $719.9 million. DFAS made a debit entry to accounts payable and a credit entry to intragovernmental expenses that decreased both items.

Seller Side Accounts. The DFAS Centers made $19.9 billion in accounting entries to seller side accounts, $17.3 billion in earned revenues and $2.6 billion in accounts receivable. In the Table 7 examples, DFAS Cleveland, Denver, and Indianapolis Centers made accounting entries to increase the amount of intragovernmental revenues and accounts receivable by reclassifying amounts from revenues and accounts receivable with the public. The increases to intragovernmental amounts were made to ensure that sufficient amounts were available to make eliminating entries.

Table 7. Increases to Seller Side Accounts

DoD Entity	Summary of the Transactions
Navy Working Capital Fund	Intragovernmental accounts receivable increased by $308.5 million, and accounts receivable with the public decreased by $308.5 million.
Air Force General Fund	Intragovernmental accounts receivable increased by $63 million, and refunds receivable decreased by $63 million.
Other Defense Organization General Funds	Intragovernmental earned revenues increased by $777.8 million, and earned revenues with the public decreased by $777.8 million.

In addition, DFAS Indianapolis Center made accounting entries to reclassify amounts from intragovernmental to public. These decreases were made in order to ensure that intragovernmental revenues would be at zero after level 1 and 2 eliminations were made. However, as shown in Table 3, DoD was not successful at ensuring that intragovernmental expenses would be at zero after eliminations. The adjustments to the Army General Fund created abnormal balances for the earned revenues. Table 4 shows material abnormal balances in the earned revenue for the Research, Development, Test, and Evaluation and Military Construction/Family Housing program cost areas, which are attributed to the Army General Fund. Table 8 shows that $3 billion in decreases were made to the Army General Fund intragovernmental revenues. That reclassification not only demonstrates the inconsistency in applying DFAS policy for making the accounting entries, but also demonstrates that seller side information may not be reliable. Table 8 shows examples of reclassified transaction amounts.

Table 8. Decreases to Seller Side Accounts

DoD Entity	Summary of the Transactions
Army General Fund	Intragovernmental earned revenues decreased by $3 billion, and earned revenues from the public increased by $3 billion.
Army General Fund	Intragovernmental accounts receivable decreased by $188.1 million, and accounts receivable with the public increased by $188.1 million.
Army Working Capital Fund	Intragovernmental earned revenues decreased by $3.1 billion, and earned revenues from the public increased by $3.1 billion.
Other Defense Organization Working Capital Funds	Intragovernmental earned revenue decreased by $131.8 million, and intragovernmental unearned revenue increased by $131.8 million.

Under Secretary of Defense (Comptroller) Elimination Procedures

DoD did not issue adequate or timely guidance for making eliminating entries and disclosing elimination information. No effective mechanism was in place to reconcile financial statement differences or test reimbursable transactions with partners. Since FY 1996, DoD made little progress in accounting for and disclosing amounts of eliminating entries. Similarly the Department has been slow to initiate improvements that are needed to ensure that all of the intragovernmental transactions were captured and that the amounts were accurate. In response to prior Inspector General, DoD, audit reports, DoD indicated that it could not perform the critical checks because many of the DoD accounting systems did not capture all the data necessary to reconcile with partners or to accurately identify elimination transactions and balances. As a possible solution, the USD (Comptroller) proposed that it execute an implementation strategy as a plan to address the elimination issues. However, DoD had not sufficiently executed the elimination strategy to collect and analyze both buyer and seller side intragovernmental transactions and did not develop and implement adequate guidance that addresses accounting, disclosing, and eliminating of intragovernmental transactions.

Prior Inspector General, DoD, Audit Reports. Since DoD published its first consolidated financial statements for FY 1996, DoD made only minimal progress in addressing and correcting the problems that it had in accounting and disclosing intragovernmental transactions and related eliminations. The Inspector General, DoD, published two reports that address the issues of intragovernmental transactions and eliminations.

Audit Coverage for FY 1996. Inspector General, DoD, Report No. 97-117, "Eliminating Entries," March 31, 1997, reports that eliminating entries generally were not reported or were not properly reported on the FY 1996 DoD consolidated financial statements. The DoD Components did not report eliminating entries because DoD accounting systems did not permit them to adequately identify the transactions. We recommended that the Director, DFAS, establish requirements for new and interim migratory accounting systems to identify sellers and purchasers in reimbursable transactions and to develop procedures to extract reimbursable transactions from databases. In response to the report, the USD (Comptroller) and DFAS were to issue additional guidance on identifying and reporting eliminating entries for Federal-wide, DoD consolidated, and DoD Component financial statements.

Although the USD (Comptroller) and DFAS issued guidance, the guidance was inadequate. The USD (Comptroller) issued guidance requiring the purchasing organization to report an equal amount of accounts payable, expenses, advances, and disbursements as the selling organization reported amounts of accounts receivable, revenues, unearned revenues, and collections. However, that kind of reporting is a forced accounting entry that presumes that the partner transactions have been entered on the accounting records of the purchasing organization. Because DoD presumes that payables, expenses, and advances were recorded in the same amount, those accounts would also be misstated.

Audit Coverage for FY 1997. In Inspector General, DoD, Report No. 98-204, "Reporting and Disclosing Intragovernmental Transactions for the FY 1997 DoD Consolidated Financial Statements," September 21, 1998, we reported that material differences of $19.7 billion existed between the amounts disclosed in the "Intrafund Eliminations" notes and related line items in the FY 1997 DoD Component Financial Statements. In addition, an eliminating entry error was made on the FY 1997 DoD Consolidated Financial Statements of $11.8 billion. The error occurred because DoD did not have procedures to reconcile all intrafund transactions, and DFAS and DoD Components did not perform critical checks to reconcile elimination amounts in the notes with the related line items in the principal statements. As a result, the FY 1997 DoD Consolidated Financial Statements contained material misstatements, and the intragovernmental line items were unreliable. Specifically, advances and prepayments had an abnormal balance of $1.5 billion.

We recommended that the USD (Comptroller) modify the DoD Financial Management Regulation, DoD Regulation 7000.14-R, volume 6B, “Form and Content of the Department of Defense Audited Financial Statements,” October 6, 1999, to require that reconciliations be performed between buyer and seller transactions. The USD (Comptroller) responded to the report, stating that the implementation strategy for eliminations would require the DoD Components to collect and analyze buyer and seller information. Based on the results of the data collection, new procedures and policies on reporting intragovernmental transactions would be issued. The data collection would be executed through an implementation strategy.

Implementation Strategy. DoD did not adequately execute the implementation strategy to collect and analyze both buyer and seller side intragovernmental transactions. Further, DoD did not perform research down to where the transaction originated. The USD (Comptroller) issued implementation strategy on eliminating entries on November 19, 1998. The strategy specified a plan for the Military Departments and the Defense agencies to analyze their seller side intra-agency transactions, and to review the capability to determine buyer side interagency transactions and identify major trading partners. The strategy stated that a request for the data would go out in November 1998 and the results would be reported back in March 1999. Based on the results of the data collected, the USD (Comptroller) would prepare guidance for documenting and reporting eliminating entries. DoD had to use a data call because DoD did not know how intragovernmental transactions originate, are accounted for, and are summarized by its accounting systems.

Data Request. On January 20, 1999, the USD (Comptroller) issued a memorandum, “Subject: Implementation Strategy Issue-Intragovernmental Eliminations,” requesting the buyer and seller information. Not only was the data collection untimely, but the effort was also inadequate. The USD (Comptroller) request gave the DoD Components only 1 month, to February 26, 1999, to respond. The implementation strategy originally allowed 2 to 3 months for the responses. In addition, the request did not ask for the DoD Components to provide details down to the transaction level for either sales or purchases. To accomplish an effort of that magnitude, 1 month is insufficient time for the DoD Components to research intragovernmental transactions down to the transaction level. Unless DoD Components research intragovernmental transactions through the financial management systems and down to the point of origin, the problems affecting the ability of DoD to account and report intragovernmental transactions will not be identified and viable solutions will not be developed.

DoD Component Responses. Because the data request did not require the DoD Components to research intragovernmental transactions down to the transaction level, the buyer side of the transactions was only reported by some of the Defense components. The Navy, Air Force, and Defense Logistics Agency responses indicated the lack of adequate accounting systems to produce the buyer side data. The Army made a minimal attempt to research buyer and seller data, and the Navy, the Air Force, and the Defense Logistics Agency responses indicated that large manual efforts would be necessary to obtain all the information requested. Table 9 summarizes the responses received to the data request.

Table 9. Summary of Responses to the Request for Buyer and Seller Information

- The Army requested that DFAS Indianapolis Center obtain the information for the January 20 request; however, DFAS Indianapolis Center was unable to meet the time frame.

- The Navy was unable to provide partial data in response to the request. According to the Navy, its ability to provide buyer information was severely restricted because of the lack of accounting data or reliable management information systems.

- The Air Force was able to report amounts for seller side transactions for the general funds; however, the Air Force was unable to provide the detailed information. The Air Force accounting systems could not capture buyer side information and the Air Force said that obtaining the data would require a manual compilation. The Air Force Working Capital Fund information was not in the Air Force package.

- The Defense Logistics Agency did not provide the requested information and responded that its legacy feeder and accounting systems were unable to capture the level of detail requested.

- The other Defense agencies were able to provide the intragovernmental amounts and elimination amounts for their general funds and the Military Retirement Fund.

DoD must execute the implementation strategy down to the level where transactions originate. If DoD does not identify the revenue and cost transaction cycles and the causes for any accounting deficiencies, then it cannot develop adequate DoD accounting policies and procedures or make improvements to DoD financial management systems. To ensure adequate execution of the implementation strategy, the USD (Comptroller) should establish a working group with DFAS and DoD Components to re-execute the implementation strategy down to the transaction origin.

Reconciliation, Reporting, and Elimination Procedures. Because DoD did not adequately execute the implementation strategy, the USD (Comptroller) could not develop an adequate plan to correct financial system deficiencies that impacted the accounting and reporting of intragovernmental transactions, nor could it develop adequate procedures for accounting for, reconciling, and reporting intragovernmental transactions.

DoD Guidance. The DoD Form and Content provides the framework of the reporting format and disclosure requirements for the preparation of financial statements by the DoD Components. On September 11, 1999, the USD (Comptroller) issued a draft chapter 13, “Fiscal Year 1999 Accounting Entries, Eliminations, and Other Special Intragovernmental Reconciliation Procedures"; however, the draft was never finalized and issued as part of the DoD Form and Content.

Draft Guidance on Intragovernmental Transactions. Because the draft chapter 13 was not finalized as of November 17, 1999, the USD (Comptroller) and DFAS issued the draft elimination guidance for the centers and DoD Components to use. However, the draft guidance was inadequate because it specified that buyer side information should be forced to agree with seller side information without requiring an adequate reconciliation. The guidance required that the DFAS Centers and DoD Components extract seller side information by trading partners because DoD presumed that the intragovernmental receivables, revenue, and unearned revenue were correct. The seller side information was then compared with the buyer side data at the appropriation and working-capital-fund levels for which the buyer side information was to be reviewed and adjusted to agree with the seller side figures at the summary level. After the accounting entries were made, the effects of the intra-entity transactions were to be eliminated when preparing the financial statements. As in prior years, the guidance specified that "eliminating entries will again be based on information provided by the seller/service provider."

The USD (Comptroller) and DFAS personnel stated that the guidance requiring the buyer data to match seller data was the result of U.S. Treasury requirements. The U.S. Treasury did require that intragovernmental transactions reported under Federal Agencies Centralized Trial Balance Systems be in balance between buyer and seller; however, DoD and the other Federal agencies were required to perform a full reconciliation of the information. In addition, the DoD guidance was in conflict with the Federal Financial Management Improvement Act of 1996 and other authoritative guidance that DoD was required to implement, which is discussed in Appendix B. The authoritative guidance requires that general ledger accounts be reconciled and accounting adjustments be supported.

DFAS personnel also stated that the unsupported buyer-to-seller accounting entries could have been avoided for the preparation of the financial statements and the differences between the intragovernmental amounts on the financial statements and Federal Agencies Centralized Trial Balance Systems could have been footnoted. However, DFAS personnel stated that they did not want the alternative of making the footnotes to the financial statements. To that end, the USD (Comptroller) should revise DoD Regulation 7000.14-R, volume 6B, to include a critical check for reconciliation, to include validating eliminating entries for all three levels of intragovernmental transactions and disclosing any unreconciled accounting entries in the footnotes.

Although all reasonable efforts should be used to reconcile elimination amounts and intragovernmental accounts, we realize that adequate reconciliations may not be possible in all cases until the implementation strategy is adequately executed. In those cases that adequate reconciliations are not performed, the USD (Comptroller) should modify DoD Regulation 7000.14-R, volume 6B, to instruct entities to properly identify and disclose all unreconciled elimination and intragovernmental account adjustment amounts in the footnotes to the financial statements. The footnotes should state that elimination transactions have not been properly reconciled and researched, that buyer side information contains unsupported accounting entries, and that actions are being taken to correct the financial management systems of DoD, so that intragovernmental transactions can be properly accounted for and made. In addition, the USD (Comptroller) needs to issue its guidance in regard to eliminating entries in a timely manner. The revisions to DoD Regulation 7000.14-R, "Financial Management Regulation," should be issued in time to prepare the FY 2000 financial statements.

Supporting Accounting Entries. The requirement to support accounting transactions to include accounting entries is well established, as discussed in Appendix B. Transactions may be supported by copies of original documentation or by performing detailed reconciliations between accounts or records. The procedures of DoD contained in the DoD Financial Management Regulation, DoD Regulation 7000.14-R, volume 6A, "Reporting Policy and Procedures," January 1998, and the DFAS draft guidance of November 17, 1999, address documentation and audit trails necessary to support department-level accounting entries. The DFAS Centers, however, did not follow those procedures for supporting and reconciling accounting entries made for the elimination process.

Presentations of Eliminations on the Consolidating Statement of Net Cost

In addition, DoD entities made the elimination of intra-agency transactions on the consolidating Statement of Net Cost to the total program cost and revenue lines and not to the specific programs that made up the totals. DoD Form and Content guidance for preparing the Statement of Net Cost was not in accordance with OMB Bulletin No. 97-01. As a result, the DoD Agency-wide consolidating Statement of Net Cost understated the intragovernmental costs and overstated earned revenues by program category. For example, the operation and maintenance intragovernmental cost reported a combined total of $43.6 billion but did not show the intra-agency elimination of $35.4 billion, or a consolidated total of $8.2 billion. The Working Capital Funds earned revenues showed a combined total of $66 billion but did not show the intra-agency elimination of $52.9 billion, or a consolidated total of $13.1 billion. Appendix D shows an audit-reconstructed FY 1999 DoD Agency-wide consolidating Statement of Net Cost.

Program Categories. The DoD Agency-wide consolidating Statement of Net Cost showed a gross sum of intragovernmental costs of $89.4 billion and a gross sum of earned revenues of $89.4 billion under total program costs. The intragovernmental cost and earned revenue amounts were not presented or broken out by the nine DoD program categories, although the information was available. If intragovernmental costs had been reported by program category, they would have shown that the intragovernmental costs for the "Other Programs" category had differences between the reported amount and the intra-agency eliminations of $7.1 billion.

DoD Form and Content. Chapter 5, paragraph 0501, of the DoD Form and Content shows the format for the consolidating Statement of Net Cost. The format shows the intra-agency eliminations at the "Total Program Cost" category; however, the format in OMB Bulletin No. 97-01 shows intra-agency eliminations by program category. The USD (Comptroller) should modify the DoD Form and Content to be in agreement with OMB Bulletin No. 97-01.

Conclusion

Merely forcing eliminating entries and intragovernmental accounts to agree does not ensure that amounts are accurately reflected on the DoD Agency-wide financial statements and reported to the U.S. Treasury. Financial accounting has no authoritative requirement that revenue and expenses have to be equal between trading partners. In fact, expenses and revenues probably would not be equal at year-end because the buyer would not have recorded expenses for goods and materials in shipment, work in process, or items that may be recorded as an asset. A strong reconciliation process between the buyer and seller should identify the causes for differences between the buyer's and seller's records and should form the basis for adjusting intragovernmental accounts. The reconciliation process is also an essential internal control in compiling accounting and financial information.

Recommendations, Management Comments, and Audit Response

We recommend that the Under Secretary of Defense (Comptroller):

1. Determine the causes for abnormal balances and document the action taken to correct the account balances.

Management Comments. The USD (Comptroller) stated that DFAS has researched abnormal balances caused by the elimination process and will document any corrections on journal vouchers.

2. Establish a working group with the Defense Finance and Accounting Service and the DoD Components to re-execute the implementation strategy down to the transaction origin level to develop solutions to improve the elimination process.

Management Comments. The USD (Comptroller) stated that the Department's accounting systems will not support the elimination process and that there was not an adequate Government-wide policy addressing the elimination and reconciliation issues. In the meantime, DFAS is attempting to identify alternative ways to develop electronic files at the transaction level.

Audit Response. The USD (Comptroller) comments were not fully responsive. In order to fix its accounting systems or to develop alternative methods to identify and eliminate intragovernmental transactions, DoD will have to start its research at the transaction point of origin and identify breakdowns in the processes as the transactions are rolled up to the DFAS Centers.

We disagree that inadequate Government-wide guidance is a major issue that precludes DoD from developing more reliable elimination processes. Most of the intragovernmental transactions recorded by DoD are intra-agency. For example, of the $108.2 billion of the reported earned revenues, $89.4 billion (82.6 percent) were intra-agency earned revenues. The magnitude of the intra-agency transactions should be sufficient incentive for DoD to develop alternative methods and to fix accounting systems in order to improve the elimination process. Also, the Department of the Treasury issued extensive guidance on eliminations in September 2000.

The details and the completion date of identifying the alternate ways were not provided. We request that the USD (Comptroller) provide additional comments on how the alternative will achieve the goals of the implementation strategy for eliminations. In addition, the details on the alternative should address coordination with the Military Departments and DoD organizations and how transactions will be captured.

3. Modify DoD Regulation 7000.14-R, "Financial Management Regulation," to require Defense Finance and Accounting Service Centers and DoD Components to reconcile buyer side and seller side information and disclose any unreconciled amounts in the footnotes to the financial statements. For example, the footnotes could state that elimination transactions have not been properly reconciled and researched, buyer side information contains unsupported accounting entries, and actions are being taken to correct DoD financial management systems, so that DoD can properly account for and make intragovernmental transactions. The Under Secretary of Defense (Comptroller) should issue the revision to the "Financial Management Regulation" in time to prepare the FY 2000 financial statements.

Management Comments. The USD (Comptroller) agreed that, ideally, buyers and sellers should record and report intragovernmental transactions consistently. However, because of the large number of intragovernmental transactions and inadequate accounting systems, it is not feasible to rely on an after-the-fact reconciliation. The USD (Comptroller) issued interim guidance that will result in a feasible approximation of intragovernmental balances and elimination. Also, chapter 10, "Notes to the Financial Statements," volume 6B, "Form and Content of DoD Audited Financial statements," of the Financial Management Regulation, issued December 5, 2000, requires that full disclosure be made of material differences identified during the comparison process of intragovernmental amounts.

4. Modify DoD Regulation 7000.14-R, "Financial Management Regulation," to make the Regulation consistent with OMB Bulletin 97-01 by requiring DoD entities to disclose elimination amounts for each program category on the DoD Agency-wide consolidating Statement of Net Cost.

Management Comments. The USD (Comptroller) stated that a revision issued in October 2000 of chapter 5, "Statement of Net Cost," volume 6B, "Form and Content of DoD Audited Financial statements," of the Financial Management Regulation requires the reporting of intra-entity eliminations for each program category.

Appendix A. Audit Process

Scope

As part of our effort to determine whether the DoD Agency-wide financial statements were presented fairly in accordance with OMB Bulletin No. 97-01, we reviewed the preparation and presentation of the DoD Agency-wide balance sheet and Statements of Net Cost, footnotes, and required supplemental information for FY 1999. We reviewed the statements as they related to the accounting and disclosure of intragovernmental transactions and elimination of intra-agency transactions between buyer and seller on the DoD Agency-wide financial statements. We did not focus our review on fiduciary transactions with other Federal agencies.

The DoD Agency-wide Statement of Net Cost for FY 1999 identified total program costs of $410.3 billion and total earned revenue of $32.5 billion for a total net cost-of-operations of $377.8 billion. In addition, DoD reported total assets of $599 billion, total liabilities of $999 billion, and total budgetary resources of $628 billion. The DoD net position at the end of the period was a negative $400 billion. The total DoD assets did not include assets identified as National Defense property, plant, and equipment. National Defense property, plant, and equipment assets were included as supplementary stewardship information in the financial statements.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measure.

- **FY 2001 Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**

- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management **(01-DoD-2.5)**

- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. The reform objectives and goals are not necessarily a part of the DoD planning and assessment effort in response to the Government Performance and Results Act. This report pertains to achievement of the following functional area objectives and goals.

- **Financial Management Area Objective:** Reengineer DoD business practices. **Goal:** Standardize, reduce, clarify, and reissue financial management policies. **(FM 4.1)**

- **Financial Management Area Objective:** Strengthen internal controls. **Goal:** 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

We analyzed the DoD Agency-wide financial statements to determine whether the intragovernmental transactions for buyers and sellers were properly disclosed on the financial statements and required supplemental information. We reviewed $298.8 billion (absolute value) in accounting entries that the DFAS Centers made to intragovernmental and related public accounts to determine whether they were properly supported. Also, we assessed whether the $236.7 billion in eliminating entries to the balance sheet, the Statement of Net Cost, and the required supplemental statement were properly made, supported, and reconciled. We obtained and reviewed trial balance data and summary partnership data that DFAS used to compile the DoD Agency-wide financial statements and required supplemental statements. We compared financial information in the FY 1999 DoD Component financial statements with the DoD Agency-wide financial statements.

We also obtained and reviewed audit reports related to the FY 1999 DoD Agency-wide and DoD Component financial statements. In addition to the FY 1999 audit reports, we reviewed followup actions on prior audit reports related to intragovernmental transactions. We also reviewed the execution of the implementation strategy and responses to the strategy. We also reviewed the FY 1999 management representation letter and the Financial Management Improvement Plan, September 1999.

We reviewed intragovernmental transactions to determine whether the presentation and disclosure was in accordance with OMB Bulletin No. 97-01 and other related guidance listed in Appendix B. We also reviewed the adequacy of the DoD Form and Content and DFAS guidance. We conducted interviews with USD (Comptroller) personnel regarding the preparation of the DoD Agency-wide and DoD Components' financial statements and compilation of and procedures used for the accounting, reporting, and disclosure of intragovernmental transactions.

Computer-Processed Data. We could not rely on the computer-processed data used to prepare the DoD Component and Agency-wide financial statements for FY 1999. DoD financial management systems were unreliable. DoD candidly addressed deficiencies in its financial management systems in the Annual Statement of Assurance, the DoD Financial Management Improvement Plan, and the management representation letter for the DoD financial statements for FY 1999. Unreliable computer-processed data were used in preparing the departmental entries, the eliminating entries, the financial statements, and this report because they were the only data available. However, when the data are reviewed in context with other available evidence, we believe that the opinions, conclusions, and recommendations in this report are valid. We will continue to review the adequacy of existing and proposed financial management systems.

Audit Type, Dates, and Standards. We performed this financial-related audit from February through July 2000. We conducted this audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls as we considered necessary.

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

Management Control Program Review

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 Management Control Program. As part of our overall objective to determine whether the DoD Agency-wide financial statements were presented fairly, we also reviewed the adequacy of management controls, which included the management control program, related to the preparation of the DoD Agency-wide financial statements and the accounting and reporting for intragovernmental transactions. We also reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified a material management control weakness for the USD (Comptroller) as defined by DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. The management controls were deficient over the preparation of the DoD Agency-wide balance sheet, the Statement of Net Cost, and required supplemental information in that we identified a material weakness in the accounting and disclosing of intragovernmental transactions. The recommendations in this report, if implemented, will improve the management controls. A copy of the report will be provided to the senior official responsible for management controls in DoD.

Adequacy of Management's Self-Evaluation. Management reported intragovernmental eliminations as a material weakness. The USD (Comptroller) acknowledged in its management representation letter for the DoD Agency-wide financial statements for FY 1999 that the financial statements may not be presented in full conformity with Federal accounting standards and that intragovernmental transactions may not have been explicitly disclosed and eliminated. Also, management reported the lack of adequate accounting systems as a management control deficiency and the problems with intragovernmental eliminations as an impediment to an audit opinion in the FY 2000 DoD Financial Management Improvement Plan.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at http:/www.gao.gov, and Inspector General, DoD, reports can be accessed on the Internet at http:/www.dodig.osd.mil/audit/reports.

Appendix B. Laws and Regulations

Laws

Federal Financial Management Improvement Act of 1996. The purposes of the Federal Financial Management Improvement Act of 1996 are to do the following:

- provide for consistency of accounting by an agency (department) from one fiscal year to the next, and provide uniform accounting standards throughout the Federal Government;
- require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, to the citizens, Congress, the President, and agency management, so that programs and activities can be considered based on the full costs and merits;
- increase the accountability and credibility of Federal financial management;
- improve performance, productivity, and efficiency of Federal Government financial management;
- establish financial management systems to support controlling the cost of Federal Government; and
- increase the capability of agencies to monitor execution of the budget by more readily permitting reports that compare spending of resources with results of activities.

General Accounting Office Guidance

General Accounting Office, "Standards for Internal Control in the Federal Government," November 1999. The General Accounting Office, "Standards for Internal Control in the Federal Government," November 1999, provides an overall framework for internal control. The standards state the following:

> Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation of related records, which provide evidence of execution of these activities as well as appropriate documentation.

In addition, the standards require clear documentation of all transactions and other significant events, and the documentation should be readily available for examination.

Statements of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards," July 31, 1995. Statement of Federal Financial Accounting Standards No. 4 contains managerial cost concepts and standards for requirements for cost accounting, responsibility segments, full cost, inter-entity costs, and cost methodology. Government managers, Congress and Federal executives, and citizens, including news media and interest groups, intend the concepts and standards for use. Statement of Federal Financial Accounting Standards No. 4 specifically requires that "intra-entity expenses/assets and financing sources would be eliminated." The standards are aimed at achieving three general objectives, which are as follows:

- to provide program managers with relevant and reliable information relating costs to outputs and activities;
- to provide relevant and reliable cost information to assist Congress and executives in making decisions about allocating Federal resources, authorizing and modifying programs, and evaluating program performance; and
- to ensure consistency between costs reported in general purpose financial reports and costs reported to program managers.

The standard was effective beginning FY 1998, according to Statement of Federal Financial Accounting Standards No. 9, "Deferral of the Effective Date of Managerial Cost Accounting Standards for the Federal Government in Statement of Federal Financial Accounting Standards No. 4," October 1997.

Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources," May 10, 1996. Statement of Federal Financial Accounting Standards No. 7 presents standards to account for inflows of resources from revenue and other financing sources. It provides standards for classifying, recognizing, and measuring resource inflows. The objective of the standards is to make the U.S. Government's proprietary accounting more supportive of the budget and more comprehensible to those who work primarily with the budget. The standard was effective beginning FY 1998.

Federal Accounting System Requirements

JFMIP-SR-99-4, "Core Financial System Requirements," February 1999. The Joint Financial Management Improvement Program publication, JFMIP-SR-99-4, "Core Financial System Requirements," February 1999, states that elimination amounts must be identified, and adequate audit trails are critical to providing support for transactions and balances maintained by the core financial system. Specifically, the core financial system must do the following:

- provide the ability to process intragovernmental transactions and track intragovernmental balances;
- specifically identify amounts that would be eliminated when preparing intra-agency and interagency consolidations;
- provide audit trails to trace transactions from source documents, original input, other systems, system-generated transactions, and internal assignment transactions through the system; provide details to support account balances; and provide audit trails to trace transactions from their point of origination through to their summarization to the financial statements and the reverse;
- provide audit trails to identify changes made to system parameters and tables that would affect the processing of financial transactions;
- provide audit trails that identify document input, change, approval, and deletions by originator, and provide audit trails to identify any system changes, as well as document progress and changes;
- ensure that all transactions are handled consistently to ensure the validity of audit trails and transactions, regardless of their point of origin; and
- provide a method for archiving data that will be needed for audit trails and a method for easily accessing any documents that are needed in the future.

The reconciliation of the general ledger is a mandatory core requirement and supports the control function of the general ledger. The reconciliation must generate reports that show amounts between components of the core accounting system and related general ledger accounts and annotate out-of-balance conditions. It also must maintain an audit trail of any corrections.

The key goal of the core financial system is to provide:

> complete, reliable, consistent, timely, and useful financial management information on operations to enable central management agencies, individual operating agencies, divisions, bureaus and other sub-units to carry out their fiduciary responsibilities. The fiduciary responsibilities

are to deter fraud, waste, and abuse of resources, and facilitate efficient and effective delivery of programs by relating financial consequences to program performance.

Office of Management and Budget Guidance

OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 7, 2000. OMB Bulletin No. 97-01 defines the form and content of financial statements that executive departments and agencies must submit to the Director, OMB, as required by the Chief Financial Officers Act of 1990. OMB Bulletin No. 97-01 is the main authority for preparing annual audited financial statements that are prepared in accordance with the Chief Financial Officers Act. The annual financial statements are different than the reports submitted to OMB for purposes of monitoring and controlling the obligation and expenditure of budgetary resources, which agencies must still prepare and submit. The Bulletin also establishes the reporting and disclosure requirements for the Statements of Federal Financial Accounting Standards, which are delineated in chapter 13, "Form and Content of Financial Statements." The Bulletin incorporates concepts and standards recommended by the Federal Accounting Standards Advisory Board and issued by OMB. It is effective in its entirety for financial statements for the fiscal year beginning October 1, 1997. The formats and instructions provide a framework within which individual agencies have the flexibility to provide information useful to Congress, agency managers, and the public. The Bulletin defines the minimal Government-wide requirements for the minimum elements of the financial statements, which include the following:

- the overview of the reporting entity,
- six principal financial statements (balance sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing, Statement of Custodial Activity),
- footnotes, and
- supplemental financial and management information.

OMB Bulletin No. 97-01 requires the balance sheet and Statement of Net Cost to be prepared on a consolidated basis. When statements are prepared on a consolidated basis, the statements should in be a multi-column format to present information on the entity's components with a column that shows the amount of intra-agency amounts needed to arrive at consolidated totals. The elimination amounts for intra-agency costs and earned revenue amounts are to be shown on the Statement of Net Cost consolidation by program cost category. Transaction amounts with other Federal agencies are to be reported as required supplemental information.

Intragovernmental amounts that are related to other Federal trading partners are to be presented as required supplemental information. Reporting entities are encouraged to reconcile intragovernmental amounts with their trading partners. Balances reported for assets and liabilities and individual transactions that collectively comprise 20 percent or more of asset and liability categories are to be reconciled. If agencies have intragovernmental earned revenues and related costs greater that $2 billion, they should be reported by trading partner.

OMB Circular No. A-127, "Financial Management Systems," July 23, 1993. OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, provides the policies and standards for developing, operating, evaluating, and reporting on financial management systems. The Circular requires that each agency establish and maintain a financial management system that does the following:

- reflects an agency-wide financial information classification structure that is consistent with the U.S. Government Standard General Ledger, provides for tracking of specific program expenditure, and covers financial and financially related information;

- provides for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data within the system by having common data elements, common transaction processing, consistent management controls, and efficient transaction entry;

- records financial events applying the U.S. Standard General Ledger at the transaction level;

- maintains accounting data to permit reporting in accordance with applicable accounting standards or, in the case of no Federal standard, maintains data in accordance with applicable accounting standards for preparing financial statements;

- meets requirements for agency financial management reporting and performance measurement (program and financial);

- conforms to existing, applicable Federal Financial Management Systems requirements issued by the Joint Financial Management Improvement Program or additional functional requirements issued by OMB or the U.S. Treasury;

- has adequate documentation; and

- includes a system of management controls.

Appendix C. Examples of FY 1999 Unreliable Seller Side Information

1. The Army Audit Agency reported that the Departmental Budgetary Accounting and Reporting System that DFAS used to compile data for the Statement of Budgetary Resources did not provide an audit trail to supporting documentation. The Army Audit Agency also tested transactions at the local level and concluded that the management controls over the accounting, processing, and reporting of collections and reimbursable orders were not fully effective. The Army General Fund reported $10.9 billion in collections. Collections and reimbursable orders were not always properly recorded using correct reimbursement source codes, with audit trails to supporting documentation, nor were the transactions recorded promptly. Reimbursement source codes are three-place digits that identify appropriations and sales customers.

2. The Army Audit Agency was unable to trace transactions or verify amounts reported in the Army Working Capital Fund Statement of Net Cost and $10 billion in budgetary resources reported on the Statement of Budgetary Resources. Accounting systems used to compile the Statement of Net Cost did not maintain sufficient information to verify reported amounts. DFAS Indianapolis Center used information that provided gross numbers and not detailed transactions. In addition, the Inspector General, DoD, determined that DFAS Indianapolis Center made $10 billion in unsupported adjustments to the budget data. Because of the accounting system deficiencies, audit trails were not available to trace transactions.

3. The Naval Audit Service reported management control deficiencies related to seller side information. The Navy did not maintain source documentation for some of the earned revenue. Transactions that needed to be eliminated on the Navy General Fund Statement of Net Cost could not be identified. In addition, the accounts receivable balance on the financial statements was found to be unreliable. The Navy reported earned revenues of $4.2 billion and accounts receivable of $2.5 billion.

4. The Naval Audit Service identified management control deficiencies over accounts receivable reported on the Navy Working Capital Fund financial statements. The Navy Working Capital Fund financial statements showed $596.7 million in accounts receivable. The Naval Audit Service reported the following:

    - accounts receivable Federal subsidiary accounts were not reconciled to the general ledger,

    - accounts receivable for supply management was not based on individual transactions,

- accounts receivable audit trails were lacking because supporting documentation was not retained and subsidiary ledgers were incomplete,

- accounts receivable management controls failed to identify irregular and noncompliant reporting practices, and

- accounts receivable eliminating entries for supply management could not be tested at the transaction level.

In addition, the Naval Audit Service reported that revenue was not always recognized on the percentage-of-completion basis.

5. The Air Force Audit Agency stated that the Air Force could not identify all intragovernmental transactions by customer for the Air Force General Fund financial statements. The Air Force reported $508.8 million in intragovernmental accounts receivable and $2.9 billion in earned revenue for FY 1999.

6. The Air Force Audit Agency reported that the Air Force Depot Maintenance Activity Group accounting systems did not retain subsidiary ledgers and transaction journals. As a result, revenue could not be recognized on the percentage-of-completion basis. The Air Force reported $5.2 billion in depot maintenance revenues for the Working Capital Fund Statement of Net Cost. In addition, the Air Force Audit Agency reported that the Supply Management Activity Group could not provide supporting documentation for $64.6 million (or 59 percent) of its $109.3 million in sales transactions reviewed.

Appendix D. Reconstructed FY 1999 DoD Agency-Wide Consolidating Statement of Net Cost

(dollars in millions)

Program Costs	DoD Combined Totals	Intra-Agency Eliminations	Audit Consolidated Totals
Military Personnel			
Intragovernmental	$ 7,410.5	$(5,839.4)	$ 1,571.1
With the Public	61,962.4	--	61,962.4
Total Program Cost	**$69,372.9**	**$ (5,839.4)**	**$ 63,533.5**
(Less: Earned Revenues)	(480.4)	433.8	(46.6)
Net Program Costs	**$68,892.5**	**$(5,405.6)**	**$63,486.9**
Operation and Maintenance			
Intragovernmental	$ 43,565.4	$(35,382.5)	$ 8,182.9
With the Public	133,893.6	--	133,893.6
Total Program Cost	**$177,459.0**	**$(35,382.5)**	**$142,076.5**
(Less: Earned Revenues)	(9,676.9)	6,852.8	(2,824.1)
Net Program Costs	**$167,782.1**	**$(28,529.7)**	**$139,252.4**
Procurement			
Intragovernmental	$ 5,212.8	$(3,773.1)	$ 1,439.7
With the Public	54,929.5	--	54,929.5
Total Program Cost	**$60,142.3**	**$(3,773.1)**	**$56,369.2**
(Less: Earned Revenues)	(397.7)	266.7	(131.0)
Net Program Costs	**$59,744.6**	**$(3,506.4)**	**$56,238.2**
Research, Development, Test, & Evaluation			
Intragovernmental	$ 3,384.3	$(767.9)	$ 2,616.4
With the Public	36,954.3	--	36,954.3
Total Program Cost	**$40,338.6**	**$(767.9)**	**$39,570.7**
(Less: Earned Revenues)	(1,704.9)	1,197.8	(507.1)
Net Program Costs	**$38,633.7**	**$ 429.9**	**$39,063.6**
Military Construction/Family Housing			
Intragovernmental	$ 1,557.7	$(136.3)	$1,421.4
With the Public	2,481.9	--	2,481.9
Total Program Cost	**$ 4,039.6**	**$(136.3)**	**$3,903.3**
(Less: Earned Revenues)	(1,331.4)	1,223.1	(108.3)
Net Program Costs	**$ 2,708.2**	**$1,086.8**	**$3,795.0**

Program Costs	DoD Combined Totals	Intra-Agency Eliminations	Audit Consolidated Totals
Military Retirement Fund			
Intragovernmental	--	--	--
With the Public	$ 49,376.9	--	$ 49,376.9
Total Program Cost	**$ 49,376.9**	**--**	**$ 49,376.9**
(Less: Earned Revenues)	(38,019.1)	$25,666.9	(12,352.2)
Net Program Costs	**$ 11,357.8**	**$25,666.9**	**$ 37,024.7**
USACE* Civil Works			
Intragovernmental	$ 781.3	$(43.8)	$ 737.5
With the Public	4,248.8	--	4,248.8
Total Program Cost	**$5,030.1**	**$(43.8)**	**$4,986.3**
(Less: Earned Revenues)	(674.4)	43.8	(630.6)
Net Program Costs	**$4,355.7**	**$ --**	**$4,355.7**
Working Capital Funds			
Intragovernmental	$ 20,197.1	$(17,552.7)	$ 2,644.4
With the Public	48,472.1	--	$ 48,472.1
Total Program Cost	**$ 68,669.2**	**$(17,552.7)**	**51,116.5**
(Less: Earned Revenues)	(66,032.2)	52,940.7	(13,091.5)
Net Program Costs	**$ 2,637.0**	**$ 35,388.0**	**$ 38,025.0**
Other Programs			
Intragovernmental	$ 18,853.9	$(25,932.7)	$(7,078.8)
With the Public	6,489.1	--	6,489.1
Total Program Cost	**$ 25,343.0**	**$(25,932.7)**	**$ (589.7)**
(Less: Earned Revenues)	(3,590.0)	802.9	(2,787.1)
Net Program Costs	**$ 21,753.0**	**$(25,129.8)**	**$(3,376.8)**
Total Program Costs			
Intragovernmental	$ 100,963.1	$(89,428.4)	$ 11,534.7
With the Public	398,808.5	--	398,808.5
Total Program Cost	**$ 499,771.6**	**$(89,428.4)**	**$ 410,343.2**
(Less: Earned Revenues)	(121,907.0)	89,428.4	(32,478.6)
Net Program Costs	**$ 377,864.6**	**$ (0.0)**	**$ 377,864.6**

* U.S. Army Corps of Engineers

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office

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

Under Secretary of Defense (Comptroller) Comments

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

DEC 11 2000

COMPTROLLER

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

SUBJECT: Office of the Inspector General, Department of Defense Draft Audit Report, "Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statements" (Project No. D2000FI-0063.005)

This is in response to the subject Office of the Inspector General, Department of Defense (OIG, DoD) draft report.

As the OIG, DoD is aware and as previously stated on several occasions, the identification, reconciliation, and elimination of intragovernmental transactions is a government-wide problem. The Office of Management and Budget and the Department of the Treasury have yet to issue sufficient government-wide guidance to enable the accurate reporting and reconciling of these transactions. Additionally, the Department's financial systems currently are not capable of producing the information necessary to be able to perform intragovernmental eliminations properly. Further, in the absence of sufficient government-wide guidance, it is not feasible to attempt to make necessary system modifications without the identification of a government-wide approach and solution. In spite of this, the Department has taken, and is taking, steps to better enable the identification and elimination of intragovernmental transactions. Specifically, the Department has developed interim procedures to aid in the elimination of intragovernmental balances where feasible. The Department believes that this interim guidance will result in the most feasible approximation of intragovernmental balances and eliminations that is realistically achievable in light of the absence of sufficient government-wide guidance and existing system limitations. Detailed comments on the specific recommendations contained in the report are provided in the attachment.

The point of contact for this matter is Ms. Barbara Zientek. She may be reached by e-mail: zientekb@osd.pentagon.mil or by telephone at (703) 697-8618 (DSN 227-8618).

William J. Lynn

Attachment

OFFICE OF THE INSPECTOR GENERAL DRAFT AUDIT REPORT

"ACCOUNTING AND DISCLOSING INTRAGOVERNMENTAL TRANSACTIONS ON THE DOD AGENCY-WIDE FINANCIAL STATEMENTS"
DATED OCTOBER 4, 2000
(PROJECT NO. D2000FI-0063.005)

*****

COMMENTS ON RECOMMENDATIONS

RECOMMENDATION 1: The Office of the Inspector General, Department of Defense (OIG, DoD) recommends that the Under Secretary of Defense (Comptroller) (USD(C)) determine the causes for abnormal balances and document the action taken to correct the account balances.

OUSD(C) Response: The Defense Finance and Accounting Service (DFAS) previously performed two formal elimination exercises to test the procedures to be used in the year-end elimination process. During these formal elimination exercises, the DFAS researched abnormal balances in individual accounts and unusual relationships among groups of accounts and notified the appropriate person for further research and resolution. The research and notification was conducted via e-mail and telephone. As a result of the elimination exercises, some allocation methods were revised to prevent abnormal balances from occurring at fiscal year-end. Any corrections to abnormal balances that were identified as of September 30, 2000 and were a result of the eliminations process will be documented by journal vouchers and adjusted in accordance with Volume 6B, "Form and Content of DoD Audited Financial Statements," of the DoD Financial Management Regulation ("DoDFMR"), DoD 7000.14-R. In addition, the DFAS has worked on the elimination issues as identified in recent audits.

RECOMMENDATION 2: The OIG, DoD recommends that the USD(C) establish a working group with the Defense Finance and Accounting Service and the DoD Components to re-execute the implementation strategy down to the transaction origin level to develop solutions to improve the elimination process.

OUSD(C) Response: As the OIG is aware, the Department currently does not have a transaction-driven general ledger system that captures information necessary for the reconciliation and disclosure of intragovernmental transaction amounts at the transaction level. The Department is working toward accounting systems that will support the elimination process; however, they will not be operational for several years. Additionally, the issue of intragovernmental eliminations is a government-wide problem. Until an adequate government-wide policy is issued, developing a DoD specific process is not practical. In the meantime, the DFAS is attempting to identify alternate ways to develop electronic files at the transactional level.

Attachment

RECOMMENATION 3: The OIG, DoD recommends that the USD(C) modify DoD Regulation 7000.14-R, "Financial Management Regulation," to require Defense Finance and Accounting Service Centers and DoD Components to reconcile buyer side and seller side information and disclose any unreconciled amounts in the footnotes to the financial statements. For example, the footnotes could state that elimination transactions have not been properly reconciled and researched, buyer's side information contains unsupported accounting entries, and actions are being taken to correct DoD financial management systems, so that DoD can properly account for and make intragovernmental transactions. The USD(C) should issue the revision to the "Financial Management Regulation" in time to prepare the FY 2000 financial statements.

OUSD(C) Response: This office agrees that, ideally, buyers and sellers should record and report intragovernmental transactions consistently. However, given the large number of intragovernmental transactions, it is not feasible to rely on an after-the-fact reconciliation. The Department's intention is to implement automated processes that contain sufficient automated edits and controls to eliminate the need for after-the-fact reconciliation. As stated above, the Department does not have the transaction-driven general ledger system that captures the information necessary for the reconciliation and disclosure of intra-DoD transactions.

Additionally, this is a government-wide problem. This office is actively involved in interagency workgroups whose goal is to develop a policy to ensure that intragovernmental transactions are identified and eliminated accurately and consistently. The Department will be working with other federal agencies to attempt to develop automated processes that would eliminate the need for manual reconciliation.

In the meantime, the Department has issued interim intragovernmental elimination policy guidance in Chapter 13, "Fiscal Year 2000 Adjustments, Eliminations, and Other Special Intragovernmental Reconciliation Procedures," Volume 6B, "Form and Content of DoD Audited Financial Statements," of the "DoDFMR." In light of the current accounting system deficiencies, the Department is requiring that buyer side records be adjusted to agree with seller side records. The Department believes that this approach will result in the most feasible approximation of intragovernmental balances and eliminations. However, the Department's guidance does provide that if the buyer can satisfy its auditors that its records (vice the seller's records) are accurate, it need not adjust its records. When this occurs, the seller's records will be adjusted to agree with the buyer's records. These adjustments are the only way the Department currently can effectively eliminate intra-agency transactions.

The Department has revised guidance in Chapter 10, "Notes to the Financial Statements," Volume 6B of the "DoDFMR" to require the disclosure of material differences identified during the comparison of intragovernmental amounts as well as whether the reporting entity was able to fully reconcile its intragovernmental balances. This disclosure is required for note 5, Accounts Receivable; note 12, Accounts Payable; and note 19, Disclosures Related to the Statement of Net Cost. Also, the instructions for the

Attachment

preparation of note 1 include a disclosure of the processes used to develop and record intragovernmental eliminations.

RECOMMENATION 4: The OIG, DoD recommends that the USD(C) modify DoD Regulation 7000.14-R, "Financial Management Regulation," to make the Regulation consistent with the Office of Management and Budget (OMB) Bulletin 97-01 by requiring DoD entities to disclose elimination amounts for each program category on the DoD Agency-wide consolidating Statement of Net Cost.

OUSD(C) Response: Chapter 5, "Statement of Net Cost," Volume 6B, "Form and Content of DoD Audited Financial Statements," of the "DoDFMR" already requires the reporting of intra-entity eliminations for each program category as required by the OMB Bulletin 97-01. This revision was issued in October 2000.

Attachment

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

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