

**A** *Audit*



**R** *Report*

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE  
AIR FORCE AUDIT AGENCY AUDIT OF THE  
FY 2000 AIR FORCE GENERAL FUND FINANCIAL STATEMENTS

Report No. D-2001-058

February 21, 2001

Office of the Inspector General  
Department of Defense

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### **Acronyms**

AFAA

Air Force Audit Agency



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

February 21, 2001

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

**SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 2000 Department of the Air Force General Fund Financial Statements (Report No. D-2001-058)**

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Air Force Audit Agency disclaimer of opinion on the FY 2000 Department of the Air Force General Fund financial statements, along with excerpts from the Air Force Audit Agency audit report, "Opinion on Fiscal Year 2000 Air Force Consolidated Financial Statements," February 7, 2001. An audit of the Department of the Air Force General Fund financial statements is required by the Chief Financial Management Act of 1990, as amended by the Federal Financial Management Act of 1994. Because this report contains no findings or recommendations, written comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Brian Flynn at (703) 604-9489 (DSN 664-9489) (bflynn@dodig.osd.mil) or Mr. Byron B. Harbert at (303) 676-7405 (DSN 926-7405) (bharbert@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink that reads "David K. Steensma".

David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. D-2001-058

February 21, 2001

(Project No. D2001FD-0051.03)

### Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 2000 Air Force General Fund Financial Statements

#### Executive Summary

**Introduction.** 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 Air Force General Fund financial statements. Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, establishes the minimum requirements for audits of these financial statements. This Bulletin requires the Inspector General, DoD, to express an opinion on the DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations. We delegated the audit of the FY 2000 Department of the Air Force General Fund financial statements to the Air Force Audit Agency. This report is the first in a series of reports and discusses the work performed on the oversight of the Air Force Audit Agency audit of the FY 2000 Department of the Air Force General Fund financial statements.

**Objective.** Our objective was to oversee the Air Force Audit Agency to determine whether we can rely on the audit conducted by AFAA, as required by Government auditing standards. See Appendix A for a discussion of the audit process.

**Results.** The Air Force Audit Agency report, “Opinion on Fiscal Year 2000 Air Force Consolidated Financial Statements,” February 7, 2001, states that the auditors were unable to express an opinion on the FY 2000 Air Force General Fund financial statements. We concur with the Air Force Audit Agency disclaimer of opinion; our endorsement of that disclaimer is Exhibit 1. Excerpts of the Air Force Audit Agency report are included as Exhibit 2 and provide the reasons for the disclaimer of opinion and identify the material weaknesses and reportable conditions associated with the internal controls and compliance with laws and regulations. The complete Air Force Audit Agency report can be accessed on the Internet at <http://www.afaa.hq.af.mil>. The FY 2000 Department of the Air Force Consolidated Financial Statements can be accessed on the Internet at <http://www.dtic.mil/comptroller>.

# Table of Contents

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<b>Executive Summary</b>	i
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## **Appendixes**

A. Audit Process	
Scope and Methodology	1
Prior Coverage	2
B. Report Distribution	3

## **Exhibits**

1. Inspector General, DoD, Endorsement Memorandum
2. Excerpts from Air Force Audit Agency Audit Report, "Opinion on Fiscal Year 2000 Air Force Consolidated Financial Statements "

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# Appendix A. Audit Process

## Scope and Methodology

**Audit Work Performed.** To fulfill our responsibilities under Public Law 101-576, the “Chief Financial Officers Act of 1990,” as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” and Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, we performed oversight of the independent audit conducted by the Air Force Audit Agency (AFAA) of the FY 2000 Department of the Air Force General Fund financial statements. We reviewed the AFAA audit approach and planning and monitored audit progress at the key points.

**Reviewing the AFAA Audit Approach.** We used the “Federal Financial Statement Audit Manual,” January 1993, issued by the President’s Council on Integrity and Efficiency, and the “Financial Audit Manual,” December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the AFAA audit approach. Specifically, we reviewed documentation for the audit planning and strategy, entity profile, general risk analysis, cycle memorandums, audit plans and programs, and other applicable documentation of the Air Force General Fund business areas.

**Monitoring Audit Progress.** Through the DoD Financial Statement Audit Executive Steering Committee, and an integrated line-item oversight effort, we provided a forum for a centrally managed exchange of guidance and information. We reviewed and commented on the Air Force Audit Agency audit opinion report, which included discussions of issues on internal controls and compliance with laws and regulations. We reviewed key workpapers and summaries of Air Force Audit Agency audit results and conclusions.

In addition to the oversight procedures, we performed other procedures necessary to determine the fairness and accuracy of the AFAA audit approach and conclusions. We reviewed findings and recommendations in previous AFAA reports.

**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 corporate-level goals, subordinate performance goal, and performance measure:

- **FY2001 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

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force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**

- **FY2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and financial systems. **(01-DoD-2.5.1)**
- **FY2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

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

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

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

**Auditing Type, Dates, and Standards.** We performed this financial statement audit from November 21, 2000, through February 7, 2001, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data or statistical sampling procedures to conduct our oversight of the Air Force Audit Agency audit of the FY 2000 Department of the Air Force General Fund financial statements.

**Contacts During the Audit.** We contacted individuals and organizations in the DoD audit community. Further details are available on request.

## **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>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>.

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## **Appendix B. 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  
Director, Defense Finance and Accounting Service Denver

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

Office of Management and Budget  
General Accounting Office

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## **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 Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform  
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

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**Exhibit 1. Inspector General, DoD,  
Endorsement Memorandum**



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-4704

February 7, 2001

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

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 2000 Air Force General Fund Financial Statements (Project No. D2001FD-0051.03)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Air Force Audit Agency (AFAA) the audit of the FY 2000 Air Force General Fund financial statements. Summarized as follows are the AFAA disclaimer of opinion on the FY 2000 Air Force General Fund financial statements, report on internal controls, report on compliance with laws and regulations, and the results of our review of the AFAA audit. We endorse the disclaimer of opinion expressed by AFAA.

**Disclaimer of Opinion.** The AFAA disclaimer of opinion, dated February 7, 2001, on the FY 2000 Air Force General Fund financial statements states that AFAA was unable to express an opinion on the financial statements. We concur with the AFAA disclaimer of opinion that material uncertainties existed regarding the reasonableness of amounts reported on Air Force General Fund financial statements. Those uncertainties existed because of the following:

- The Defense Finance and Accounting Service (DFAS) has not fully implemented the U.S. Government Standard General Ledger chart of accounts, and the systems used to account for Air Force funds did not employ a transaction-driven ledger to capture financial management information.
- The Air Force did not comply with Federal accounting standards because it used latest acquisition price to value operating materials and supplies, and it did not do the following:
  - report gains and losses on disposal of general property, plant, and equipment;
  - recognize holding gains and losses related to revaluations of operating materials and supplies; and
  - fully use the consumption method of accounting for operating materials and supplies.
- The DFAS and Air Force could not accurately identify all intragovernmental transactions by customer.
- Canceled-year appropriation balances are not reliable for accounts receivable and payable.

- The Air Force estimated that it still needed to determine the historical cost, accumulated depreciation, and acquisition date for \$662 million in General Fund equipment as of September 30, 2000.
- The extent of environmental cleanup liabilities was uncertain because of incomplete documentation for cleanup cost estimates.
- The AFAA could not reconcile or validate real property construction-in-progress of \$1.5 billion, which was reported by Army Corps of Engineers and Naval Facilities Engineering Command. Further, associated real property data required for performing audit tests were not received in time to conduct the tests.
- The AFAA also could not confirm the ending obligated and unobligated balances on the Statement of Budgetary Resources for FY 1999; consequently, AFAA could not confirm the beginning balances on the FY 2000 statement.

**Internal Controls.** The AFAA tested internal controls but did not express a separate opinion because opining on internal controls was not one of its objectives. However, AFAA determined that internal controls did not provide reasonable assurance of achieving the internal control objectives described in the Office of Management and Budget Bulletin No. 01-02, October 16, 2000, "Audit Requirements for Federal Financial Statements." We concur in the following material weaknesses and reportable conditions that AFAA identified.

- DFAS Denver and DFAS field organizations processed accounting entries valued at over \$1.6 billion were not adequately prepared or supported. Similar problems were disclosed in a DoD Inspector General review of FY 2000 DFAS Denver accounting entries.
- DoD Inspector General reviews performed during FYs 2000 and 2001 determined that system security controls for electronic commerce were inadequate and did not assure that electronically transmitted data were secure.
- Reporting of obligated balances was subject to material weaknesses because transaction records were not available and internal controls did not ensure proper matching of disbursements with related obligations.

In addition to the AFAA audit work on internal controls, we reviewed accounting entries processed by DFAS Denver valued at over \$406 billion. Our review determined that more than \$320 billion were either improper or unsupported. Details on this review will be included in a separate report issued by the DoD Inspector General.

The Air Force and DFAS recognized many of the financial reporting weaknesses and reported them in their FY 2000 Annual Statements of Assurance. Details on the internal control weaknesses will be provided in separate AFAA reports.

**Compliance With Laws and Regulations.** We concur in the areas of noncompliance with laws and regulations that AFAA identified, which will be discussed in more detail in separate AFAA reports. Under the Federal Financial Management Improvement Act of 1996, the AFAA work showed that the financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

**Review of Air Force Audit Agency Work.** To fulfill our responsibilities for determining the accuracy and completeness of the independent work that AFAA conducted, we reviewed the audit approach and planning and monitored progress at key points for selected areas. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the AFAA work on the FY 2000 Air Force General Fund financial statements from November 21, 2000, through February 7, 2001, in accordance with generally accepted Government auditing standards.



David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

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**Exhibit 2. Excerpts from Air Force  
Audit Agency Audit  
Report, “Opinion on  
Fiscal Year 2000 Air  
Force Consolidate  
Financial Statements”**



**DEPARTMENT OF THE AIR FORCE**  
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

7 February 2001

To the Acting Secretary of the Air Force  
Chief of Staff, USAF

We were engaged to audit the accompanying Air Force General Fund financial statements for the fiscal year (FY) ended 30 September 2000. The annual financial statements consist of the Balance Sheet and the related Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing. Preparing these financial statements is the responsibility of the Defense Finance and Accounting Service (DFAS) and Air Force management. This report presents our opinion on the financial statements, evaluation on the effectiveness of internal controls over financial reporting, and assessment of compliance with laws and regulations.

### **OPINION ON THE FINANCIAL STATEMENTS**

We are unable to express, and we do not express, an opinion on the Air Force Balance Sheet or the Statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing. We were unable to obtain sufficient, competent evidential matter, or apply other auditing procedures, to satisfy ourselves as to the fairness of these statements under provisions of the *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, 16 October 2000. Material uncertainties exist regarding the reasonableness of amounts reported on these statements. Air Force management has disclosed many of these uncertainties in the financial statement notes as compliance or data problems. For example:

- The DFAS has not fully implemented the U.S. Government Standard General Ledger Chart of Accounts. Further, systems that account for Air Force funds do not reflect a true transaction-driven general ledger or provide a consolidated source of financial management information for

either management or financial statement purposes. (Financial Statement Note 1)

- The Air Force use of latest acquisition cost to value operating materials and supplies does not comply with federal accounting standards.<sup>1</sup> For example, Air Force managers do not report gains and losses on disposal of general property, plant, and equipment, nor do they recognize holding gains and losses related to operating materials and supplies inventory revaluation that occurs when latest acquisition costs are used. Further, the Air Force does not use the consumption method of accounting for operating materials and supplies. (Financial Statement Note 1)
- The DFAS and Air Force cannot accurately identify all intragovernmental transactions by customer. (Financial Statement Note 1)
- Canceled-year appropriation balances are not reliable for accounts receivable and payable. (Financial Statement Note 1)
- Air Force management officials estimated that, as of 30 September 2000, the Air Force still needed to determine historical cost, accumulated depreciation, and acquisition dates for general fund equipment valued at \$662 million. (Financial Statement Note 10)

Our disclaimer is also based on our inability to reconcile or validate \$1.5 billion of \$2.3 billion in reported construction-in-progress because Army Corps of Engineers and Naval Facilities Engineering Command supporting documentation was not timely received and project costs were not identified to allow audit testing. Further, the Department of Defense (DoD) did not publish the FY 2000 Financial Management Improvement Plan in time for us to determine if known Air Force and DFAS financial system weaknesses were included and that remediation plans were established. We found material uncertainties related to environmental cleanup liabilities due to incomplete documentation for cleanup costs. Finally, we disclaim an opinion on the Statement of Budgetary Resources because our FY 1999 audit work could not confirm the ending FY 1999 obligated and unobligated balances on that statement. Consequently, we could not confirm the beginning balance for FY 2000. Efforts are ongoing to establish audited beginning period balances for FY 2001.

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<sup>1</sup> The American Institute of Certified Public Accountants recognizes the Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board as generally accepted accounting principles for federal government agencies.

## **REQUIRED SUPPLEMENTARY INFORMATION**

The Required Supplementary Information is not a required part of the principal financial statements, but is supplementary information required by OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, 16 October 1996. We applied limited audit procedures to the deferred maintenance portion of this information, but did not audit it and, therefore, express no opinion on the information.

The Required Supplementary Stewardship Information is also not a required part of the principal financial statements and, therefore, is not required to be audited. However, we selectively tested additions and deletions of national defense property, plant, and equipment, but express no opinion on the Required Supplementary Stewardship Information.

## **MANAGEMENT INITIATIVES**

In FY 1998, the Office of the Under Secretary of Defense (Comptroller/Chief Financial Officer) initiated strategies designed to produce auditable financial statements. The DFAS and Air Force continued in FY 2000 to improve financial data accuracy and reporting to support those initiatives. To illustrate:

- The Air Force and DFAS undertook extensive measures to improve the accuracy and auditability of budgetary data through periodic obligations reviews.
- The Air Force worked with DFAS to improve all accounting systems and "feeder" systems that provide financial data to accounting systems, and established an Integrated Process Team (IPT) comprised of functional subgroups responsible for corrective actions. Specifically, the IPT is working to correct deficiencies affecting the reporting accuracy of property, plant and equipment; deferred maintenance; environmental liabilities; inventory; munitions; and operating materials and supplies. Each of these accounts materially impacts financial statement balances.
- The DFAS initiated actions to integrate and modernize DFAS accounting systems into a comprehensive management system. The overall goal is to bring financial data under general ledger control, using the U.S. Government Standard General Ledger Chart of Accounts.
- During FY 1999, the Air Force fielded the Automated Civil Engineer System real property module at active Air Force bases and began reporting real property information to the general ledger for financial

statement preparation. The Air National Guard implementation was completed in FY 2000. To ensure system data reliability, the DoD contracted to evaluate the accuracy of values reported in the Automated Civil Engineer System, and the General Accounting Office (GAO) is currently validating contract results. Further, the DoD contracted to validate the data and methodology used for populating the Air Force Equipment Management System. This contract was ongoing as of 30 September 2000.

- The Air Force continued to develop the Air Force Total Ownership Cost management information system in FY 2000. This system analyzes a myriad of standard Air Force system data to provide detailed cost information on weapon systems and infrastructure. The system is expected to become the single source of cost information for mid- to long-range analyses, as well as to directly support the Air Force Reduction in Total Ownership Cost program. Current efforts focus on capturing daily flying hour data and related costs.
- The Air Force continued efforts to implement the consumption method of accounting for operating materials and supplies and has determined that the moving average cost approach will be used in valuing these assets. In addition, an Air Force study is underway to identify a consumption accounting system, and follow-on implementation is expected to take approximately 2 years.
- The Air Force continued to identify assets not previously reported in the financial statements. For example, during FY 2000, contractors for the C-17 and C-130J aircraft reported operating materials and supplies for the first time. Further, prior-period adjustments were made for \$195 million in aircraft spare parts acquired from working capital funds and \$1.5 billion in assets for U-2 aircraft.

We believe these efforts are steps in the right direction and will help to resolve many of the problems with existing systems. We will continue to work closely with management to address the material deficiencies precluding an unqualified audit opinion.

## **REPORT ON INTERNAL CONTROLS**

Management is responsible for establishing and maintaining an internal control structure to provide reasonable, but not absolute, assurance that transactions are properly recorded, processed, and summarized to permit both financial statement

preparation in accordance with federal accounting standards and safeguarding assets against loss from unauthorized acquisition, use, or disposal. Because of inherent limitations in any system of internal controls, errors or fraud may nevertheless occur and not be detected. Also, projecting internal control evaluation results to future periods is subject to the risk that procedures may become inadequate. In addition, our consideration of internal controls would not necessarily disclose all material weaknesses. A material weakness is a condition where controls do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, may occur and not be detected on a timely basis by employees performing their assigned functions.

Although we accomplished internal control testing, our financial statement audit objectives did not include providing a separate internal control opinion. Accordingly, we do not express such an opinion. However, OMB Bulletin, *Audit Requirements for Federal Financial Statements*, requires that we describe reportable conditions and material weaknesses identified during the audit. Accordingly, the following paragraphs summarize material weaknesses and reportable conditions that existed in the design or operation of the internal control structure over financial reporting in effect at 30 September 2000 for the Air Force consolidated financial statements. These weaknesses, along with recommended remedial actions and time frames for corrective actions, are more fully described in supporting audit reports issued to Air Force and DFAS management.

#### **SUPPORTING DOCUMENTATION**

Based on our review of accounting entries processed by DFAS Denver (DFAS-DE) and journal vouchers prepared by DFAS field organizations (previously called operating locations), transactions valued at over \$1.6 billion were not adequately prepared or were not properly supported. Primarily, the vouchers and supporting documentation did not (1) explain why the transactions were processed or (2) support the transaction amount. While the absence of adequate explanation and support creates an internal control issue, it does not necessarily mean that the entries were invalid or erroneous. (Air Force Audit Agency (AFAA) Project 01053009, *Revenue and Other Financing Sources-Journal Vouchers and Adjustments*) The DoD Inspector General reviewed additional DFAS-DE accounting transactions and reported similar preparation and support problems in Draft Report of Audit D2001-0014, *Compilation of Fiscal Year 2000 Financial Statements for the Department of the Air Force and Other Defense Organizations*.

a. Departmental Adjustments and Entries. In reviews of 861 DFAS field organization adjustments and 16 DFAS-DE entries requiring journal vouchers

(valued at \$2.2 billion), 39 adjustments and 10 vouchered entries (valued at \$1.3 billion) were not adequately prepared or supported.

b. Disbursement and Collection Journal Vouchers. In reviews of 296 DFAS field organization disbursement journal vouchers (valued at \$1.9 billion) and 124 DFAS field organization collection journal vouchers (valued at \$66 million), approximately 46 percent and 48 percent, respectively, were inadequate. Specifically, 136 disbursement vouchers (valued at \$325 million) and 60 collection vouchers (valued at \$22 million) were not adequately prepared or supported.

## **ELECTRONIC COMMERCE INITIATIVES**

As part of a Deputy Secretary of Defense department-wide initiative to expand use of new technologies, improve business practices, and progress toward paperless contracting, the DFAS is participating in a series of electronic commerce initiatives to support DoD agencies. These initiatives include Electronic Document Access (shared documents across DoD using the Internet), Electronic Data Interchange (computer-to-computer exchange of business information in a standard format), and Electronic Document Management (imaging to eliminate reliance on paper versions of documents such as invoices). Because these initiatives do not entail use of hard-copy, original source documentation, the possibility of fraudulent or erroneous information entering accounting systems without being detected increases. During FYs 2000 and 2001, the DoD Inspector General reviewed the electronic commerce initiatives and concluded system security controls were insufficient and did not provide reasonable assurance that electronically transmitted data were secure. (DoDIG Report D-2001-029, *General Controls Over the Electronic Document Access System*, 27 December 2000; DoDIG Draft Report, D2000FG-0057.01, *Controls for the Electronic Data Interchange at the Defense Finance and Accounting Service Columbus*, and DoDIG Draft Report D2000FG-0057.02, *Controls Over Electronic Document Management*)

## **OBLIGATIONS**

The process for reporting obligated balances was subject to material weaknesses because transaction records were unavailable and internal controls did not ensure proper matching of disbursements with related obligations. (AFAA Project 00053007, *Revenue and Other Financing Sources – Obligated Balances, Fiscal Year 2000*)

a. Obligations Incurred and Recoveries of Prior-Year Obligations. The DFAS accounting systems did not maintain individual transaction records of Air Force obligations incurred and recoveries of prior-year obligations. Rather, the systems

calculated totals for these types of transactions based on net changes in obligated balances during the period. As a result, specific transaction records were not available for audit. Moreover, obligations incurred and recoveries of prior-year obligations included on the Statement of Budgetary Resources (\$88.2 billion and \$1.5 billion, respectively) could be materially misstated because DFAS accounting systems ignored individual increases and decreases that may have contributed to calculated net changes in obligations.

b. Matching Disbursements to Obligations. The DFAS internal controls did not ensure proper matching of disbursements with related obligations, resulting in \$60.8 million of negative unliquidated obligations in the accounting systems. Through electronic commerce initiatives and prevalidation of disbursements, DFAS and Air Force officials continued work in FY 2000 to resolve this long-standing internal control issue. These efforts have reduced negative amounts more than 85 percent, from \$434.2 million, since FY 1997.

## **PERFORMANCE MEASURES**

Our limited review of internal controls related to performance measures, reported in the Management Discussion and Analysis section of the principal statements, did not identify any control weaknesses. Because we only obtained an understanding of the sources and controls related to performance measures, our work was not intended to determine whether controls were in place and working as designed. However, we concluded the information presented in the Management Discussion and Analysis section was materially consistent with the financial statements and footnotes.

## **REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS**

Air Force management is responsible for complying with applicable laws and regulations. Issues that should concern management include compliance with laws and regulations pertaining to the objectives of Air Force General Fund programs and the activities, functions, and manner in which programs and services are delivered. Material instances of non-compliance are failures to follow requirements or violations of prohibitions contained in laws or regulations that cause us to conclude the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause others to perceive the misstatements as significant.

As part of obtaining reasonable assurance that financial statements are free of material misstatement, we tested Air Force compliance with certain laws and regulations where noncompliance could have a direct and material effect on

financial statement amounts, to include requirements contained in the Federal Financial Management Improvement Act (FFMIA) and Federal Managers' Financial Integrity Act (FMFIA). We concluded Air Force and DFAS systems and controls did not achieve full compliance with applicable laws and regulations that could have a direct and material effect on the FY 2000 Air Force financial statements. We considered noncompliance issues discussed below in forming our opinion on the financial statements. These weaknesses, along with recommended corrective actions and time frames for corrective actions, are described in cited supporting audit reports. Our audit objectives did not include providing a separate opinion on overall compliance with laws and regulations and, accordingly, we do not express such an opinion.

#### **FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT**

The FFMIA requires report disclosure on whether Air Force financial management systems substantially comply with federal financial management system requirements, federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Our audit tests disclosed instances where Air Force or DFAS systems did not substantially comply with the three FFMIA requirements.

a. Federal Financial Management System Requirements. In FY 2000, we reported that general and application controls related to seven Air Force- and six DFAS-operated systems were deficient in at least one control category. The more significant weaknesses identified and the number of deficient systems were: access controls (9); completeness (7); documentation, audit trails, and transaction controls (6) each; separation of duties (5); and accreditation and configuration management (4 each). We also identified and recommended that the Air Force add two feeder systems, three budget systems, and a budget system under development to the inventory of critical financial systems. (AFAA Report of Audit 99054038, *General Fund Financial System Reviews*, 4 August 2000)

b. Federal Accounting Standards. Air Force management acknowledged in FY 2000 that its financial management systems did not allow substantial compliance with federal accounting standards. Specifically, financial statement footnotes disclosed the following areas of noncompliance. The Air Force did not (1) use the correct basis to value material and equipment; (2) recognize gains and losses on disposal of general property, plant, and equipment; (3) recognize holding gains and losses related to operating materials and supplies revaluation; or (4) use the consumption method of accounting for operating materials and supplies. Further, government furnished material and contractor acquired material in the possession of contractors was not included in operating materials and supplies. In addition,

intragovernmental transactions could not be accurately identified by customer, trading partner data were not captured at the transaction level to facilitate trading partner aggregations and reconciliation of transactions, and canceled-year appropriation balances for accounts receivable and payable were not reliable. Additional, substantial departures from federal accounting standards that existed during FY 2000 are described below:

(1) Consumption Accounting. Air Force logistics organizations did not implement the consumption method of accounting to recognize all inventory and related property expenses, as required by Statement of Federal Financial Accounting Standard (SFFAS) Number 3, *Accounting for Inventory and Related Property*, 27 October 1993. This departure occurred because information systems were designed for inventory control and not for financial accounting. The Air Force reached agreement with OMB, GAO, and the DoD Inspector General to move in future years toward consumption accounting for operating materials and supplies and determined that the moving average cost method will be used to value operating materials and supplies. As previously stated under Management Actions above, a study is underway to identify a consumption accounting system, and implementation is expected to take 2 years.

(2) Cost Accounting. The Air Force and DFAS were unable to prepare the Statement of Net Cost in full conformance with SFFAS Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, 31 July 1995. The Air Force was unable to accumulate costs for major programs based on performance measures identified under the requirements of the *Government Performance and Results Act of 1993* because the financial processes and systems in use were not designed to collect and report this type of cost information. Deviations from the standard occurred in the areas of reporting program costs and reporting by responsibility segments. The Air Force is reviewing available data and attempting to develop a cost reporting methodology. We advised the DoD Inspector General of this issue because it affects all DoD components.

(3) Statement of Budgetary Resources. The DFAS was unable to prepare the Statement of Budgetary Resources in full conformance with SFFAS Number 7, *Accounting for Revenue and Other Financing Sources*, 10 May 1996. As covered in the earlier section on internal controls, accounting system deficiencies did not provide or capture data needed to calculate obligations incurred and recoveries of prior year obligations in accordance with OMB Circular A-34, Instructions on Budget Execution, October 1999. The DFAS is developing an electronic database that will produce a monthly Supplemental Data Base Transfer Report that should provide obligations incurred and recoveries of prior-year obligation amounts.

(AFAA Project 01053007, *Revenue and Other Financing Sources-Obligated Balances*, Fiscal Year 2000)

c. U.S. Government Standard General Ledger at the Transaction Level. As disclosed in the financial statement footnotes, DFAS managers had not implemented the U.S. Government Standard General Ledger. Lacking a transaction-driven general ledger process, managers extracted data from multiple automated and manual systems, many of which were outside the accounting and finance network, to derive account balances. This process significantly increased the potential for account balance misstatements.

#### **FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT**

Air Force management acknowledged in the FY 2000 Statement of Assurance and in the Management Discussion and Analysis section of the financial statements that Air Force systems do not fully comply with federal financial management system requirements. The Annual Report on the Department of the Air Force Critical Financial Management Systems for Fiscal Year 2000, included in the Statement of Assurance, identified 42 systems that provide significant information to accounting systems producing financial reports. Both of these documents describe actions underway to bring systems into conformance with requirements. Because the FY 2000 DoD Financial Management Improvement Plan was not yet published, we could not confirm that all system deficiencies were reported, along with remediation plans. We did confirm, however, material control weaknesses disclosed in our audit reports were reported in Air Force, DFAS-DE, or the DFAS FY 2000 Statements of Assurance.

#### **OBJECTIVE, SCOPE, AND METHODOLOGY**

Management responsibilities are to:

- Prepare the annual financial statements in conformity with applicable accounting principles.
- Establish and maintain internal controls and systems to provide reasonable assurance that the broad control objectives of the FMFIA are met.
- Implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

- Comply with other applicable laws and regulations.

AFAA responsibilities are to:

- Plan and perform an audit to obtain reasonable assurance about whether the principal financial statements are reliable (free of material misstatement) and presented fairly in conformity with OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, and applicable accounting principles.
- Obtain reasonable assurance about whether relevant management internal controls are in place and operating effectively.
- Test management compliance with selected provisions of laws and regulations and perform limited procedures to test the consistency of other information presented with the financial statements.

To fulfill these responsibilities, we:

- Examined, on a test basis, evidence supporting the amounts and disclosures in the principal financial statements.
- Assessed the accounting principles used and significant estimates made by management.
- Evaluated the overall presentation of the financial statements.
- Tested compliance with selected provisions of laws and regulations.
- Obtained an understanding of the design of internal controls, determined whether they had been placed in operation, assessed control risk, and obtained sufficient evidence from our tests to support our assessment of internal controls.
- Performed the procedures described in the Codification of Statements on Auditing Standards, AU Section 558, *Required Supplementary Information*, as they apply to the reporting of deferred maintenance.
- Selectively tested evidence supporting additions, deletions, and disclosures in the Required Supplementary Stewardship Information.

- Followed up on previously reported deficiencies.

In reviewing the Air Force consolidated financial statements, we evaluated internal controls to determine the reliability of financial and performance reporting related to the principal statements, accompanying footnotes, and the Overview of the Reporting Entity, including performance measures. In the area of financial reporting, we determined whether Air Force and DFAS personnel properly recorded, processed, and summarized transactions to permit financial statement preparation in accordance with federal accounting standards. We also (1) evaluated the safeguarding of assets against loss from unauthorized acquisition, use, or disposition; (2) obtained an understanding of the design of internal controls; (3) determined whether the controls were in operation; (4) assessed control risk; and (5) tested the controls.

With respect to information in the Overview of the Reporting Entity, we determined whether the information presented was materially consistent with the information presented in the principal statements and accompanying footnotes. In the area of performance measures, we determined whether Air Force personnel properly recorded, processed, and summarized transactions and other data that support performance measures included in the overview accompanying the Air Force consolidated financial statements. We obtained an understanding of the design of internal controls related to the existence and completeness assertions.

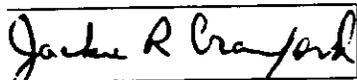
We accomplished the audit at the Office of the Assistant Secretary of the Air Force, Financial Management and Comptroller; DFAS locations (DFAS centers and DFAS field organizations); HQ Air Force Materiel Command; and Air Force active duty units. Specific locations are listed in the individual audit reports. We completed audit fieldwork in December 2000 and provided a draft report to management in January 2001.

## **SUMMARY OF PRIOR AUDIT COVERAGE**

The GAO, DoD Inspector General, and the AFAA have conducted multiple reviews related to financial management issues. Last year, we issued a disclaimer on the FY 1999 Air Force consolidated financial statements. The

GAO reports can be accessed over the Internet at <http://www.gao.gov>; DoD Inspector General reports, at <http://www.dodig.osd.mil>; and AFAA reports, at <http://www.afaa.hq.af.mil>.

We appreciate the cooperation and courtesies extended to our auditors.

A handwritten signature in cursive script, enclosed in a rectangular box. The signature reads "Jackie R Crawford".

JACKIE R. CRAWFORD  
The Auditor General

## **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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