

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**DEFENSE FINANCE AND ACCOUNTING SERVICE
WORK ON THE AIR FORCE FY 1993 FINANCIAL
STATEMENTS**

Report No. 95-067

December 30, 1994

Department of Defense

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Acronyms

AFAA	Air Force Audit Agency
AFR	Air Force Regulation
CFO	Chief Financial Officers
DAO	Defense Accounting Office
DFAS	Defense Finance and Accounting Service
FMR	Financial Management Regulation
FMS	Foreign Military Sales
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget



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



December 30, 1994

MEMORANDUM FOR: DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements (Report No. 95-067)

We are providing this final report for your review and comments. The audit was made as part of the audits required by the Chief Financial Officers Act of 1990 and addressed systemic issues that bear on the reliability of future financial statements and reports. In preparing the final report, we considered your comments on the draft report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that you provide comments on the unresolved recommendation by February 28, 1995. See the chart at the end of Finding A for the specific requirements for your comments. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment.

The courtesies extended to the audit staff are appreciated. If you have questions about this audit, please contact Mr. David C. Funk, Audit Program Director, at (303) 676-7445 (DSN 926-7445) or Mr. Thomas J. Winter, Audit Project Manager, at (303) 676-7416 (DSN 926-7416). Copies of the report will be distributed to the activities listed in Appendix D. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Audit Report No. 95-067
(Project No. 3FD-2040)

December 30, 1994

DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE AIR FORCE FY 1993 FINANCIAL STATEMENTS

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires the Inspector General (IG), DoD, or an independent auditor appointed by the IG, DoD, to audit the financial statements of DoD activities. The IG, DoD, delegated the audit of the Air Force's FY 1993 financial statements to the Air Force Audit Agency (AFAA). To assist the AFAA, the IG, DoD, did audit work at the Defense Finance and Accounting Service (DFAS) Denver Center (DFAS Denver Center). Local Defense Accounting Offices and Air Force offices maintain base records and report the results to the DFAS Denver Center. The DFAS Denver Center maintains the Air Force's department-level accounting records and prepares the Air Force's financial statements. Over \$327.5 billion in assets and approximately \$77.8 billion of available appropriations were reported on the Air Force's financial statements for FY 1993. The AFAA disclaimed an opinion on the overall financial statements for FYs 1992 and 1993 because of inadequate accounting systems and uncertainties in the amounts reported.

Objective. The overall objective of the audit was to determine the fairness, accuracy, completeness, and reliability of the DFAS Denver Center's consolidation of Air Force financial data and preparation of the Air Force's financial statements for FY 1993. As part of the audit, we examined associated internal controls and compliance with existing laws and regulations.

Audit Results. The DFAS Denver Center may not have prepared fair, complete, accurate, and reliable FY 1993 financial statements for the Air Force. Our specific findings follow.

- o The DFAS Denver Center did not adequately monitor U.S. Treasury clearing accounts. Reconciliations were not performed for differences totaling \$67.4 million, clearing accounts were not maintained for contract payments, old clearing account balances were not adequately monitored, and directives did not require DFAS Denver Center oversight of clearing accounts. As a result, clearing accounts were inaccurate and financial statement expenses could be materially misstated. Also, because of unresolved old clearing account balances, Defense Accounting Offices could lose their authority to disburse previously appropriated funds (Finding A).

- o Accounts Payable and Accounts Receivable contained material errors. A transaction that was not made with Air Force funds was included in the financial statements, causing Accounts Receivable-Public and Accounts Payable-Federal to be overstated by \$605 million each. Computational errors resulted in an understatement of Accounts Payable-Public and an overstatement of Accounts Payable-Federal by \$787 million each. As a result, the Air Force's draft Statement of Financial Position was inaccurate. Management corrected the computational errors before final release of the financial statements (Finding B).

Internal Controls. The audit identified material internal control weaknesses. Specifically, internal controls at the DFAS Denver Center were not adequate to monitor U.S. Treasury clearing accounts (Finding A). Part I of this report discusses the internal controls we reviewed. To comply with Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, we evaluated the DFAS Denver Center's process for implementing the DoD Internal Management Control Program. The process was in place, but internal control weaknesses existed that had not been formally reported.

Potential Benefits of Audit. The recommendations in this report, if implemented, will improve both compliance with regulations and the accuracy of Air Force financial statements. Improved oversight and timely resolution of clearing account items will allow for earlier and more appropriate use of available funds; however, we could not quantify the monetary benefits. Fiscal responsibility should improve when the DFAS Denver Center establishes adequate internal controls over the current nonintegrated financial systems, and implements a transaction-driven general ledger that complies with DoD Manual 7720.9-M, "DoD Accounting Manual." These actions are contained in DFAS Plan 3000.1, "Defense Finance and Accounting Service (DFAS) Business Plan," March 1994. See Appendix B for the details of all potential benefits resulting from the audit.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service, establish policies and procedures to monitor U.S. Treasury clearing accounts for Air Force funds, and improve the processes used to compile and compute the amounts reported on financial statements.

Management Comments. Management either concurred or concurred in principle with all recommendations. Management agreed to establish policies and procedures to monitor U.S. Treasury clearing accounts, and to improve the processes used to compile and compute the amounts shown on financial statements. The unresolved portion of Recommendation A.1. involves reconciling one of the four clearing accounts. See Part II for a full discussion of management's responses, and Part IV for the full text of management's comments.

Audit Response. Management's comments were responsive to most recommendations in the draft report. We are requesting additional comments on using detailed data from U.S. Treasury that will allow a reconciliation of one of the clearing accounts. We also clarified several statements based on input from management. Although the DFAS Denver Center has made all recommended adjustments, the nonintegrated systems that it uses cannot be relied on to generate accurate accounting data. We request that DFAS respond to the unresolved recommendation by February 28, 1995.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Introduction

Background

Public Law 101-576, the Chief Financial Officers Act of 1990 (the CFO Act), requires the annual preparation and audit of Government financial statements for trust funds, revolving funds, and substantial commercial activities of 23 executive departments and agencies, as well as Government corporations. For designated organizations, including the Air Force, the CFO Act also requires pilot audits and preparation of organization-wide financial statements for FY 1992. The Inspectors General, or appointed external auditors, are required to audit the financial statements in accordance with generally accepted Government auditing standards and Office of Management and Budget (OMB) standards. The Inspector General (IG), DoD, delegated the audit of the Air Force's FY 1993 financial statements, including expressing the opinion, to the Air Force Audit Agency (AFAA). To assist the AFAA, the IG, DoD, did audit work at the Defense Finance and Accounting Service (DFAS) Denver Center.

In FY 1993, the Air Force reported resources valued at about \$327.5 billion and received about \$77.8 billion in appropriations. As of September 30, 1993, the Air Force reported \$228.2 billion in property, plant, and equipment.

In January 1991, the finance and accounting centers of the Military Departments and Defense agencies were combined into DFAS. DFAS established centers at Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; Kansas City, Missouri; and Washington, D.C. A goal of the reorganization was to standardize, consolidate, and improve finance and accounting systems and operations throughout DoD.

The DFAS Denver Center is responsible for providing timely, accurate, and meaningful financial information to the Air Force, and is the focal point for the CFO Act as it pertains to the Air Force. The DFAS Denver Center maintains Air Force department-level records and prepares financial statements from data submitted by Air Force field activities. In FY 1993, the DFAS Denver Center also made payments of \$20 billion to active duty and Reserve Air Force personnel, and maintained billing and collection functions for the \$2.1 billion in receivables recorded in the Air Force's Departmental Debt Management System.

Objective

The overall objective of this IG, DoD, audit was to determine whether the DFAS Denver Center prepared fair, complete, accurate, and reliable FY 1993 financial statements for the Air Force. We reviewed and tested the internal controls and methods that the DFAS Denver Center used to

consolidate and prepare the Air Force financial statements. We determined whether the DFAS Denver Center complied with existing laws and regulations and accounting principles.

Scope and Methodology

We performed this financial-related audit at the DFAS Denver Center during the period June 1993 through May 1994. Our audit assisted AFAA in attempting to opine on the Air Force's FY 1993 financial statements. To assess compliance with DoD accounting policies, General Accounting Office (GAO) standards, and OMB guidance, we reviewed documents supporting the FY 1993 financial statements. Those documents included the Air Force's consolidated trial balance, the Report on Budget Execution, and various adjustments that the DFAS Denver Center made to the statements. The data used to support those documents were computer-processed; we determined that the data were unreliable because the reconciliations needed for a nonintegrated system were not performed. This deficiency had been identified in previous audit reports, and DFAS is taking corrective actions. We also evaluated selected line-item amounts and related adjustments on the Statement of Financial Position and the Statement of Operations, including associated footnotes. We did not use statistical sampling procedures to conduct this audit. Our audit was primarily performed at the DFAS Denver Center; we also met with or contacted other organizations that affect the financial statements. Those organizations are listed in Appendix C.

Limitations. We evaluated the DFAS Denver Center's procedures for preparing the Statement of Financial Position and the Statement of Operations. We did not review the procedures used by the DFAS Denver Center to prepare the Statement of Cash Flows or the Statement of Budget and Actual Expenses. In addition, we did not evaluate the accuracy of data provided by outside sources.

The objective of our audit was to evaluate whether the DFAS Denver Center fulfilled its responsibilities for preparing the Air Force financial statements. Accordingly, we did not express an opinion on the financial statements. AFAA disclaimed an opinion on the Air Force financial statements in its Report No. 94053022, "Opinion on Fiscal Year 1993 Air Force Consolidated Financial Statements," June 30, 1994.

Auditing Standards. We performed the audit in accordance with auditing standards established by the Comptroller General, as implemented by the IG, DoD, and in accordance with OMB guidance. Accordingly, we included such tests of internal controls and management's compliance with laws and regulations as we considered necessary.

Internal Controls

The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. To comply with OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, we evaluated the DFAS Denver Center's process for implementing the DoD Internal Management Control Program. We found that the program was in place, but significant internal control weaknesses had not been reported. The clearing account weaknesses (Finding A) were not reported in the DFAS Denver Center's Annual Statement of Assurance, required by DoD Directive 5010.38, for the year ended September 30, 1993. Those weaknesses were not reported because DFAS Denver Center managers did not consider them to be material. We disagree with their assessment of materiality; we consider the weaknesses to be material because of their sensitive nature and the potential for loss of funds. DFAS commented on the draft report and agreed to include the clearing account weaknesses in its Annual Statement of Assurance for FY 1994. The lack of a transaction-driven general ledger, which management reported as a material weakness, was the primary cause of the errors in manual computations that are discussed in Finding B of this report. The lack of a transaction-driven general ledger had been previously reported in an IG, DoD, audit of the DFAS Denver Center. See Part II of this report for further information on the internal controls reviewed and specific internal control weaknesses.

Improved oversight and timely resolution of clearing account items will allow earlier and more appropriate use of available funds. However, we could not quantify the monetary benefits resulting from the audit. Other potential benefits of this audit are detailed in Appendix B, "Summary of Potential Benefits Resulting From Audit." A copy of this report will be provided to the senior DFAS official responsible for internal controls.

Prior Audits and Other Reviews

The GAO issued a report in 1990 on the Air Force financial statements for FY 1988, and another report in 1992 on the Air Force financial statements for FY 1989. The IG, DoD, has recently performed seven financial audits. The AFAA also performed 30 audits of the Air Force's financial statements for FYs 1992 and 1993. The audits listed below apply specifically to this report. Appendix A lists the titles of related audit reports.

GAO Audits. GAO Report No. AFMD-90-23 (OSD Case No. 8193-A), "Air Force Does Not Effectively Account for Billions of Dollars of Resources," was issued in February 1990. The principal findings were that financial systems did not provide reliable financial data, basic internal control weaknesses existed, the full costs of weapon systems were not identified, and inventory systems did not provide accurate data. The Under Secretary of Defense (Comptroller) concurred with the report's 26 recommendations. Recommendations were made

for the Air Force to make better use of existing financial information, develop more accurate financial information, perform reconciliations and document adjustments, account for the costs of weapon systems, achieve financial management of inventories, and develop a new accounting system. To date, the Air Force has made limited progress in correcting deficiencies in its financial management systems. The reason for the Air Force's limited progress is that DoD has emphasized long-term efforts to improve and standardize its financial management operations, and the benefits of those efforts will not be realized for several years. The DFAS Denver Center has expended significant resources to improve financial reporting during FY 1992. For example, the DFAS Denver Center trained more than 400 Air Force personnel on the requirements of the CFO Act, and developed a pamphlet for self-paced training on the general ledger. During FY 1993, the DFAS Denver Center worked with DFAS Headquarters to improve the Denver Center's financial management system. The DFAS Denver Center plans to spend more than \$100 million on the Interim Migratory Accounting System, which should correct deficiencies mentioned in CFO audit reports and improve other weaknesses. The Interim Migratory Accounting System is currently being developed.

GAO Report No. AFMD-92-12 (OSD Case No. 8376-L), "Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act," was issued in February 1992. The report's principal findings were that financial systems were nonintegrated and generated unreliable information; the reported costs of weapon systems were unreliable; accounting and controls over Air Logistics Command inventories were inadequate; internal accounting controls were inadequate; and short-term actions were needed to improve the quality of financial data and allow completion of a financial statement audit. GAO Report No. AFMD-92-12 reaffirmed the 26 recommendations in the GAO's February 1990 report, and made additional recommendations to improve management's accountability, strengthen internal controls, improve the quality of financial information, and assist the Air Force in meeting the objectives of the CFO Act.

IG, DoD, Audits. IG, DoD, Audit Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994, reported that the DFAS Denver Center did not prepare complete, accurate, and reliable FY 1992 financial statements for the Air Force. Most of the financial information came from nonintegrated management systems that were not designed as accounting systems. As a result, the financial statements were unreliable. This condition existed during the FY 1993 audit, and we expect it to continue for several years.

The IG, DoD, issued Audit Report No. 93-123, "Consolidating Financial Statements of the Foreign Military Sales Trust Fund - FY 1992," on June 24, 1993. The IG, DoD, expressed an adverse opinion because the Foreign Military Sales (FMS) Trust Fund financial statements did not report revenues, expenses, and equity. Report No. 93-123 is related to the problem of reporting FMS transactions, which is also discussed in Finding B of this report.

Introduction

AFAA Audits. The AFAA performed two audits on the consolidated Air Force financial statements for FYs 1992 and 1993. In support of the consolidated financial statement audits, the AFAA also conducted 16 audits on FY 1992 general fund data and 12 audits on FY 1993 general fund data. Those audits were performed concurrently with our audit. Appendix A lists the titles of the AFAA reports.

In its final report on Project No. 94053022, "Opinion on Fiscal Year 1993 Air Force Consolidated Financial Statements," June 30, 1994, the AFAA disclaimed an opinion on the Air Force's consolidated financial statements for FY 1993. The disclaimer was issued because of material uncertainties related to the reasonableness of amounts reported in the financial statements; the uncertainties were caused by the inadequate Air Force accounting systems. The AFAA also found that the conditions reported in FY 1992 still exist. Those conditions are:

- o lack of a transaction-driven general ledger;
- o inability of the accounting systems to produce auditable financial statements;
- o failure to use acquisition costs for all assets;
- o inaccurate reporting of equipment, inventories, and real property;
- o questionable account balances for disbursements and collections; and
- o underestimation of contingent liabilities.

Part II - Findings and Recommendations

Finding A. U.S. Treasury Clearing Accounts

The DFAS Denver Center did not adequately monitor U.S. Treasury clearing accounts. This condition existed because the DFAS Denver Center:

- o did not perform reconciliations for differences that totaled \$67.4 million as of September 30, 1993;
- o did not take sufficient actions to maintain clearing accounts related to contract payments;
- o did not adequately monitor old clearing account balances; and
- o did not have written procedures for oversight of clearing accounts.

As a result, unreconciled clearing accounts may distort expenses on the financial statements; undetected fraud may occur; and unresolved old clearing account balances may cause the loss of authority to disburse appropriated funds.

Background

Clearing Account Procedures. The U.S. Treasury established budget clearing accounts as temporary holding accounts for collections or disbursements until they can be posted to the appropriate receipt or expenditure account. The "Deposits in Transit Differences" account (3878) is used to record deposit discrepancies that have not been resolved and have aged 6 months or more. To identify these discrepancies, the U.S. Treasury compares deposits received by financial institutions to deposits reported by the Air Force. The U.S. Treasury then notifies the DFAS Denver Center of the differences. The "Unavailable Check Cancellations and Overpayments (Suspense)" account (3880) is charged for the amount of replacement checks issued until the U.S. Treasury provides a credit by notifying the DFAS Denver Center. Buyers and sellers use the "Undistributed Intergovernmental Payments" account (3885) when assistance from the DFAS Denver Center is needed to solve problems with interfund billing system transactions. The "Budget Clearing Account (Suspense)" (3875) is used by Defense Accounting Offices (DAOs) for miscellaneous receipts that are not immediately identified with specific appropriations. To prevent the loss of authority to disburse appropriated funds, the DAOs are required to take prompt action to identify and properly account for clearing account transactions.

Criteria. The Air Force's criteria and guidance for controlling and managing budget clearing accounts are found in Air Force Regulation (AFR) 177-101, "General Accounting and Finance Systems at Base Level," February 15, 1991,

and AFR 177-108, "Paying and Collecting Transactions at Base Level," May 31, 1991. AFR 177-101 requires accounting and finance officers to certify budget clearing account balances semiannually as of March 31 and September 30. Certifications should be attached to the Consolidated General Ledger Trial Balance (Report Control Symbol HAF-ACF [SA] 7105), and bases should forward the certifications to the DFAS Denver Center for consolidation. In the future, DoD Financial Management Regulations (FMRs) will replace AFRs and directives. The DoD FMR, Volume 5, "Disbursing Policy and Procedures," May 3, 1993, contains guidance for clearing accounts 3878 and 3880. The Air Force directives and the final draft of the DoD FMR, Volume 5, did not require the DFAS Denver Center to oversee clearing accounts. Specifically, the guidance did not require the DFAS Denver Center to maintain accurate clearing account balances, to reconcile departmental balances to the DAOs' and the U.S. Treasury's balances, or to identify old accounts to the DAOs for prompt resolution. The DFAS Denver Center was not required to properly monitor clearing accounts, which contributed to other problems discussed in this report.

Scope. We reviewed the procedures used by the DFAS Denver Center to monitor clearing accounts 3878, 3880, 3885, and 3875. We reviewed these four accounts because of their high dollar value and because prior audits by the GAO, and the AFAA's discussions with the U.S. Treasury, identified them as being susceptible to fraud or misuse. We did not use statistical sampling to evaluate the four clearing accounts. Specifically, we determined whether the DFAS Denver Center:

- o performed reconciliations between departmental, base-level, and U.S. Treasury balances;
- o provided the DFAS Columbus Center with the data necessary to maintain contract payments; and
- o notified Air Force bases when old clearing account balances required resolution.

We also determined whether current regulations required the DFAS Denver Center to maintain oversight of clearing accounts. Oversight would include performing reconciliations and notifying base-level DAOs of problems that require prompt resolution.

Reconciliation of Clearing Accounts

The DFAS Denver Center did not reconcile the four clearing accounts to base-level account balances as of September 30, 1993. Also, the DFAS Denver Center did not reconcile clearing account 3885 to the U.S. Treasury balance. This occurred because directives did not require reconciliations and none were performed. Also, for clearing accounts 3885 and 3875, the DFAS Denver Center did not provide copies of the semiannual certifications to the employees

Finding A. U.S. Treasury Clearing Accounts

responsible for the accounts, although base-level DAOs sent the certifications to the DFAS Denver Center. The DFAS Denver Center did not perform reconciliations, although significant differences existed between its own records and those maintained at base level and by the U.S. Treasury. Consequently, the DFAS Denver Center did not know the correct balances in the clearing accounts.

Table 1. shows base-certified amounts for clearing accounts 3878 and 3880, DFAS Denver Center amounts for clearing accounts 3885 and 3875, and the absolute differences between these amounts and U.S. Treasury balances as of September 30, 1993.

Table 1. Amounts in Clearing Accounts as of September 30, 1993
(\$ in Millions)

<u>Account</u>	<u>Amounts Shown by:</u>		<u>Absolute Differences</u>
	<u>Base/DFAS</u>	<u>U.S. Treasury</u>	
3878	\$ 0.4 (Base)	\$ 14.8	\$14.4
3880	51.5 (Base)	81.7	30.2
3885	81.0 (DFAS)	103.6	22.6
3875	50.0 (DFAS)	49.8	<u>0.2</u>
Total Absolute Differences			\$67.4

Clearing Accounts for Contract Payments

The DFAS Columbus Center did not adequately maintain the four clearing accounts for Air Force contract payments. This condition existed because the DFAS Denver Center did not send applicable U.S. Treasury clearing account transactions to the DFAS Columbus Center, an action that is necessary in order to maintain clearing accounts. Also, the DFAS Columbus Center did not maintain clearing accounts or send the DFAS Denver Center the required clearing account certifications. Personnel at the DFAS Denver Center could not provide estimated dollar amounts for these clearing accounts. They told us that this problem had been previously addressed, but had not been resolved because they expected future FMRs to provide appropriate guidance. This condition prevented the DFAS Denver Center from performing reconciliations between Air Force department-level, U.S. Treasury, and base-level balances. As a result, expenses reported on the financial statements may be inaccurate. By failing to promptly reconcile clearing accounts for contract payments, and making large write-offs instead, DFAS could allow improper payments to go undetected.

Old Clearing Account Balances

The DFAS Denver Center was not taking adequate actions to resolve old clearing account balances at the DAOs. The DFAS Denver Center prepared aging analysis reports for clearing accounts 3878, 3880, and 3885. Also, for clearing accounts 3878 and 3880, the DFAS Denver Center regularly sent letters to the Air Force major commands regarding old accounts and other problems. However, during FY 1993, the DFAS Denver Center directed 40 bases to write off, without adequate documentation, \$1.4 million from clearing accounts 3878 and 3880. These funds were written off against the 3400 appropriation for merged ("M") years. This indicated that the DAOs and DFAS Denver Center were not promptly resolving clearing account balances at bases. Also, as of September 30, 1993, clearing account 3885 (\$81 million) included \$18 million (over 20 percent) that was more than 1 year old, and \$50.4 million (over 60 percent) that was 7 to 11 months old. During the audit, the DFAS Denver Center made plans to identify and visit bases where clearing account 3885 balances were more than 120 days old. AFR 177-101 states that if transactions in clearing account 3885 are not resolved within 1 year, the DAOs will normally write off appropriated funds for previous payments. When this occurs, materials previously ordered cannot be delivered. DAOs should be more aggressive in resolving clearing account items before they become 1 year old.

Conclusion

The DFAS Denver Center did not adequately monitor clearing accounts maintained at the DAOs. Specifically, reconciliations were not performed between Air Force department-level clearing account balances, balances certified at base level by the DAOs, and U.S. Treasury balances. Because the DFAS Denver Center did not exercise oversight, the DFAS Columbus Center did not have the data needed to maintain adequate clearing accounts for contract payments and receipts. The DFAS Denver Center did not adequately monitor old clearing account balances to prevent the DAOs from losing authority to disburse available appropriated funds for clearing account items. Also, the DFAS Denver Center did not issue guidance for the proper oversight of clearing accounts. Proper oversight would include maintaining accurate balances in clearing accounts, sending U.S. Treasury transactions to the DAOs, performing reconciliations, monitoring old balances, and notifying the DAOs about old account balances. Consequently, clearing account balances were not accurate, which may result in distorted financial statements and may cause the DAOs to lose their authority to disburse available appropriated funds. Also, undetected fraud could occur if contract payments are not promptly reconciled, and duplicate payments could result from issuing replacement checks.

Recommendations, Management Comments, and Audit Response

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

1. Perform semiannual reconciliations between Air Force department-level clearing account balances, base-level certified balances, and U.S. Treasury balances.

Management Comments. Management concurred in principle with the recommendation and stated that base-level accounts 3878 and 3880 are reconciled to departmental and Treasury balances. Treasury data are not sufficiently detailed to allow reconciliation of account 3885. The DFAS Denver Center is developing procedures to reconcile account 3875 to Treasury balances. The estimated completion date for this action is September 30, 1995.

Audit Response. Management's comments were responsive for accounts 3878, 3880, and 3875, but we request further explanation for account 3885. We agree that without adequate information about the balances in account 3885, reconciliation is not feasible. We ask that the DFAS Denver Center contact the U.S. Treasury to obtain the information needed to reconcile account 3885, or a further explanation as to why the information cannot be provided. We request that the results of discussions with the U.S. Treasury be provided to us in your final management comments.

2. Distribute semiannual certifications of clearing accounts to all personnel at the Defense Finance and Accounting Service Denver Center who are responsible for monitoring clearing accounts.

Management Comments. Management concurred in principle with the recommendation, stating that the DFAS Denver Center's Accounting and Reporting Division receives the semiannual certifications for deposit funds and certifications for accounts 3875, 3878, and 3880, and reconciles accounts 3878 and 3880 to cumulative balances in the department-level Merged Accounting and Fund Reporting system. Certifications for account 3885 are obtained quarterly from the DAOs, and operating accountants use these certifications to monitor accounts over 1 year old. Management considers this recommendation closed.

Audit Response. Management's comments on the recommendation were responsive. In follow-up discussions with personnel at the DFAS Denver Center, we confirmed that account 3875 will be reconciled by the same employee who reconciles the other two accounts.

3. Send U.S. Treasury clearing account transactions to the Defense Finance and Accounting Service Columbus Center, and obtain the required semiannual certifications of clearing accounts from the Defense Finance and Accounting Service Columbus Center.

Finding A. U.S. Treasury Clearing Accounts

Management Comments. Management concurred with the recommendation and stated that the DFAS Columbus Center "does not presently accept by-other payments." The DFAS Denver Center is developing methods to send charges on accounts 3878 and 3880 to the DFAS Columbus Center and to require semiannual certification. The estimated completion date for this corrective action is September 30, 1995.

Audit Response. Management's comments were responsive to the recommendation.

4. Notify Defense Accounting Offices when clearing account balances are over 60 days old and require resolution.

Management Comments. Management concurred in principle with the recommendation. The DFAS Denver Center requested that DoD Financial Management Regulation 7000.14-R be changed to require bases to resolve clearing account items within 1 year. Bases submit aging schedules to major commands on a quarterly basis, and annotations for items over 180 days old are required for the Semiannual Certification of Deposit Fund Balances. The DFAS Denver Center is taking aggressive actions to reduce unmatched deposits before making chargebacks to account 3878. In August 1993, the DFAS Denver Center began building a database to identify chargebacks, by base, for the total cumulative balance. As of February 1994, the balance of unmatched deposits had decreased to \$8.6 million. The estimated completion date for this corrective action is September 30, 1995.

Audit Response. Management's comments were responsive to the recommendation.

5. Issue directives requiring the Defense Finance and Accounting Service Denver Center to oversee clearing accounts. The Defense Finance and Accounting Service Denver Center should:

- (a) maintain accurate balances,
- (b) reconcile Air Force department-level balances to base-level and U.S. Treasury balances,
- (c) send U.S. Treasury transactions to Defense Accounting Offices,
- (d) notify Defense Accounting Offices of clearing account problems that require resolution, and
- (e) provide training to personnel at Defense Accounting Offices.

Management Comments. Management concurred in principle with the recommendation. Accounting Operating Instruction #3 gives accounting procedures for deposits in transit, and Air Force Regulation 177-101, paragraph 27, gives procedures for interfund accounting. The DFAS Denver Center reconciles base-level accounts 3878 and 3880 to Air Force department-level cumulative balances. Every effort is made to maintain accurate base-level

Finding A. U.S. Treasury Clearing Accounts

and departmental balances, to reduce unmatched deposits, and to clear aging accounts. The DFAS Denver Center's Network Assistance Division and staff members at the major commands provide ongoing assistance and training to DAO personnel on clearing accounts. Management considers this recommendation closed.

Audit Response. Management's comments were responsive to the recommendation. Corrective actions taken on this and other recommendations in this report should reduce deficiencies in the clearing account balances.

6. Add clearing accounts to the criteria for management indicators that the Defense Finance and Accounting Service Denver Center, Directorate of Field Operations, uses to evaluate Defense Accounting Offices.

Management Comments. Management concurred with the recommendation and stated that the DAO Network Profile was revised to track the top 10 performance indicators. Performance indicators on the profile include account 3878, Deposits in Transit with Treasury Over 90 Days; account 3880, Replacement Checks Over 90 Days; and account 3885, Interfund Unmatched Buyer and Sellers amounts. Management considers this recommendation closed.

Audit Response. Management's comments were responsive to the recommendation.

See Part IV for the complete text of management's comments on the draft report. Comments on the final report must be received by February 28, 1995. The following chart gives specific requirements for those comments.

Response Requirements for Each Recommendation

Responses to the final report are required from the DFAS Denver Center for the recommendation indicated with an "X" in the chart below.

<u>Number</u>	<u>Response Should Cover:</u>		
	<u>Proposed Action</u>	<u>Completion Date</u>	<u>Related Issues*</u>
1.	X	X	IC

* IC = material internal control weakness.

Finding B. Reporting of Accounts Receivable and Accounts Payable

Accounts Payable and Accounts Receivable on the FY 1993 Air Force financial statements contained material errors. Internal controls over manual computations used to calculate the balances of asset and liability accounts were not sufficient to ensure that only Air Force data were presented in the financial statements. The improper reporting of a Foreign Military Sales (FMS) claim caused Accounts Receivable-Public and Accounts Payable-Federal accounts to be overstated by \$605 million each. Also, a computational error by the DFAS Denver Center caused Accounts Payable-Public to be understated and Accounts Payable-Federal to be overstated by \$787 million each.

Background

Accounting Capabilities. Because the Air Force does not have a transaction-driven general ledger, the DFAS Denver Center must use computer inquiries and secondary reports to perform manual computations that extract individual account balances from the total funded liabilities and total receivables reported by the DAOs. The DFAS Denver Center also manually reviews selected financial data to ensure that all transactions are reported. Previous audits by the IG, DoD, and the GAO have addressed the need to develop a transaction-driven general ledger, and the DFAS Denver Center has initiated the Interim Migratory Accounting System project to resolve this issue.

Reporting FMS Trust Fund Activity. The Air Force often enters into contracts to obtain goods and services on behalf of the FMS program. These goods and services are obtained for delivery to foreign countries. Contractors may be paid from Air Force appropriations, which are reimbursed by the FMS Trust Fund, or directly from FMS Trust Fund appropriations (known as "direct cite"). Generally, FMS contracts paid from Air Force appropriations on a reimbursable basis are recorded in the Air Force's accounting systems, and should be shown on Air Force financial statements. Conversely, FMS contracts paid by direct cite from an FMS Trust Fund appropriation are not recorded in the Air Force's accounting systems, and therefore are not shown on Air Force financial statements.

Computing Payable Accounts. Accounts Payable-Public and Accounts Payable-Federal are derived from the total funded liabilities reported on Treasury Financial Statement Form 2108, "Yearend Closing Statement." Computer inquiries use vendor codes to identify the Form 2108 amounts to be prorated to Accounts Payable-Public and Accounts Payable-Federal. Secondary reports are then used to deduct amounts from the payable accounts; the amounts deducted are reported as separate account balances on the financial statements.

Finding B. Reporting of Accounts Receivable and Accounts Payable

For example, accrued civilian pay is extracted from Accounts Payable-Public, and accrued military pay from Accounts Payable-Federal. These amounts are combined and reported as Accrued Payroll and Benefits on the financial statements. Canceled "M" year payables are also deducted from Accounts Payable-Public, and are included in the financial statements as Other Unfunded Liabilities. Also, intra-Air Force transactions are deducted from Accounts Payable-Federal and are reported in the footnotes to the financial statements. After all necessary deductions are made, the balances remaining in the payable accounts are reported as Accounts Payable-Public and Accounts Payable-Federal.

Reporting FMS Transactions

The DFAS Denver Center overstated Accounts Receivable-Public and Accounts Payable-Federal in the financial statements dated March 7, 1994, by including a claim (a receivable) against a contractor on an FMS direct cite contract, and reporting a corresponding payable amount to the FMS Trust Fund. The DFAS Denver Center manually reviewed selected claims to ensure that all reportable claims were included; as a result, this claim was erroneously added to the total amounts reported by field units. The DFAS Denver Center's review did not initially disclose the fact that the contract cited payments made directly from the FMS Trust Fund to the contractor. Because the claim was included in the totals reported by field units, Accounts Receivable-Public and Accounts Payable-Federal were overstated by \$605 million each. In the financial statements dated March 7, 1994, this \$605 million error was 84 percent of the \$721 million reported for Accounts Receivable-Public, and 62 percent of the \$974 million reported for Accounts Payable-Federal.

Computing Payable Accounts

Computational errors in the draft financial statements caused Accounts Payable-Public to be understated and Accounts Payable-Federal to be overstated. The error occurred when the DFAS Denver Center deducted all accrued payroll liabilities from Accounts Payable-Public, instead of deducting accrued civilian payroll liabilities from Accounts Payable-Public and deducting accrued military payroll liabilities from Accounts Payable-Federal. The DFAS Denver Center used manual computations and secondary reports to extract the amounts to be reported in each individual liability account from the total liabilities reported. Air Force budget personnel had coded military pay obligations with the vendor code for "Other Government Agencies" (code 4) instead of using the code for "Commercial and Nongovernmental" (code 5). Therefore, the DFAS Denver Center should have deducted the accrued military pay from Accounts Payable-Federal. Air Force budget personnel had used code 4 in FY 1992, and the DFAS Denver Center personnel appropriately deducted the military pay data from Accounts Payable-Federal. The DFAS Denver Center did not analyze

Finding B. Reporting of Accounts Receivable and Accounts Payable

these manually computed amounts to ensure that the correct methods had been used and that any large variances between fiscal years were appropriate. The first draft of the financial statements, dated December 30, 1993, contained the error. This error understated Accounts Payable-Public and overstated Accounts Payable-Federal by \$787 million each. This \$787 million error was 40 percent of the \$1.98 billion reported for Accounts Payable-Public and 45 percent of the \$1.76 billion reported for Accounts Payable-Federal in the draft financial statements dated December 30, 1993. The DFAS Denver Center corrected the draft financial statements dated March 7, 1994, after we informed them of the error in February 1994.

Conclusion

Table 2. summarizes the effect of these errors on the amounts in the financial statements.

Table 2. Effect of Errors on Receivables and Payables
(\$ in Millions)

<u>Description</u>	<u>Accounts Payable-Public</u>	<u>Accounts Payable-Federal</u>	<u>Accounts Receivable-Public</u>
December 30, 1993, Draft Balance	\$1,984	\$1,761	\$718
Deleted FMS Transaction	0	(605)	(605)
Corrected Error in Accrued Pay	787	(787)	0
Corrected Balance	\$2,771	\$369	\$113
Percent Change	40	79	84

The lack of a transaction-driven general ledger increased the likelihood of errors in financial statement data; additional internal controls were needed to correct these weaknesses. Specifically, when computing payable and receivable accounts, errors may be made in systems reporting, formats for computer inquiries, and computations and reviews performed manually. In addition to the staff time required to perform these computations, internal controls must be established and administered to prevent and detect errors in each step of the process.

Finding B. Reporting of Accounts Receivable and Accounts Payable

Corrective Actions Taken

The DFAS Denver Center corrected the error in Accounts Payable that had been reported in the draft financial statements dated December 30, 1993. As a result, the dollar amounts were reported correctly in the draft financial statements dated March 7, 1994; however, our recommendations address a systemic problem.

Recommendations, Management Comments, and Audit Response

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

1. Exclude the \$605 million receivable amount for the Foreign Military Sales Trust Fund, and the corresponding payable amount, from the Air Force's financial statements, and notify the Deputy for Security Assistance, Defense Finance and Accounting Service Denver Center, of the change.

Management Comments. Management concurred in principle with the recommendation and referred to the new reporting guidance for FY 1994, Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," which requires reporting of both entity and nonentity assets. This guidance states that some of the Air Force's FMS transactions should be reported as nonentity assets in FY 1994, and that this receivable transaction should be restated as a nonentity asset in the FY 1993 financial statements, when shown for comparison with the FY 1994 financial statements. The estimated completion date of this corrective action is March 1, 1995.

Audit Response. Management's comments were responsive to the recommendation. Although the Statement of Federal Financial Accounting Standards No. 1 requires financial statement reporting of nonentity assets beginning in FY 1994, we agree that this amount should also be restated as a nonentity asset in FY 1993 reporting, for comparison with the new reporting requirements for FY 1994. We contacted OMB to confirm the intent of the new guidance. No further response is required on this recommendation.

2. Coordinate with the Deputy Assistant Secretary of the Air Force (Budget) to ensure that military pay obligations are correctly coded as "Commercial and Nongovernmental."

Management Comments. Management concurred with the recommendation and stated that the Deputy Assistant Secretary of the Air Force (Budget) has been notified that vendor code 5, "Commercial and Nongovernmental," should

Finding B. Reporting of Accounts Receivable and Accounts Payable

be used for military pay obligations. Amounts payable will be analyzed to ensure that the correct vendor code has been used, and that large variances between fiscal years are explained. The estimated completion date for this corrective action is March 1, 1995.

Audit Response. Management's comments were responsive to the recommendation.

3. Develop procedures to perform variance analysis on account balances to ensure that the balances are reasonable. The variance analysis should be done during preparation of the annual financial statements.

Management Comments. Management concurred with the recommendation, and stated that procedures have been developed to perform variance analysis on the FY 1994 account balances. These procedures will be included in the operating instructions being drafted for the preparation of financial statements. The variance analysis and resulting issues and actions will be documented in work papers. The estimated completion date for this corrective action is March 1, 1995.

Audit Response. Management's comments were responsive to the recommendation. See Part IV for the complete text of the comments.

Part III - Additional Information

Appendix A. Audits of Air Force Financial Statements for Fiscal Years 1992 and 1993

GAO Audit Reports

Report No. AFMD-90-23 (OSD Case No. 8193-A), "Air Force Does Not Effectively Account for Billions of Dollars of Resources," February 23, 1990

Report No. AFMD-92-12 (OSD Case No. 8376-L), "Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act," February 19, 1992

IG, DoD, Audit Reports

Report No. 92-119, "Defense Agency Trust Fund Financial Statements for FY 1991," June 30, 1992

Report No 93-123, "Consolidating Financial Statements of the Foreign Military Sales Trust Fund - FY 1992," June 24, 1993

Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," June 30, 1993

Report No. 94-035, "Financial Reporting Procedures for Defense Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund," February 8, 1994

Report No. 94-062, "Financial Status of Air Force Expired Year Appropriations," March 18, 1994

Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994

Report No. 94-159, "Fund Balances with the Treasury Accounts on the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for Fiscal Year 1993," June 30, 1994

AFAA Audit Reports

Consolidated Air Force Financial Statements

Project No. 92053011, "Review of FY 1992 Air Force Consolidated Financial Statements," June 29, 1993

Appendix A. Audits of Air Force Financial Statements for Fiscal Years 1992 and 1993

Project No. 94053022, "Opinion on Fiscal Year 1993 Air Force Consolidated Financial Statements," Final Report, June 30, 1994

Reports on General Funds, FY 1993

Project No. 93053007, "Review of Equipment and Vehicle Inventory," April 6, 1994

Project No. 93053013, "Review of the Civilian Payroll," March 7, 1994

Project No. 93053014, "Review of Military Personnel Costs," March 7, 1994

Project No. 93053015, "Review of Accuracy and Validity of Air Force Obligations," August 26, 1994

Project No. 93053020, "Review of Cash Operations and Reporting of Payments and Collections, Fiscal Year 1992 Air Force Consolidated Financial Statements," February 4, 1994

Project No. 93053024, "Review of Military Equipment," March 22, 1994

Project No. 94053021, "Review of Management Initiatives to Improve Financial Reporting," October 15, 1993

Project No. 94053024, "Review of Contingent Liabilities," April 14, 1994

Project No. 94053026, "Review of the Real Property Accounting Process," April 28, 1994

Project No. 94053029, "Review of Overview and Performance Measures," January 14, 1994

Project No. 94053030, "Review of the Funds Control Process," March 8, 1994

Project No. 94053031, "Review of Inventories Not Held For Sale," March 8, 1994

Reports on General Funds, FY 1992

Project No. 92053003, "Review of the Military Payroll Process," October 12, 1993

Project No. 92053004, "Review of the Civilian Payroll Process," January 12, 1994

Project No. 92053007, "Review of Cash Operations," October 27, 1992

Project No. 92053008, "Review of the Military Equipment Inventory Process - Aircraft," November 15, 1993

**Appendix A. Audits of Air Force Financial Statements
for Fiscal Years 1992 and 1993**

- Project No. 92053009, "Review of the Military Equipment Inventory Process - Satellites," October 21, 1993
- Project No. 92053010, "Review of the Liabilities Process," January 14, 1994
- Project No. 92053012, "Review of the Military Equipment Inventory Process - Guided and Ballistic Missiles," October 21, 1993
- Project No. 92053013, "Review of the Budget Allocation and Fund Control Process," December 3, 1993
- Project No. 92053014, "Review of the Operating Consumable Inventory Process," November 12, 1992
- Project No. 92053015, "Review of the Accounts Receivable Process," December 17, 1993
- Project No. 92053016, "Review of the Real Property Inventory Process," January 25, 1994
- Project No. 92053017, "Review of the General Fund Revenue Process," October 30, 1992
- Project No. 92053018, "Review of the Equipment and Vehicle Inventory Process," January 24, 1994
- Project No. 92053019, "Review of the General Fund Operating Expenditure Process," January 10, 1994
- Project No. 92053020, "Air Force Implementation of Section 4 (Accounting Systems) of the Federal Managers' Financial Integrity Act," November 3, 1993
- Project No. 92053023, "Review of the Military Equipment Inventory Process - Uninstalled Engines," October 21, 1993

Appendix B. Summary of Potential Benefits Resulting From Audit

Reference	Description of Benefit	Type of Benefit
A.1.	Internal controls. Reconciliations will improve the accuracy of clearing account balances.	Nonmonetary.
A.2.	Internal controls. Procedures will allow DFAS Denver Center personnel to reconcile and properly monitor clearing accounts.	Nonmonetary.
A.3.	Compliance. Procedures will improve maintenance of clearing accounts for contract payments and receipts.	Nonmonetary.
A.4.	Internal controls. Procedures will help to promptly eliminate old clearing account balances so that DAOs will not lose authority to spend available appropriated funds.	Nonmonetary.
A.5.	Program results. Guidance will improve the accuracy of clearing accounts and financial statements, and could help prevent fraud and loss of funds.	Nonmonetary.
A.6.	Program results. Inclusion of clearing accounts as criteria for management indicators will improve management of clearing accounts at DAOs.	Nonmonetary.

Appendix B. Summary of Potential Benefits Resulting From Audit

Reference	Description of Benefit	Type of Benefit
B.1.	Compliance. Air Force financial statements will report only Air Force funds.	Nonmonetary.
B.2.	Internal controls. Coordination will result in properly coded data for military pay obligations.	Nonmonetary.
B.3.	Internal controls. Procedures will require analysis of account balances with large variances between fiscal years.	Nonmonetary.

Appendix C. Organizations Visited or Contacted

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller),
Washington, DC
Deputy Assistant Secretary of the Air Force (Budget), Washington, DC
Headquarters, Air Force Audit Agency, Arlington, VA
Financial and Support Audits Directorate, March Air Force Base, CA

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Denver Center, Denver, CO
Defense Finance and Accounting Service Columbus Center, Columbus, OH
Defense Information Services Organization, Denver, CO

Non-Defense Organizations

Office of Management and Budget, Washington, DC
Federal Accounting Standards Advisory Board, Washington, DC
General Accounting Office, Washington, DC
General Accounting Office, Denver Region, Denver, CO

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)
 Deputy Assistant Secretary of the Air Force (Budget)
 Director (Audit Liaison and Follow-up)
Auditor General, Department of the Air Force
 Financial and Support Audits Directorate
 Acquisition and Logistics Audit Directorate

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
Director, Defense Finance and Accounting Service
 Director, Customer Service and Performance Assessment Deputate
 Director, Defense Finance and Accounting Service, Denver Center
 Internal Review Office
 Director, Defense Finance and Accounting Service, Columbus Center
Director, Defense Logistics Studies Information Exchange
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency

Non-Defense Organizations

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

Chairman and Ranking Minority Member of Each of the Following Congressional
Committees and Subcommittees:

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

Part IV - Management Comments

Defense Finance and Accounting Service Comments

Final Report
Reference



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

SEP 22 1994

DFAS-HQ/GC

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE

SUBJECT: Defense Finance and Accounting Service Work on the Air
Force FY 1993 Financial Statements (DoDIG 3FD-2040)

We have reviewed the above draft report. Our general
comments and management comments in response to findings A and B
directed to Defense Finance and Accounting Service are attached.

My point of contact for this matter is Mr. Tom Tresslar,
703-607-1120.

A handwritten signature in cursive script, appearing to read "Arnold R. Weiss".

Arnold R. Weiss
Deputy Director for General
Accounting

Attachment

cc: DFAS-DE

Defense Finance and Accounting Service Comments

Final Report
Reference

DoD(IG) Draft Report, "Defense Finance and Accounting
Service Work on the Air Force FY 1993 Financial Statements,"

(Project No. 3FD-2040)

General Comment: The published Air Force FY 93 Financial Statements contained no material accounting errors, i.e., auditor recommended material adjustments were made to the statements. We do not believe the statement made on page ii of this report "the Air Force's Statement of Financial Position was inaccurate", as well as the statement on page 11 "clearing account balances were not accurate, which resulted in distorted financial statements" are fair, substantiated, conclusive statements. Overall, we believe this report did not portray to the public the fact that the published financial statements were rid of all known material errors. Lastly, we agree that oversight of clearing account reconciliations requires strengthening, and will include this weakness in the FY 94 Statement of Assurance.

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Page 11

Finding A. U.S. Treasury Clearing Accounts

Recommendation A.1., page 12. "Perform semiannual reconciliations between Air Force departmental-level clearing account balances, base-level certified balances, and U.S. Treasury balances."

Page 12

Management Comments: Concur in principle. Air Force Regulation (AFR) 177-101, paragraph 27-53, outlines base procedures for certification of balances in deposit fund accounts. The Defense Accounting Offices (DAOs) attach this semiannual certification to the General Funds General Ledger report submitted to Defense Finance and Accounting Service Denver (DFAS-DE) Center, Accounting and Reporting Division. The DAOs are requested to obtain major command assistance, as required, when certifying. The DFAS-DE, Treasury Accountability Branch reconciles the "Deposits in Transit Differences" account (3878) and "Unavailable Check Cancellations and Overpayments" suspense account (3880) to departmental Merged Accounting and Fund Reporting (MAFR) cumulative balances; DFAS-DE then monthly reconciles MAFR cumulative balances to the Treasury trial balance.

It is not possible to reconcile "Undistributed Intergovernmental Payments" account (3885) to U.S. Treasury balances, because Treasury does not have the limit detail necessary for balancing. We are currently developing procedures for reconciling "Budget Clearing Account (Suspense)" (3875) to U.S. Treasury balances, Estimated completion date: September 30, 1995.

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Defense Finance and Accounting Service Comments

Final Report Reference

Page 12

Recommendation A.2., page 12. "Distribute semiannual certifications of clearing accounts to all personnel at the Defense Finance and Accounting Service-Denver Center who are responsible for monitoring clearing accounts."

Management Comments: Concur in principle. After the DFAS-DE, Accounting and Reporting Division receives the semiannual deposit fund certifications, the 3875, 3878, and 3880 certifications they reconcile the 3878 and 3880 to departmental MAFR cumulative balances. Quarterly, 3885 certifications are obtained from the DAOs, which the operating accountants use to monitor accounts over 1 year old. Estimated completion date: August 31, 1994 Closed.

Page 12

Recommendation A.3., page 12. "Send U.S. Treasury clearing account transactions to the Defense Finance and Accounting Service-Columbus Center, and obtain the required semiannual certifications of clearing accounts from the Defense Finance and Accounting Service-Columbus Center."

Management Comments: Concur. DFAS-CO does not presently accept by-other payments. DFAS-DE is currently developing methods to send 3878 and 3880 charges to DFAS-CO, as well as requiring semiannual certification. Estimated completion date: September 30, 1995.

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Recommendation A.4., page 12. "Notify Defense Accounting Offices when clearing account balances are over 60 days old and require resolution."

Management Comments: Concur in principle. DFAS-DE requested a change to Department of Defense (DoD) Financial Management Regulation 7000.14-R to require bases to resolve clearing account items within 1 year. Presently, bases submit aging schedules to major commands quarterly; annotations for items over 180 days are required for the Semiannual Certification of Deposit Fund Balances. Additionally, DFAS-DE has instituted aggressive actions to reduce unmatched deposits prior to 3878 charge backs. Starting August 1993, DFAS-DE started building a database of all charge backs; this database has over 4 years of data (FY 90 through FY 94). When complete, this database will identify the charge backs, by base, making up the total cumulative balance. As of February 1994, the unmatched deposits balance had dropped to \$8.6 million. Per Air Force Regulation 177-101, paragraph 27-96, DAOs must also resolve 3885 accounts within 1 year. Estimated completion date: September 30, 1995.

Page 13

Recommendation A.5., page 12. "Issue directives requiring the Defense Finance and Accounting Service-Denver Center to oversee clearing accounts. The Defense Finance and Accounting

Page 2

Defense Finance and Accounting Service Comments

Final Report
Reference

Service-Denver Center should:

- (a) maintain accurate balances,
- (b) reconcile Air Force departmental-level balances to base-level and U.S. Treasury balances,
- (c) send U.S. Treasury transactions to Defense Accounting Offices,
- (d) notify Defense Accounting Offices of clearing account problems that require resolution, and
- (e) provide training to personnel at the Defense Accounting Offices."

Management Comments: Concur in principle. DFAS-DE Accounting Operating Instruction #3 delineates Deposits in Transit accounting procedures, and AFR 177-101, paragraph 27 delineates Interfund accounting procedures. Additionally, DFAS-DE does reconcile bases' 3878 and 3880 accounts to departmental cumulative balances. Every effort is made to maintain accurate base and departmental balances, reduce unmatched deposits, and clear aging deposit accounts, as described above (Recommendations A1 through A4). The DFAS-DE Network Assistance Division, as well as major command staff continually provide assistance and training to DAO personnel on clearing accounts. Estimated completion date: August 31, 1994 Closed.

Recommendation A.6., page 12. "Add clearing accounts to the criteria for management indicators that the Defense Finance and Accounting Service-Denver Center, Directorate of Field Operations, uses to evaluate Defense Accounting Offices."

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Management Comments: Concur. The DAO's Network Profile was revised to track the top 10 performance indicators. The Profile includes 3878 Deposits in Transit with Treasury over 90 days, 3880 Replacement Checks Over 90 Days, and Interfund Unmatched Buyer and Sellers amounts as performance indicators. Estimated completion date: August 31, 1994 Closed.

Finding B. Reporting of Accounts Receivable and Accounts Payable

Recommendation B.1., page 17. "Exclude the \$605 million receivable amount for the Foreign Military Sales Trust Fund, and the corresponding payable amount, from the Air Force's financial statements, and notify the Deputy of Security Assistance, Defense Finance and Accounting Service-Denver Center, of the change."

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Management Comments: Concur in principle. "Nonentity" (Foreign Military Sales Trust Fund) account balances must be

Defense Finance and Accounting Service Comments

Final Report
Reference

separately disclosed. However, the Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities", requires "both entity assets and nonentity assets under an entity's custody or management should be reported in the entity's financial statements." Accordingly the \$605 million receivable amount, a nonentity asset, was reported in the FY 93 financial statements as required, but not separately disclosed. We will segregate entity and nonentity receivables in the restated FY 93 financial statements and FY 94 financial statements. Estimated completion date: March 1, 1995.

Page 18

Recommendation B.2., page 17. "Coordinate with the Deputy Assistant Secretary of the Air Force (Budget) to ensure that military pay obligations are correctly coded as "Commercial and Nongovernmental."

Management Comments: Concur. The Deputy Assistant Secretary of the Air Force (Budget) has been notified to code military pay obligations with the vendor code for "Commercial and Nongovernmental" (code 5). Additionally, we will analyze the computed payable amounts to ensure that the correct vendor code has been used, and that large variances between fiscal years are explained. Estimated completion date: March 1, 1995.

Page 19

Recommendation B.3., page 17. "Develop procedures to perform variance analysis on account balances to ensure the balances are reasonable. The variance analysis should be done during preparation of the annual financial statements."

Management Comments: Concur. The financial statement preparation team has developed procedures to perform variance analysis on FY 94 account balances. These procedures will be described in the Financial Statement Preparation Operating Instructions, presently being developed. The variance analysis, as well as the resulting issues and actions, will be documented in our work papers. Estimated completion date: March 1, 1995.

Audit Team Members

Russell A. Rau
David C. Funk
Thomas J. Winter
Harold J. Simmons
Ronald D. Cheatham
Jewell F. Levy
Ben J. Meade
Edwin L. Wilkinson
Susanne B. Allen