

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

ANNUAL REVIEWS OF USER ACCOUNTING
CONTROLS FOR THE WASHINGTON HEADQUARTERS
SERVICES ALLOTMENT ACCOUNTING SYSTEM

Report No. 96-080

February 29, 1996

Department of Defense

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Acronyms

DAO/WHS	Defense Accounting Office, Washington Headquarters Services
DFAS	Defense Finance and Accounting Service
KAR	Key Accounting Requirement
WAAS	Washington Headquarters Services Allotment Accounting System
WHS	Washington Headquarters Services



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



February 29, 1996

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, WASHINGTON HEADQUARTERS
SERVICES

SUBJECT: Audit Report on Annual Reviews of User Accounting Controls for the
Washington Headquarters Services Allotment Accounting System
(Report No. 96-080)

We are providing this audit report for review and comment. We performed the audit in response to a congressional request. In preparing the final report, we considered management comments on a draft of this report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service nonconcurred with Recommendation 1. to furnish comprehensive review guidance to the Washington Headquarters Services Allotment Accounting System manager, but stated that an appropriately tailored guide would be issued in March 1996. We request that the Defense Finance and Accounting Service provide a copy of the guide and indicate to whom it will be issued in response to the final report by April 29, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529) or Mr. John M. Donnelly, Audit Project Manager, at (703) 604-9549 (DSN 664-9549). See Appendix I for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-080
(Project No. 5RF-6010.07)

February 29, 1996

Annual Reviews of User Accounting Controls for the Washington Headquarters Services Allotment Accounting System

Executive Summary

Introduction. This audit was performed as part of the Research for Audits of Defense Agencies' Financial Statements (Project No. 5RF-6010).

The purpose of annual accounting system reviews is to determine whether DoD accounting systems are in compliance with accounting principles, standards, and related accounting requirements established by the General Accounting Office, the Office of Management and Budget, the Department of the Treasury, and DoD. The Defense Finance and Accounting Service, which is responsible for the conduct of annual accounting system reviews, requires system users to participate in the reviews because users must establish adequate accounting system controls to ensure the accuracy, completeness, and reliability of their financial statements and other financial reports. In FY 1994, the Washington Headquarters Services Allotment Accounting System (the System) processed financial transactions for 20 DoD users with assets of about \$21.5 billion.

Objectives. The audit objective was to determine the effectiveness of annual reviews of the System. We also evaluated the Defense Finance and Accounting Service's management control procedures for annual reviews of the System.

Audit Results. The annual reviews were not fully coordinated with System users for FYs 1994 and 1995, although coordination with System users is required by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, and DoD Financial Management Regulation 7000.14-R, "Financial Management Regulation," volume 1, chapter 3, May 1983. As a result, annual reviews of the Washington Headquarters Services Allotment Accounting System were incomplete and cannot be relied on to verify the adequacy of principal user accounting system controls (see Part I). Recent financial audits of selected System users identified significant accounting system control weaknesses that could have been detected and corrected by completed annual reviews of principal user accounting system controls. The management control program can be improved by correcting a material weakness in that the abbreviated annual review guidance did not ensure the inclusion of principal users during annual system reviews. Recommendations in the report, if implemented, will result in the inclusion of principal users in annual reviews of the System.

Summary of Recommendations. We recommend that the Defense Finance and Accounting Service provide comprehensive annual accounting system review guidance to the System manager and that the System manager include principal users in annual accounting system reviews.

Management Comments. The Defense Finance and Accounting Service nonconcurred with the recommendation to provide comprehensive annual accounting system review guidance stating that revised guidance was already under development. The Washington Headquarters Services concurred with the recommendation to include principal users in annual accounting system reviews.

Audit Response. The Defense Finance and Accounting Service comments were partially responsive. We request a copy of the new guidance. In addition, the Defense Finance and Accounting Service did not comment on the need to provide review guidance to the system manager. The Washington Headquarters Services comments were responsive. We request that the Defense Finance and Accounting Service provide comments on the final report by April 29, 1996.

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Part I - Audit Results

Audit Background

Washington Headquarters Services (WHS) owns and manages the WHS Allotment Accounting System (WAAS). The WAAS is a General Accounting Office approved, installation-level accounting system (see Appendix C).

Definition of an Accounting System. An accounting system records, classifies, accumulates, analyzes, summarizes, and reports information on the financial condition and operating position of an organization. As defined in DoD 7000.14-R, "Financial Management Regulation" (the Regulation), volume 1, chapter 3, May 1993, accounting systems:

- o consist of the various functional operations involved in authorizing, recording, classifying, analyzing, and reporting financial information related to financing sources, gains, expenses, losses, transfers, assets, liabilities, equity, and management controls; and

- o encompass the procedures and processes from the time at which a transaction is authorized, through processing of the data either manually or automatically, to issuance of financial and management information statements and reports.

In March 1993, the Defense Finance and Accounting Service, Denver Center, Defense Accounting Office, Washington Headquarters Services (DAO/WHS), was assigned responsibility to provide accounting support and data entry for certain DoD Components using WAAS, while the WHS retained that responsibility for other WAAS users.

WAAS Users. The WAAS processes and records DoD Component financial transactions in a DoD general ledger account structure maintained for each WAAS user. In FY 1994, 20 DoD Components, with total assets of \$21.5 billion, used the WAAS. Of the 20 Components, some performed their own accounting system functions and input financial transactions into WAAS, while others relied on WHS and DAO/WHS to perform certain accounting functions and to input financial transactions into WAAS. Appendix D lists the DoD Components that use WAAS and their respective FY 1994 assets. In addition, Appendix D identifies the DoD Components that:

- o perform their own accounting functions and enter financial transactions into WAAS,

- o rely on WHS to perform accounting functions and enter financial transactions into WAAS, and

- o rely on DAO/WHS to perform accounting functions and enter financial transactions into WAAS.

DoD Requirements Related to Accounting System Controls. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of

management controls to provide reasonable assurance that assets are used properly and that programs are efficiently and effectively managed. The Directive also requires a review of management controls that are an integral part of an accounting system for compliance with accounting principles, standards, and related requirements established by the General Accounting Office and the Office of Management and Budget.

The Directive states that specific DoD policies for evaluating accounting systems are in DoD Manual 7220.9-M, "Department of Defense Accounting Manual," chapter 12, October 1983. The Regulation, volume 1, chapter 3, May 1993, superseded chapter 12 of the DoD Accounting Manual.

The Regulation implements the statutory and Office of Management and Budget requirement to review accounting systems and to report to Congress and the President on whether the systems comply with Comptroller General standards. The Regulation states that the annual report will be based on the annual review of accounting system controls performed by system managers and users and the results of detailed cyclical evaluations of accounting system controls performed by an independent Defense Finance and Accounting Service (DFAS) review team.

Annual and Cyclical Reviews. The Regulation discusses two types of reviews performed as part of the accounting system review process: annual reviews and cyclical reviews. The Regulation specifies 13 key accounting requirements with which accounting systems must comply. The accounting requirements are a composite of requirements of the General Accounting Office, Office of Management and Budget, Department of the Treasury, and DoD.

The Regulation states that system managers will perform annual reviews of accounting systems and that DFAS evaluation teams will perform cyclical reviews of accounting systems to determine their compliance with the 13 key accounting requirements. The Regulation further states that a material noncompliance with a key accounting requirement requires corrective action within a reasonable period. The 13 key accounting requirements and a brief description of each requirement are in Appendix E.

Audit Objectives

The audit objective was to determine the effectiveness of annual reviews of the WAAS. We also evaluated DFAS management control procedures for annual reviews of the WAAS. Appendix A discusses the audit scope, methodology, and review of the management control program. Appendix B provides a summary of prior audit coverage related to the audit objectives.

Reviews of Accounting System Controls

The annual reviews were not fully coordinated with system users for FYs 1994 and 1995. The lack of coordination with WAAS users occurred because the DFAS:

- o issued the FYs 1994 and 1995 annual Review Guides to the DAO/WHS instead of to the WAAS manager, and

- o required abbreviated rather than comprehensive annual reviews of the WAAS.

As a result, the FYs 1994 and 1995 annual reviews of the WAAS were incomplete and cannot be relied on to verify the adequacy of principal user accounting system controls, constituting a material management control weakness. Recent financial audits of selected WAAS users identified accounting system control weaknesses that materially affected the accuracy, completeness, and reliability of user financial statements. Comprehensive annual reviews could have identified and corrected the weaknesses.

Conducting Annual Accounting System Reviews

Annual Reviews of System User Accounting System Controls. The DFAS is responsible for establishing procedures for conducting annual reviews of accounting system controls. The Regulation states that system managers are responsible for performing annual reviews and that users of DoD accounting systems shall work with system managers in performing the annual reviews and in producing the documented results of management's assessment. A primary reason for annual reviews is to verify that accounting controls are adequate to ensure the accuracy, completeness, and reliability of accounting system users' financial reports. System users are responsible for establishing specific accounting system controls because system users are involved in the various functional operations that comprise an accounting system.

System users are also responsible for procuring, using, and maintaining visibility over their assets such as cash, property, and receivables; incurring and extinguishing debt and other obligations and liabilities; and incurring and paying periodic operating expenses. System users authorize accounting transactions, prepare initiating documentation, maintain subsidiary ledgers, and may participate in various degrees in recording, classifying, and analyzing the transactions.

Annual Review Guide. The DFAS prepares and issues a System Manager/User Review Guide (the Review Guide) annually to assist system managers and users of DoD accounting systems in conducting annual reviews of

accounting system controls. DFAS headquarters distributes the Review Guide annually to its five regional DFAS centers; the centers, in turn, are responsible for obtaining and reviewing the annual Review Guide, for issuing the Review Guide to their respective system managers, and for certifying that reviews have been properly completed. The results of the annual reviews are used to support the DFAS Annual Statement of Assurance to the Secretary of Defense.

The Regulation states that the Review Guide contains a structured and objective method for system managers to review their accounting systems for compliance with key accounting requirements. The Regulation further states that the Review Guide provides review techniques for managers to use in performing annual reviews. The Review Guide contains detailed questions for system managers and system users to answer in determining compliance of their accounting systems with each applicable key accounting requirement. The Review Guide requires documentation and testing of accounting system controls.

Compliance with Key Accounting Requirements. The Regulation requires that users work with system managers in producing the documented results of the assessments of system compliance with key accounting requirements. Twelve of the thirteen key accounting requirements (excluding Key Accounting Requirement 10) in the Regulation cover specific user responsibilities. Table 1 shows those key accounting requirements and summarizes user responsibilities. Appendix F provides more detail on the responsibilities.

Table 1. Key Accounting Requirements and System User Responsibilities

<u>Key Accounting Requirements</u>	<u>User Responsibilities</u>
1. General Ledger/Financial Reports	Maintain general ledger account balances. Prepare financial reports.
2. Property and Inventory	Report and classify assets in the general ledger. Perform and verify physical inventory.
3. Receivables	Record and document receivables.
4. Cost Accounting	Record all costs by project.
5. Accrual Accounting	Record liabilities and obligations when incurred.
6. Payroll	Maintain accurate payroll records, and separate payroll duties.
7. Systems Controls	Record and support obligations and disbursements.
8. Audit Trials	Maintain audit trails from source documents to general ledger and from general ledger to source documents.

Reviews of Accounting System Controls

Table 1. Key Accounting Requirements and System User Responsibilities
(Cont'd)

<u>Key Accounting Requirements</u>	<u>User Responsibilities</u>
9. Accounts Payable	Record accounts payable based on receipt of goods and services.
11. System Operations	Validate data entry, and participate in performance tests and quality reviews.
12. User Information	Respond to user surveys.
13. Budgetary Accounting	Record funding in general ledger accounts.

The lack of user participation in annual reviews results in less assurance to preparers and readers of financial reports that accounting controls are adequate to detect or prevent the input of inaccurate or unauthorized financial information into the accounting systems.

Annual Reviews of the WAAS

DFAS Distribution of Review Guides and Requirement for Abbreviated Reviews. The DFAS Denver Center distributed the FYs 1994 and 1995 Review Guides to the DAO/WHS and assigned responsibility for performing the annual reviews to the DAO/WHS, even though the Regulation requires that the system manager perform the reviews with system users. Further, the DFAS Denver Center only required abbreviated annual reviews.

Distribution of the Review Guides to DAO/WHS. The DFAS Denver Center issued the FYs 1994 and 1995 Review Guides to the DAO/WHS instead of to the WAAS manager because officials at DFAS Denver Center believed that the Review Guides should be issued only to a DFAS organization. However, the Regulation requires DFAS to issue Review Guides to accounting system managers, and, therefore, does not limit the issuance of Review Guides to only DFAS accounting system managers.

Lack of User Participation in the FYs 1994 and 1995 Annual Reviews. The DAO/WHS requested that the WAAS manager perform the FYs 1994 and 1995 annual reviews. The WAAS manager did not coordinate the two annual reviews with WAAS users as required by the Regulation. Because the DFAS Denver Center distributed the FYs 1994 and 1995 Review Guides to DAO/WHS, the WAAS manager believed that only the DAO/WHS was authorized to make a decision regarding the coordination with system users. During the FYs 1994 and 1995 annual reviews, the WAAS manager did not detect accounting system control weaknesses.

Abbreviated Annual Reviews Instead of Comprehensive Annual Reviews. The DFAS Denver Center distributed abbreviated FYs 1994 and 1995 Review Guides that did not clearly require user participation. A DFAS Denver Center official said that the Center issued abbreviated FYs 1994 and 1995 Review Guides to the DAO/WHS because the DFAS headquarters instructed the Denver Center to issue abbreviated guides.

The abbreviated guides required minimal effort in determining system compliance with key accounting requirements because the guides included only one question for each applicable key accounting requirement. The question related to whether the accounting system conformed with the applicable key accounting requirement. Therefore, the abbreviated guides, unlike the more comprehensive guide discussed in the Regulation, did not include accounting requirement questions that only system users could answer. Appendix G compares the FY 1995 abbreviated Review Guide to the comprehensive Review Guide for key accounting requirements 2 and 9. Also, Appendix F shows the specific user responsibilities for the key accounting requirements.

The WAAS manager told us that the instructions in the FYs 1994 and 1995 abbreviated Review Guides were not clear on how system users could be included in the annual review. The WAAS manager stated that, in his opinion, abbreviated Review Guides require the system manager to complete the one question for each key accounting requirement then return the guide to DFAS.

DFAS Policy Concerning Abbreviated Annual Reviews. The Regulation does not discuss abbreviated annual reviews. In addition, the DFAS does not have written policies and procedures for performing abbreviated reviews. DFAS headquarters officials told us that abbreviated reviews were applicable only to legacy accounting systems¹ because legacy systems have a limited life and will be replaced by interim migratory accounting systems.² Nonetheless, the DFAS centers, which distribute annual Review Guides to accounting system managers, have the authority to distribute comprehensive guides for systems that may require more extensive annual accounting reviews than legacy accounting systems. As of October 1995, the DFAS was evaluating the WAAS to determine whether it should remain a legacy system or be designated an interim migratory system.

Effects of Not Including Users in Accounting System Reviews. None of the 20 WAAS users, which have total assets of \$21.5 billion (see Appendix D), participated in annual reviews. As a result, the reviews cannot be relied on to verify the adequacy of principal user accounting system controls. The lack of adequate accounting controls, identified in previous financial audits,

¹Automated information systems that are candidates for phaseout, upgrade, or replacement, usually because the systems do not comply with data standards or other standards.

²An existing or planned and approved automated information system that has been officially designated as the single system to provide functionality for a standard process.

Reviews of Accounting System Controls

significantly increases the risk of material noncompliances with key accounting requirements and material misstatements and omissions in users' financial statements.

Table 2 shows the numbers of users by descending asset ranges.

Table 2. FY 1994 Assets of WAAS Users

<u>Range</u>	<u>Number of Users</u>
More than \$1 billion	2
\$500 million to \$1 billion	6
Less than \$500 million	<u>12</u>
Total	20

User Accounting Control Weaknesses

Four FYs 1994 and 1995 financial audits of WAAS user financial transactions identified material noncompliances with key accounting requirements. Table 3 identifies the specific key accounting requirement, the WAAS user involved, and briefly summarizes the noncompliances.

Table 3. WAAS Users' Noncompliances with Key Accounting Requirements

<u>Key Accounting Requirement</u>	<u>WAAS User</u>	<u>Noncompliance¹</u>
1. General Ledger	DISA ²	Did not use general ledger account balances to prepare financial statements.
	ARPA ³	Did not maintain general ledger accounts.
		Did not use general ledger account balances to prepare financial statements.
2. Property and Inventory	WHCA ⁴	Did not maintain adequate controls over repair parts inventories.
		Did not report excess nonexpendable property.
7. Systems Controls	Various ⁵	Did not maintain audit trails to general ledger.
8. Audit Trails	Various ⁵	Made incorrect payments and improper certification.

¹The noncompliances are summarized in Appendix B.

²Defense Information Systems Agency.

³Advanced Research Projects Agency.

⁴White House Communications Agency.

⁵We could not identify the specific users because the report (Audit Report No. 95-231, June 12, 1995) on the financial audit did not identify them.

The material noncompliances could have been detected and corrected or, more important, prevented by including the WAAS users in the FYs 1994 and 1995 annual reviews.

Cyclical Review of the WAAS

On a cyclical basis, DFAS review teams conduct an independent, comprehensive evaluation (Consolidated System Evaluation) of accounting system controls. The Regulation states that DFAS will perform a cyclical review of each accounting system once every 3 years. The DFAS performed a cyclical review of the WAAS in January 1993. The results of the review are discussed in detail in Appendix B.

The DFAS Richmond Detachment review team issued "Evaluation of the Washington Headquarters Services Allotment Accounting System at the Washington Headquarters Services, Washington, DC," on April 15, 1993 (see Appendix B). The DFAS concluded that WAAS was in compliance with the requirements of the Federal Managers' Financial Integrity Act.

The cyclical review included only two DAO/WHS users and tested requirements for only key accounting requirement 8, Audit Trails. Specifically, the team tested the requirement that the accounting system should permit tracing transactions through the accounting system. The review team verified that selected financial transactions for two DAO/WHS users were traceable to pertinent documents and source records, that the transactions were authorized, and that the financial information in the records and documents was essentially in agreement with information processed by the WAAS.

Conclusion

The Regulation requires that WAAS users be included in annual reviews because the integrity of user financial statements is dependent on the adequacy of user accounting system controls. None of the 20 WAAS users with total assets of \$21.5 billion participated in annual reviews.

The DFAS annual Review Guide requires documentation and testing of user accounting system controls. The DFAS Denver Center needs to ensure that the WAAS system manager is provided comprehensive guides to meet that requirement.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service, Denver Center, issue a comprehensive System Manager/User Review Guide to the Washington Headquarters Services Allotment Accounting System manager in FY 1996 and subsequent fiscal years.

Management Comments. The DFAS nonconcurrent with the need to use a comprehensive Review Guide. The DFAS stated that the recommendation was not germane because DFAS planned to issue an automated Review Guide for FY 1996 that is tailored to specific requirements of accounting systems. The DFAS stated that it had informed the audit staff of the planned FY 1996 tailored Review Guide before the start of the audit.

The DFAS also disagreed with the material control weakness concerning the risk associated with using an abbreviated rather than a comprehensive Review Guide to perform annual system reviews of the WAAS. The DFAS stated that both guides require:

- o annual reviews to be staffed with knowledgeable officials, and
- o certification as to the ability of the system to meet the user's information needs.

Finally, DFAS stated that the Financial Management Regulation requires user participation in performing annual reviews.

Audit Response. The DFAS comments are partially responsive. Although DFAS stated that it developed a new tailored Review Guide to conduct FY 1996 annual accounting system reviews, the DFAS had not yet completed the new Review Guide. The DFAS stated that they would provide the audit team with a copy of the new Review Guide when completed in March 1996. Therefore, we are not yet able to determine whether the new DFAS tailored Review Guide represents an acceptable alternative to use of the recommended comprehensive guide. We request that, in response to the final report, DFAS provide a copy of the final version of the tailored Review Guide to be used for the FY 1996 annual accounting system reviews.

In addition, DFAS did not comment on the need to issue the FY 1996 and subsequent fiscal year Review Guides to the Washington Headquarters Services system manager of the WAAS, rather than to the DAO/WHS. Therefore, we request that DFAS provide comments in response to the final report that address this issue.

Regarding the identified material weakness, we disagree with the DFAS position that the extent of user participation in annual reviews is not related to the type of guide used to perform annual accounting system reviews. Abbreviated guides do not include review techniques and guidance to assist system managers and users in determining whether accounting controls are sufficient to ensure

compliance with key accounting requirements. Appendix G illustrates the difference between the guides for two key accounting requirements. The questions in the abbreviated guide simply ask the reviewer whether the review disclosed any departures, whereas the comprehensive guide provides detailed questions on accounting techniques, accounting principles, and accounting applications. The comprehensive guide, therefore, would have given both system managers and system users a structured approach to determine compliance with key accounting requirements. We do not object, however, to the concept of appropriate tailoring.

2. We recommend that the Director, Washington Headquarters Services, coordinate the FY 1996 and subsequent annual reviews with selected system users that have material proprietary general ledger account balances.

Management Comments. The Washington Headquarters Services concurred.

Audit Response. The Washington Headquarters Services comments are responsive.

Part II - Additional Information

Appendix A. Scope and Methodology

Audit Scope

We evaluated annual and cyclical reviews of the WAAS that were completed from FYs 1993 through 1995. We reviewed the methodology the system manager used in performing two annual reviews and the methodology DFAS used in performing one cyclical review of the WAAS.

Limitations to Audit Scope. The audit scope was limited as follows.

- o We did not perform audit work at WAAS system user locations to determine the adequacy of accounting system controls; however, we did rely on the results of recent audits and other evaluations of WAAS user financial systems to illustrate weaknesses in user accounting system controls.

- o We did not review DFAS procedures for performing cyclical reviews.

- o The review of the DFAS Denver Center management control program was limited to controls in place to ensure that DFAS provided adequate annual review guidance to the WAAS manager.

Audit Locations Visited. The audit was performed at Washington Headquarters Services, DFAS headquarters, and the DFAS Denver Center. Appendix H lists the organizations visited or contacted.

Computer-Processed Data. We did not rely on computer-processed data, and we did not use statistical sampling procedures in arriving at audit conclusions.

Audit Methodology

To evaluate the annual and cyclical reviews of accounting system controls, we:

- o reviewed DoD regulations for performing and reporting the results of annual reviews;

- o analyzed and documented DFAS responsibilities, accounting system manager responsibilities, and accounting system user responsibilities for performing reviews;

- o obtained and evaluated the FYs 1994 and 1995 Review Guides completed by the system manager;

- o discussed the annual review methodology with the system manager;

- o determined the extent to which system users participated in the reviews;

- o determined the extent to which the system manager documented and tested automated system controls;

- o ascertained the extent of annual accounting system review training provided to the system manager; and

- o evaluated the methodology, scope, and results of the FY 1993 DFAS cyclical review of the WAAS.

Audit Period and Standards. We performed this financial-related audit from September through November 1995 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls considered necessary.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed WHS management control procedures relating to the WHS performance of FYs 1994 and 1995 annual accounting system reviews of the WAAS. We also evaluated the DFAS management control procedures for distributing WAAS annual review guidance. Additionally, we reviewed management's self-evaluation applicable to all the controls.

Adequacy of Management Controls. We identified a material management control weakness in that abbreviated annual review guidance did not ensure that WAAS system users were included in annual accounting system reviews. See Part I for details. Recommendations 1. and 2. if implemented, will improve the quality of annual reviews by identifying control weaknesses in system users' accounting procedures and practices. A copy of the report will be provided to the senior officials responsible for management controls within WHS and the DFAS Denver Center.

Adequacy of Management's Self-Evaluation. The DFAS Denver Center FYs 1994 and 1995 evaluations of management controls did not assess the risks of using abbreviated annual review guides instead of comprehensive review guides to perform annual reviews of the WAAS. In addition, the self-evaluations did not consider the risks of providing WAAS annual review guidance to the DAO/WHS instead of providing the guidance to the WAAS

Appendix A. Scope and Methodology

system manager. Therefore, management's self-evaluations did not show that management control techniques were not in place to ensure performance of adequate annual reviews of the WAAS.

Appendix B. Summary of Prior Audits and Other Reviews

During the last 5 years, six reports were issued that discuss the annual accounting system review process. Five reports identify WAAS user noncompliances with key accounting requirements that could have been detected and corrected by comprehensive FYs 1994 and 1995 annual reviews (Table 3 in Part I identifies the WAAS users and summarizes the noncompliances). Also, DFAS issued the report on the Consolidated System Evaluation on the WAAS.

Inspector General, DoD, Audit Reports

Report No. 96-048, "Defense Accounting Office, Washington Headquarters Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency," December 19, 1995. The report states that the DAO/WHS used budget execution data instead of proprietary general ledger account information to prepare the FY 1994 financial statement for the Advanced Research Projects Agency. As a result, the FY 1994 financial statement overstated the Advanced Research Projects Agency financial position by \$2.2 billion in assets, \$25 million in liabilities, and \$2.3 billion in equity. The report recommends that the DAO/WHS comply with DoD guidance in preparing FY 1996 and subsequent Advanced Research Projects Agency financial statements and train employees assigned to prepare general-purpose financial statements. The DAO/WHS did not comment on the recommendation.

Report No. 96-003, "Defense Information Systems Agency FY 1994 General-Purpose Financial Statements," October 5, 1995. The report concludes that DISA used budget execution reports instead of the standard general ledger available in the WAAS to prepare FY 1994 general-purpose financial statements. Therefore, DISA FY 1994 general-purpose financial statements were materially incorrect. Omissions, misclassifications, and overstatements totaled about \$775 million. Also, the DISA did not request and the WHS did not make annual accounting entries to close (zero balance) DISA general ledger accounts. Therefore, DISA general ledger account balances were overstated by \$7.9 billion. Management concurred with all recommendations and either implemented corrective actions or stated that corrective actions would be taken.

Report No. 96-033, "White House Communications Agency," November 29, 1995. The report concludes that the White House Communications Agency (WHCA), a field activity of the Defense Information Systems Agency, did not maintain sufficient control over repair parts inventories because WHCA had not fully implemented its maintenance management system. As a result, WHCA could not ensure the adequacy or accountability of repair parts inventories. The report recommends that WHCA fully implement the existing maintenance management system. Also, WHCA

Appendix B. Summary of Prior Audits and Other Reviews

had not established accountability for all nonexpendable property on hand. The report made recommendations to ensure accurate property records. The WHCA concurred with the recommendations and stated that corrective actions would be implemented in 1995 or early 1996.

Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995. The DAO/WHS made incorrect payments; improperly certified vouchers; did not update the accounting system; did not maintain proper supporting documents for obligations, accruals, and disbursements; and did not adequately use exception reports that identified accounting errors. As a result, duplicate and erroneous payments of at least \$629,000 were made; vouchers of \$335,000 were not certified properly; and transactions totaling \$102 million lacked supporting documentation. The report recommends that DFAS/WHS make improvements in accounting procedures and maintain adequate supporting documentation for accounting transactions. Management concurred with the recommendations and either implemented corrective actions or stated that corrective actions would be taken.

Other Reviews

Inspector General, DoD, Inspection Report No. 91-INS-03, "Report on the Verification Inspection of the Department of Defense Dependents Schools," March 1, 1991. The inspection report states that the DoD Dependents Schools did not reconcile accounting and property records, identify costs of specific programs, retain documents to support obligations or commitments, and verify fund availability before committing and obligating funds. DoD Dependents Schools concurred with the recommendations and provided responsive corrective actions.

Defense Finance and Accounting Service Consolidated System Evaluation Report, "Evaluation of the Washington Headquarters Services Allotment Accounting System at the Washington Headquarters Services, Washington, DC," April 15, 1993. The purpose of the evaluation was to determine whether the WHS Allotment Accounting System was operating in accordance with the accounting principles promulgated by the General Accounting Office as implemented by the Office of Management and Budget and DoD. The DFAS evaluation team identified two material procedural deficiencies concerning accounts receivable and property accounting and made recommendations to correct the deficiencies. The WHS concurred with the deficiency concerning accounts receivable and implemented adequate corrective actions. The WHS and DFAS Denver Center concurred with recommendations concerning property accounting and stated that corrective actions would be implemented in late FY 1993 and early FY 1994; however, corrective action had not been fully implemented.

Appendix C. Description of Washington Headquarters Services Allotment Accounting System

The WAAS operates an International Business Machine-9221 mainframe computer, which is a menu-driven system that gives system users the capability of accessing functions and tasks needed for performance of daily operations. The WAAS provides access to 10 years of accounting data stored in data bases that include about 2 million transactions. The WAAS provides:

- o accurate financial control of appropriated funds to prevent overobligations and overdisbursements of funds;
- o line-item accounting for about 575,000 expenditure and reimbursable transactions per year;
- o DoD standard general ledger control and the ability to display subsidiary records for any general account;
- o timely, consistent, and accurate generation of accounting and budget reports from an automated general ledger;
- o ready access to the WAAS data base by budget personnel to allow document research and execution of various reports;
- o capability to automatically retrieve payroll cost data from the Bolling Air Force Base payroll system;
- o automatic generation of billing documents based on the recording of an earned disbursement;
- o management controls to ensure the accuracy of accounting data and financial reports; and
- o the capability of providing cost accounting data for management information reports.

Appendix D. Assets of DoD Components Using the Washington Headquarters Services Allotment Accounting System

DoD Component	FY 1994 Assets (millions)
(Component performs accounting function.)	
Defense Information Systems Agency	\$ 751
Defense Security Assistance Agency	12,719
DoD Dependents Education	<u>809</u>
Subtotal	\$14,279
(WHS performs accounting function.)	
Court of Military Appeals	4
Office of the Secretary of Defense	774*
Washington Headquarters Services	<u>529</u>
Subtotal	\$ 1,307
(DAO/WHS performs accounting function.)	
Advanced Research Projects Agency	2,927
Armed Forces Information Service	126
Ballistic Missile Defense Organization	710
Corporate Information Management	186
Defense Health Program	461
Defense Legal Services Agency	3
Defense Medical Program Activity	231
Defense Prisoners of War/Missing in Action Office	8
Defense Technology Security Administration	16
Joint Staff	756
Office of Economic Adjustment	131
Office of the Inspector General	69
Office of the Secretary of Defense	222
Section 6 Schools Program	<u>31</u>
Subtotal	\$ 5,877
Total	\$21,463

*Includes Federal Energy Management Program.

Appendix E. Key Accounting Requirements

The DFAS established 13 key accounting requirements, which are included in DoD 7000.14-R, "Financial Management Regulation," volume 1, chapter 3, May 1993. The annual Review Guide contains questions designed to assist system managers and users in determining whether accounting system controls are in place and working for the 13 key accounting requirements. Responses to questions related to seven key accounting requirements are mandatory and must be completed for all DoD accounting systems. The Review Guide requires the reviewer to determine the applicability of the other six key accounting requirements to the specific accounting system under review. The following list of the 13 key accounting requirements (KARs) includes a brief description of each.

KAR 1, General Ledger Control and Financial Reporting. The system must have general ledger control and maintain a general ledger account structure for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources.

KAR 2, Property and Inventory Accounting. The system must account in quantitative and monetary terms for the procurement, receipt, issue, and control of plant property, equipment, inventory, and material.

KAR 3, Accounting for Receivables Including Advances. The system must account for all accounts receivable (all debts to the U.S. Government).

KAR 4, Cost Accounting. Cost accounting must involve accounting analysis and reporting on costs of production of goods or services or operation of programs, activities, functions, or organizational units.

KAR 5, Accrual Accounting. Accrual accounting must recognize the accountable aspects of financial transactions or events as they occur.

KAR 6, Military and Civilian Payroll Procedures. Payroll systems must incorporate controls of both gross and net payroll amounts and payroll deductions to ensure smooth payroll processing action and to minimize incorrect payments.

KAR 7, System Controls (Fund and Internal). The system must show the appropriations and funds to be accounted for and a description of the accounting entity's proposed fund distribution and control process. Separation of duties and responsibilities must be maintained for initiating, authorizing, processing, recording, and reviewing transactions.

KAR 8, Audit Trails. The financial transactions on accounting system processes must be adequately supported with pertinent source documents.

Appendix E. Key Accounting Requirements

KAR 9, Cash Procedures and Accounts Payable. The system shall be designed to verify timely payments based on properly approved disbursement documents. Payment procedures must comply with the Prompt Payment Act. Accounts payable should be recorded when goods or services are received.

KAR 10, System Documentation. The accounting system must have adequate system documentation, including documented interfaces between accounting system segments.

KAR 11, System Operations. Accounting system operations shall be adequately planned and organized to assure that financial management and accounting objectives are met in an economical and efficient manner.

KAR 12, User Information Needs. The accounting system must satisfy users' needs of quality, accuracy, timeliness, and reliability to facilitate management's decisionmaking process.

KAR 13, Budgetary Accounting. The accounting system shall support budget formulation and budget requests and control budget execution. Programming, budgeting, accounting, reporting, classification, and coding structure should be uniform, mutually consistent, and synchronized with the organizational structure so that actual activity can be compared with enacted budgets to support future budget formulation for each activity.

Appendix F. User Responsibilities

This appendix summarizes system user responsibilities specified in the Review Guide by Key Accounting Requirement (KAR). KAR 10 does not include user responsibilities and is excluded from this appendix.

KAR 1 General Ledger Control and Financial Reporting

- | |
|---|
| <ul style="list-style-type: none">o Reconcile subsidiary accounts to control accounts at least monthly.o Maintain appropriate general ledger account balances.o Prepare financial reports for management and external sources.o Compare actual operations to planned operations. |
|---|

KAR 2 Property and Inventory Accounting
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- | |
|--|
| <ul style="list-style-type: none">o Report and classify assets in appropriate general ledger accounts.o Record and identify all Government-owned property held by contractors in property accounts.o Perform and verify inventory.o Record transfers and dispositions in property accounts.o Provide visibility of physical assets.o Verify inventories periodically and adjust accounting records accordingly. |
|--|

KAR 3 Accounting for Receivables Including Advances
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- | |
|---|
| <ul style="list-style-type: none">o Record and age receivables promptly.o Deposit cash immediately.o Write off uncollectible accounts.o Document collection process for delinquent accounts. |
|---|

Appendix F. User Responsibilities

KAR 4 Cost Accounting

- o Maintain detailed cost accounting information by project.
- o Record material, labor, and depreciation costs in the accounting system.

KAR 5 Accrual Accounting

- o Record transactions on the accrual basis of accounting.
- o Record appropriate liabilities and obligations.

KAR 6 Military and Civilian Payroll Procedures

- o Maintain timely, accurate, and complete records for every individual.
- o Maintain separation of duties for the different phases of the payroll transaction process.

KAR 7 System Controls (Fund and Internal)

- o Verify funds availability before creating obligations.
- o Support obligations with documentation.
- o Record disbursements when actual payment is rendered and matched to the obligation and receipt of goods documents.
- o Record obligations when contract is awarded or competitive offer is accepted.

KAR 8 Audit Trails

- o Establish procedures that require audit trails.
- o Maintain audit trails from source documents.

KAR 9 Cash Procedures and Accounts Payable

- o Record accounts payable only when supported by valid claims.
- o Record accounts payable based on receipt of goods, services, or plant property.
- o Establish procedures to allow for writeoff of accounts payable.
- o Record accounts payable in the period incurred.
- o Deposit cash and checks as expeditiously as possible, and record deposit in the accounting system.

KAR 11 System Operations

- o Enter data into the accounting system only once.
- o Participate in quality reviews.
- o Evaluate and certify performance tests and review results, and review changes and recommend changes.

KAR 12 User Information Needs

- o Verify periodically the satisfaction of the level of detail, frequency, and report distribution.
- o Do not maintain duplicate records.
- o Monitor report error rates.

KAR 13 Budgetary Accounting

- o Record increases in funding authority in general ledger accounts when increased authority is made available.

Appendix G. Comparison of Key Accounting Requirement Questions in Abbreviated and Comprehensive Review Guides

Key Accounting Requirement (KAR) 2, Property and Inventory Accounting

Abbreviated Review Guide Question

Based on your review did you identify a departure?

Comprehensive Review Guide Questions

1. Are assets reported and classified in the appropriate accounts, for example land, equipment, etc.?
2. Do accounting records identify all Government-owned property held by contractors?
3. Do you record the acquisition and construction of capital assets at cost and the costs of construction, transportation, installation, handling, and storage costs and any related costs of obtaining and preparing the property?
4. Are costs of additions, alterations, or replacements that extend the asset's useful life or service capacity capitalized?
5. Do you capitalize in your financial records all property and equipment, including automated data processing software, with an initial acquisition cost of \$25,000 and an estimated useful life of more than 2 years?
6. Do you record in your financial records the value for property and equipment acquired by transfer without reimbursement; at the transferor's recorded acquisition cost minus accumulated depreciation; plus transportation, installation, and other costs of obtaining the property?
7. Is depreciation calculated and recorded in the financial reports for all depreciable assets in the period in which benefits result from use of the asset?
8. Are repair and maintenance costs incurred to keep property in satisfactory operating condition accounted for as current operating costs?
9. When property is returned or disposed of, are complete reversing entries made in asset, depreciation, and equity accounts?
10. Are inventories periodically verified and accounting records adjusted accordingly?

Appendix G. Comparison of Key Accounting Requirement Questions in Abbreviated and Comprehensive Review Guides

11. Are materials and supplies charged to using activities on basis of cost determined by simplest method that produces reasonable and useful measures of cost?
12. Does the system contain monetary property accounting records?

KAR 9, Cash Procedures and Accounts Payable

Abbreviated Review Guide Question

Based on your review did you identify a departure?

Comprehensive Review Guide Questions

1. Are amounts recorded as liabilities supported by documentation (for example, receiving report, court decision, estimates of accruals for personnel services, etc.) that establishes the basis for claim?
2. Where payment is probable and can be estimated, are contingent liabilities recorded?
3. Are amounts withheld from a contractor, pending final payment, recorded as liabilities?
4. Are accounts payable recorded at net when available cash discounts are to be taken?
5. Are followup activities performed and documented for accounts payable when no invoice is received for 6 months or more?
6. Do procedures exist to allow for writeoff of accounts payable?
7. Do amounts recorded as liabilities represent the amounts actually owed under contractual or other arrangements?
8. Are amounts received in advance of performance accounted for as liabilities?
9. Are accounts payable recorded based on the certification of receipt of goods, services, or plant property?
10. Are accounts payable recorded in the period in which incurred?
11. Does the disbursement of an accounts payable item result in liquidation of the liability item within the same period?
12. Does the system produce an accounts payable aging report?

Appendix G. Comparison of Key Accounting Requirement Questions in Abbreviated and Comprehensive Review Guides

13. Are estimated losses recorded in the system and reported in the financial reports, if information available indicates that an asset probably has been impaired or a liability probably has been incurred as of the date of the financial reports, and the amount can be reasonably estimated?
14. Does the system employ effective procedures to prevent duplicate payments?
15. Are cash and checks deposited as expeditiously as possible and recorded in the accounting system?
16. Are differences in accounting office records and Department of the Treasury records for cash deposits rectified promptly?
17. Are undistributed collections separately recorded and researched for proper disposition?
18. Is there at least a quarterly review of funds, including cash count, held by accountable officers to ensure funds are commensurate with actual needs?
19. Are daily deposits made when collections exceed \$1,000 a day, but not less frequently than weekly, regardless of the amount?
20. For imprest funds, are responsibilities for authorizing procurements, making purchases, and receiving materials and services divided among several individuals?
21. Are undistributed disbursements controlled and promptly and accurately researched and resolved?
22. If disbursing is performed by another agency, can the recorded voucher disbursements be reconciled with the Central Accounting Records of the Department of the Treasury?
23. Does the system have adequate cash management procedures to mechanically do the following?
 - Suspend invoices for the prescribed period?
 - Take discounts only when advantageous to the Government?
 - Base the cash management period on the date of acceptance rather than invoice where applicable?
 - Account for refused discounts?

**Appendix G. Comparison of Key Accounting Requirement Questions in
Abbreviated and Comprehensive Review Guides**

24. For prompt payment purposes, does the system do the following?
- Provide invoice-aging capability to alert users of potential interest-due conditions?
 - Compute prompt pay interest and pay the interest at the time the voucher is paid?
25. Are prompt pay interest payments tracked in a manner that annual reports required by the Prompt Pay Act can be generated?

Appendix H. Organizations Visited or Contacted

Defense Agencies

Defense Finance and Accounting Service, Arlington, VA

Defense Finance and Accounting Service, Richmond Detachment, Richmond, VA

Defense Accounting Office, Defense Information Systems Agency, Arlington, VA

Defense Finance and Accounting Service, Denver Center, CO

Defense Accounting Office, Washington Headquarters Services, Arlington, VA

Defense Information Systems Agency, Arlington, VA

Washington Headquarters Services, Arlington, VA

Appendix I. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Director, Washington Headquarters Services

Appendix I. Report Distribution

Non-Defense Federal Organizations and Individuals

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 National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Defense Finance and Accounting Service Comments



DFAS-HQ/P

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

FEB - 7 1996

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT
DIRECTORATE, INSPECTOR GENERAL, DOD

Subject: Response to DoDIG Draft Report, "Annual Reviews of User
Accounting Controls for the Washington Headquarters
Services Allotment Accounting System," dated
December 15, 1995, (Project No. 5RF-6010.07)

As requested in your memorandum dated December 15, 1995,
attached is the comment to Recommendation 1, and comment on the
purported material weakness discussed in Appendix A of the
subject report.

My point of contact is Mr. Kris Beaubien. He may be
contacted on (703) 607-0093.


Michael E. Wilson
Deputy Director,
Customer Service and
Performance Assessment

Attachment
As stated

Response to DoDIG Draft Report, "Annual Reviews of User Accounting Controls for the Washington Headquarters Services Allotment Accounting System," dated December 15, 1995, (Project No. 5RF-6010.07)

- **RECOMMENDATION 1:** Director, Defense Finance Accounting Service, issue a comprehensive System Manager/User Review Guide for the Washington Headquarters Services Allotment Accounting System.

- **DFAS COMMENTS:** Do not concur. The recommendation is not germane because as we informed your staff prior to the start of this audit we will no longer be issuing comprehensive or abbreviated System Manager/User Review Guides (SM/URs) after FY 1995. In 1995 we developed a process that produces an automated SM/UR that is tailored to address specific requirements of each system, rather than the general system characteristics addressed in the comprehensive SM/UR. The automated SM/UR to be issued for the FY 1996 program will help us provide a more accurate assessment of an individual accounting system's compliance with Government accounting principles and standards.

- **DFAS COMMENTS APPENDIX A:** The conclusions reached in the audit report on the risks associated with the review guides are erroneous. The use of a comprehensive guide over an abbreviated guide has no bearing on the amount of user involvement. Both guides require that the review must be staffed with personnel who are knowledgeable in the system's operations, and both guides require a certification to the systems ability to meet the user's information needs. Furthermore, guidance developed and maintained by DFAS in the DoD Financial Management Regulation 7000.14-R requires user participation in performing the annual reviews. User involvement can only be ensured by diligent adherence to the established review guidelines.

Washington Headquarters Services Comments



(Budget and Finance)

DEPARTMENT OF DEFENSE
WASHINGTON HEADQUARTERS SERVICES
1155 DEFENSE PENTAGON
WASHINGTON, DC 20301-1155



26 January 1996

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT
DIRECTORATE, DODIG

SUBJECT: Audit Report on Annual Reviews of User Accounting
Controls for the Washington Headquarters Services
Allotment Accounting System (Project No. 5RF-6010.07)

The Washington Headquarters Services concurs in recommendation
2 of the subject audit report.

William J. Bader
Deputy Director



Audit Team Members

This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Thomas F. Gimble
Salvatore D. Guli
Mary Lu Ugone
John Donnelly
Kathleen Fitzpatrick
Timothy E. Moore
Jennifer Zucal
Nancy C. Cipolla
Cristina Maria H. Giusti