Audit Report

COMPILATION OF THE FY 1996 ARMY FINANCIAL STATEMENTS AT THE DEFENSE FINANCE AND ACCOUNTING SERVICE INDIANAPOLIS CENTER

Report Number 98-120

April 23 1998

Office of the Inspector General
Department of Defense

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Acronyms

CFO	Chief Financial Officers
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
GLAC	General Ledger Account
SGL	Standard General Ledger
USD(C)	Under Secretary of Defense (Comptroller)
AAA	Army Audit Agency

INSPECTOR GENERAL
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April 23, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on the Compilation of the FY 1996 Army Financial Statements at the Defense Finance and Accounting Service Indianapolis Center (Report No. 98-120)

We are providing this report for review and comment. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Under Secretary of Defense (Comptroller), and the Director, Defense Finance and Accounting Service Indianapolis Center, did not comment on a draft of this report. Accordingly, we request that the Under Secretary of Defense (Comptroller), and the Director, Defense Finance and Accounting Service Indianapolis Center, provide comments on the final report by June 22, 1998.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9175) or e-mail RBird@DODIG.OSD.MIL, or Mr. John J. Vietor, Audit Project Manager, at (317) 510-3855 (DSN 699-3855) or e-mail JVietor@DODIG.OSD.MIL. See Appendix D for the report distribution. The audit team members are listed on the inside back cover.

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Report No. 98-120 **April 23, 1998**
(Project No. 6FI-2023)

Compilation of the FY 1996 Army Financial Statements at the Defense Finance and Accounting Service Indianapolis Center

Executive Summary

Introduction. The Defense Finance and Accounting Service (DFAS) Indianapolis Center maintains the Army departmental accounting records and compiles the Army General Fund financial statements.

This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with applicable generally accepted Government auditing standards but allows the delegation of the audit work. The Inspector General, DoD, delegated the audit of the FY 1996 Army General Fund financial statements to the Army Audit Agency and assisted by performing the required audit work at the DFAS Indianapolis Center. The Army Audit Agency disclaimed an opinion on the FY 1996 Army General Fund financial statements, and we concurred with the disclaimer.

The Army FY 1996 General Fund financial statements included the Statement of Financial Position and the Statement of Operations and Changes in Net Position, along with the supporting footnotes, supplementary schedules, and a management overview. The FY 1996 Statement of Financial Position reported total assets of $201 billion and total liabilities of $25.3 billion as of September 30, 1996. The Statement of Operations and Changes in Net Position reported total revenues of $62.3 billion and total expenses of $64.7 billion for the fiscal year ended September 30, 1996.

Audit Objectives. Our audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial information from field activities and other sources into the FY 1996 Consolidated Financial Statements of the Army General Fund. We evaluated the processes, including internal controls and methods that the DFAS Indianapolis Center used to compile the Army FY 1996 General Fund financial statements. In addition, we reviewed the adequacy of the internal control program as it applied to our objectives.

Audit Results. The DFAS Indianapolis Center compiled financial data from field entities and other sources into the FY 1996 Army General Fund financial statements in a manner generally consistent with applicable laws and regulations. However, the financial statements were inaccurate in several material respects, and the procedures and internal controls used to compile the financial statements needed improvement. See Appendix A for details on the internal control program.

o The DFAS Indianapolis Center needed to improve its process for compiling the Army General Fund financial statements. The process that was used to prepare 265

adjustments to the departmental general ledger data for about $298.9 billion could have been more efficient or better controlled. Departmental general ledger adjustments were made for many reasons, including changing General Ledger Accounts (GLACs) to match certified status data, recording auditors' adjustments, recording information on ammunition assets received from external sources, or correcting errors made by field accounting entities. Also, at the end of FY 1996, the DFAS Indianapolis Center was required to make 17,312 correcting adjustments to data on the status of appropriations for about $1.5 billion that would not have been necessary if existing policies had been enforced. The DFAS Indianapolis Center completed research and documentation supporting 43 Treasury reconciliation adjustments for about $122.4 million; however, the DFAS Indianapolis Center did not complete the research and documentation to support an additional 5 Treasury reconciliation adjustments for about $7 million. In addition, the DFAS Indianapolis Center could not determine the correct balance for Non-Entity Assets Fund Balance With Treasury, Army Suspense Account (Appropriation 21-X-6875). As a result, the compilation of the financial statements was prone to error, and the statements were subject to material misstatement. The Statement of Operations and Changes in Net Position (FYs 1996 and 1995 balances) and the Statement of Financial Position (FY 1995 balances) were misstated by at least $15.2 billion because of an error in posting a single general ledger adjustment. Also, the negative $133 million reported as Non-Entity Assets Fund Balance With Treasury for FY 1996 was both abnormal and inaccurate (Finding A).

o Army general ledger accounts did not accurately reflect the value of assets transferred to or from the Army. As a result, the balances recorded for assets transferred to or from the Army were not supportable, and the Army will not be able to meet the expanded financial reporting requirements effective for FY 1998 yearend reporting (Finding B).

Part I of this report provides the details of our audit.

Summary of Recommendations. We recommend that the Director, DFAS Indianapolis Center, improve the efficiency of and control over the process that the DFAS Indianapolis Center uses to adjust departmental general ledger data, enforce the existing guidance for status data and Department of the Treasury reconciliation adjustments, determine the actual FY 1996 yearend balance of the Army Suspense Account (Appropriation 21-X-6875), and report the correct FY 1996 Non-Entity Fund Balance With Treasury as a prior-period correction on the FY 1997 Army General Fund financial statements.

We also recommend that the Under Secretary of Defense (Comptroller) revise the DoD Standard General Ledger Chart of Accounts to permit Army general ledger accounts to accurately reflect the value of assets transferred to or from the Army, and that the Director, DFAS Indianapolis Center, determine the correct balances to be recorded for transferred assets.

Management Comments. The Under Secretary of Defense (Comptroller) and the Director, DFAS Indianapolis Center, did not respond to a draft of this report. We request that the Under Secretary of Defense (Comptroller), and the Director, DFAS Indianapolis Center, provide comments on the report by June 22, 1998.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 3
Finding A. Compiling the FY 1996 Army General Fund Financial Statements 4
Finding B. Adjustments to General Fund Invested Capital 13

Part II - Additional Information

Appendix A. Audit Process
Scope and Methodology 18
Management Control Program Review 19
Appendix B. Summary of Prior Coverage 21
Appendix C. Process Used to Prepare the Army General Fund Financial Statements 22
Appendix D. Report Distribution 24

Part I - Audit Results

Audit Background

Chief Financial Officers Act. This audit was performed in response to the Chief Financial Officers Act (the CFO Act) of 1990, as amended by the Federal Financial Management Act of 1994. The CFO Act requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments and agencies, as well as Government corporations. The CFO Act also requires the Inspectors General, or appointed external auditors, to audit financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget.

Role of the DFAS Indianapolis Center. The Defense Finance and Accounting Service (DFAS) Indianapolis Center provides finance and accounting support to all DoD organizations, but especially to the Army and Defense agencies. Support includes maintaining departmental accounting records and preparing financial statements from general ledger trial balances and financial data on the status of appropriations, both submitted by DoD field accounting entities and other sources. However, the compilation process is complicated because financial data submitted to the DFAS Indianapolis Center were not generated by integrated, transaction-driven general ledger systems. See Appendix C, "Process Used to Prepare the Army General Fund Financial Statements," for details.

Audit of the FY 1996 Army General Fund Financial Statements. The Inspector General, DoD, delegated the FY 1996 audit of the Army General Fund financial statements to the Army Audit Agency (AAA). The Inspector General, DoD, assisted the AAA by performing the required audit work at the DFAS Indianapolis Center, including examining the processes used to prepare the Army General Fund financial statements.

FY 1996 Army General Fund Financial Statements. The Army FY 1996 financial statements consisted of the Statement of Financial Position and the Statement of Operations and Changes in Net Position, along with the supporting footnotes, supplementary schedules, and a management overview. The Statement of Financial Position includes both Entity Assets and Non-Entity Assets, as well as liabilities. Entity Assets are assets that the Army is authorized to use in its operations, and Non-Entity Assets are assets held by the Army but not available to it. The FY 1996 Statement of Financial Position reported total assets of $201 billion and total liabilities of $25.3 billion as of September 30, 1996. The Statement of Operations and Changes in Net Position reported total revenues of $62.3 billion and total expenses of $64.7 billion for the fiscal year ended September 30, 1996.

Audit Objectives

The audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial information from field activities and other sources into the FY 1996 Consolidated Financial Statements of the Army General Fund. We evaluated the processes, including internal controls and methods that the DFAS Indianapolis Center used to compile the Army FY 1996 General Fund financial statements. In addition, we reviewed the adequacy of the internal control program as it applied to our objectives.

See Appendix A for a discussion of the audit process, the DFAS Indianapolis Center's internal control program, and the material internal control weaknesses identified during our review. See Appendix B for a summary of prior audit coverage at the DFAS Indianapolis Center related to the audit objective.

Finding A. Compiling the FY 1996 Army General Fund Financial Statements

The DFAS Indianapolis Center needed to improve its process for compiling the Army General Fund financial statements. The process used to prepare 265 adjustments to the departmental general ledger data for about $298.9 billion could have been more efficient and better controlled. Departmental general ledger adjustments were made for many reasons, including changing General Ledger Accounts (GLACs) to match certified status data, recording auditors' adjustments, recording information on ammunition assets received from external sources, or correcting errors made by field accounting entities Also at the end of FY 1996, the DFAS Indianapolis Center made 17,312 correcting adjustments, valued at $1.5 billion, to data on the status of appropriations. Research and documentation supporting 43 Department of the Treasury reconciliation adjustments for about $122.4 million was late, and the research and documentation needed to support an additional 5 adjustments for about $7 million was not completed. In addition, the DFAS Indianapolis Center inaccurately reported an abnormal negative balance of $134.3 million for Non-Entity Assets Fund Balance With Treasury because of posting errors. These problems existed because the DFAS Indianapolis Center had not developed a formal plan to analyze and control departmental general ledger adjustments and did not follow existing guidance for adjustments to status data. Also, an automated process that transfers cross disbursements generated and posted the wrong transactions to a suspense account supporting the Non-Entity Assets Fund Balance With Treasury. All the resulting errors were not corrected. As a result, the process of compiling the financial statements was inefficient, and the statements were subject to material misstatement. The Statement of Operations and Changes in Net Position (FYs 1996 and 1995 balances) and the Statement of Financial Position (FY 1995 balances) were misstated by at least $15.2 billion.

Departmental Adjustments

The DFAS Indianapolis Center makes many adjustments to both general ledger trial balances (general ledger data) and data on the status of appropriations (status data). Data submitted by field accounting entities are subjected to basic data edits and balancing routines. Status data recorded by the DFAS Indianapolis Center during the fiscal year are adjusted to match yearend reports on the status of appropriations certified by responsible officials. The adjusted status data are referred to as certified status data. The DFAS Indianapolis Center then makes departmental adjustments to general ledger and certified status data.

Departmental General Ledger Adjustments. To present the Army General Fund financial data on the FY 1996 financial statements, the DFAS Indianapolis Center prepared 260 manual adjustment vouchers and 5 automated adjustment vouchers for about $298.9 billion. Individual vouchers ranged in value from $.01

to about $74.9 billion. In comparison, the preparation of the FY 1995 financial statements required 172 vouchers for about $238 billion. Auditors identified 32 different purposes for general ledger adjustments, such as changing General Ledger Accounts (GLACs) to match certified status data, recording auditors' adjustments, recording information on ammunition assets received from external sources, or correcting errors made by field accounting entities. Table 1 lists the types of departmental general ledger adjustments.

Table 1. FY 1996 Departmental General Ledger Adjustments

Purpose of Adjustments	Amount (Billions)	Percent of Total
Changing general ledger accounts to match certified status data	$127.8	43
Recording appropriated capital used	55.2	18
Recording auditors' adjustments	31.2	10
Recognizing contingent liabilities	14.6	5
Recording prior period adjustments	13.5	5
Making intra-agency eliminations	11.9	4
Recording ammunition assets	10.4	3
Reclassifying military pay expenses	7.5	3
All others (24 additional purposes, including correcting errors made by field accounting entities.)	26.8	9
Total	**$298.9**	**100**

Automated vouchers were used to change general ledger accounts to match certified status data, to record appropriated capital used, and to make intra-agency eliminations. All other adjustments were made using manual journal vouchers.

Types of Status Data Adjustments. The DFAS Indianapolis Center makes two types of departmental adjustments to status data. The first type is bulk adjustments, which are applied mechanically to address deficiencies in the accounting system and in the reporting by field accounting entities. The second type is individual adjustments, which are manually prepared to correct errors and to meet accounting or reporting requirements. Individual adjustments are also used to eliminate differences that are detected during the yearend reconciliation of the net expenditures recorded by the DFAS Indianapolis Center and those recorded by the Treasury (Treasury reconciliation adjustments). The Treasury reconciliation adjustments ensure that the status data reported by the field accounting entities and recorded by the DFAS Indianapolis Center agree with the appropriation balances on record at the Treasury. DFAS Indianapolis Center standard operating procedures require that the causes for the differences eliminated

by the Treasury reconciliation adjustments should be researched and documented before adjustments are made. Research and documentation ensure that the Treasury reconciliation adjustments are appropriate and correct. The Treasury reconciliation adjustments are critical to the preparation of the Army financial statements because status data, as reconciled with the Treasury, are the basis for the Fund Balance With Treasury reported for the Army General Fund.

General Ledger Adjustments

The DFAS Indianapolis Center had not developed and documented a formal plan to control the departmental general ledger adjustment process. The process that the DFAS Indianapolis Center used to adjust departmental general ledger data was not efficient or well controlled. Preparation of the departmental general ledger adjustments was a large, complex task, with significant effects on the FY 1996 Army General Fund financial statements. Further, DFAS Indianapolis Center personnel had not sufficiently determined which adjustments could be eliminated or designed the most accurate and efficient method of making the adjustments that could not be eliminated.

Changing General Ledger Accounts to Match Certified Status Data. For FY 1996, the DFAS Indianapolis Center prepared three automated vouchers for about $127.8 billion to change general ledger accounts to match certified status data. For financial resources and liabilities such as accounts receivable and accounts payable, the DFAS Indianapolis Center considers certified status data to be more reliable than general ledger data. Review of the adjustments identified the following problems.

Use of Status Data. At the DFAS Indianapolis Center, financial statements are not prepared using a transaction-driven, integrated accounting system that is based on general ledger accounting. Using status data is an acceptable substitute only until reliable general ledger data are available. Also, the magnitude of the differences between general ledger balances and status data calls the reliability of both into question. For example, the unadjusted FY 1996 general ledger balance for accounts payable was about $27 billion, but the corresponding status data balance was $3 billion. However, the DFAS Indianapolis Center has not taken effective actions to identify and correct the causes of the differences between the general ledger balances and status data. Each month, DFAS Indianapolis Center personnel identify the differences between general ledger balances and status data, and they require field accounting entities to reconcile and explain the differences. However, few field accounting entities complete these tasks, and the DFAS Indianapolis Center performs limited followup. DFAS Indianapolis Center made no systematic attempt to use the monthly process to identify and eliminate the causes of the differences between general ledger balances and status data.

Computation of Accounts Payable Adjustments. The database application used to prepare the automated vouchers computed the adjustments to accounts payable and did not differentiate between FY 1996 payables of $1.8 billion due to the public and FY 1996 payables of $2.1 billion due to other Federal organizations. The status data used to compute the adjustments included the information necessary to differentiate, but the DFAS Indianapolis Center made adjustments only to payables due to other Federal activities. This error not only made the financial statement line item balances reported for accounts payable unreliable, but also resulted in abnormal balances in accounts payable due to other Federal activities for some appropriations. The abnormal balances had to be individually corrected with 44 additional manual vouchers for about $2.1 billion. If the DFAS Indianapolis Center properly analyzed accounts payable adjustments, the application could be modified to correct this deficiency.

Timing of Adjustments. The DFAS Indianapolis Center did not test status data that were used to compute the adjustments for completeness and accuracy before making the adjustments. As a result, an additional automatic adjustment for $136.9 million had to be made to reflect changes in the status data. If the status data had been reconciled first, the extra adjustments could have been avoided.

The $127.8 billion adjustment that the DFAS Indianapolis Center made to force general ledger accounts to match certified status data was the largest general ledger adjustment made at yearend, and should be very carefully controlled until it can be eliminated.

Recording Appropriated Capital Used. For FY 1996, the DFAS Indianapolis Center prepared an automated voucher for about $55.2 billion to adjust GLAC 5700 to reflect appropriated capital used. Field accounting entities should record an entry in GLAC 5700 whenever an expense is entered into the accounting records. However, field accounting entities do not make the required entries, and the DFAS Indianapolis Center must prepare a departmental adjustment to negate this omission. The DFAS Indianapolis Center has not taken action to identify and eliminate the cause for this problem.

Recording Auditors' Adjustments. The DFAS Indianapolis Center did not properly record adjustments prepared by the AAA. The AAA prepared an adjustment to record prior-period contingent liabilities of about $15.22 billion. However, the proposed journal voucher that the AAA provided to the DFAS Indianapolis Center displayed the recommended adjustment amount of $15.22 billion rounded to the nearest thousand ($15,220,000). None of the other 32 adjustments that the AAA proposed for FY 1996 used rounded values, so DFAS Indianapolis Center personnel did not recognize that the recommended amount was rounded and recorded the adjustment as $15.22 million. This error was not detected until after the financial statements were completed. Table 2 shows the effect of this error on the FY 1996 Army General Fund financial statements.

Table 2. Effects of Prior-Period Adjustment Error

		FY 1996	FY 1995
Statement of Operations			
21.	Net Position, Beginning Balance	Over[1]	
23.	Non-Operating Changes	Under[2]	Over
24.	Net Position Ending Balance		Over
Statement of Financial Position			
5.b.5.	Other Unfunded Governmental Liabilities		Under
5.c.	Total Liabilities Not Covered by Budget		Under
7.b.	Invested Capital		Over
7.c.	Cumulative Results of Operations		Over
7.e.	Future Funding Requirements		Under
7.f.	Total Net Position		Over
	Error Amount: $15,214,780,000		

[1]Overstated
[2]Understated

Also, the error resulted in a variance of about $13.4 billion between the FY 1996 and FY 1995 balances for Statement of Financial Position, line 5.b.5., Other Unfunded Governmental Liabilities. This material variance should have been detected by the DFAS Indianapolis Center during quality control reviews and fully explained in the footnotes to the financial statements.

The DFAS Indianapolis Center will continue to make large yearend general ledger adjustments to correct accounting system deficiencies and incorrect accounting practices unless each type of adjustment is analyzed and the causes of problems are identified and eliminated. If the adjustments must be made because of systemic problems that cannot be corrected in legacy accounting systems, the DFAS Indianapolis Center should ensure that the problems are avoided in migratory accounting systems such as the Defense Joint Accounting System - Army. After comprehensively analyzing the adjustments, the DFAS Indianapolis Center should establish and document a detailed plan to control the identification, documentation, and implementation of departmental general ledger adjustments. Such a plan will help to avoid duplication of effort, ensure that automatically prepared adjustments are correctly computed, and control the form and timing of adjustments by third parties.

Adjustments To Status Data

At FY 1996 yearend, the DFAS Indianapolis Center made 17,312 avoidable adjustments to status data. Reconciliation and research supporting 43 Treasury reconciliation adjustments for about $122.4 million were late, and research and

documentation needed to support an additional five adjustments for about $7 million was not completed because DFAS Indianapolis Center personnel did not follow existing guidance.

Deobligation Adjustments. The DFAS Indianapolis Center made unnecessary adjustments to status data because DFAS Indianapolis Center managers rescinded valid accounting policy. DFAS Indianapolis Center personnel were making a large number of automatic adjustments to correct a common error made by Army accounting entities. The DoD requires that adjustments to prior year obligations should be recorded as recoveries, but Army accounting entities consistently reported such adjustments as credit obligations. In June 1995, the DFAS Indianapolis Center issued a message instructing Army accounting entities to comply with the Treasury requirements for recording recoveries and credit obligations. However, the message was rescinded in July because some Army entities used the data on recoveries and credit obligations for management purposes and objected to the correct accounting procedures. The U.S. Army Forces Command stated, "This proposed policy is certain to overstate our true deobligations." At the end of FY 1996, the DFAS Indianapolis Center was forced to make 17,312 adjustments to correct errors valued at about $1.5 billion. The DFAS Indianapolis Center should enforce Treasury accounting policy.

Treasury Reconciliation Adjustments. Research and documentation supporting 43 Treasury reconciliation adjustments for about $122.4 million were late, and the research and documentation needed to support an additional five adjustments for about $7 million were not completed. The DFAS Indianapolis Center made the 48 required Treasury reconciliation adjustments for about $129.4 million at the end of October 1996. However, contrary to established guidance and practice, the research and documentation needed to support the adjustments were not completed before the adjustments were made. Formerly, the Treasury reconciliation adjustments, including the research and documentation necessary to support the adjustments, were finished in late October. However, for FY 1996, the research and documentation needed to support 43 adjustments were not completed until December 7, 1996, and the research needed to support the remaining 5 adjustments for about $7 million was not completed. The status data reports used to determine the Fund Balance With Treasury reported for the Army General Fund were completed about November 7, 1996. If the research and documentation needed to support the Treasury reconciliation adjustments are not completed before the adjustments are made, there is no assurance that the adjustments are accurate and complete.

Non-Entity Fund Balance With Treasury

The DFAS Indianapolis Center could not determine the correct balance for the Army FY 1996 Non-Entity Fund Balance With Treasury because of posting errors made to a supporting suspense account.

The Army Suspense Account. The Non-Entity Fund Balance With Treasury included the yearend balance of the Budget Clearing Account (Suspense) for the Department of the Army (Appropriation 21-X-6875, the Army Suspense Account). For FY 1996, the Army reported the Non-Entity Fund Balance With Treasury as a negative $134.3 million and the fiscal yearend balance of the Army Suspense Account as a negative $188 million. Both are abnormal account balances. The DFAS Indianapolis Center uses the Army Suspense Account to record differences between cross-disbursing transaction amounts reported to the Treasury and the amounts reported to the DFAS Indianapolis Center for the same transactions, if the differences cannot be resolved within 12 months.
A cross-disbursing transaction occurs when a Federal entity other than the Army disburses Army funds. For example, the State Department disburses $3 million from an Army construction appropriation and reports this disbursement to the Treasury correctly. However, the detailed record of the disbursement, which the State Department sends to the DFAS Indianapolis Center, incorrectly shows that the disbursement was for $2 million. DFAS Indianapolis Center personnel would attempt to reconcile this $1 million difference ($3 million minus $2 million), but if they were not successful after 12 months, the difference would be removed from the Army construction appropriation and recorded in the Army Suspense Account. The transfer to the Army Suspense Account is automated.

Automated Process. At the end of FY 1996, the Army Suspense Account had an abnormal balance of a negative $188 million. DFAS Indianapolis Center personnel determined that the abnormal balance existed because the automated process that transfers cross-disbursing differences over 12 months old was generating incorrect transactions. The DFAS Indianapolis Center recently began processing cross-disbursing transactions for other DoD organizations. Cross-disbursing differences over 12 months old that arise from DoD transactions should be recorded in the DoD Suspense Account (Appropriation 97-X-6875). However, the automated process was recording DoD cross-disbursing differences in the Army Suspense Account. The automated process has been discontinued.

As of February 1997, the DFAS Indianapolis Center was unable to determine the actual fiscal yearend balance of the Army Suspense Account. As a result, DFAS Indianapolis Center personnel could not determine or report the actual Army Non-Entity Fund Balance With Treasury for FY 1996. Instead, the DFAS Indianapolis Center reported an abnormal balance amount that included the erroneous Army Suspense Account balance and disclosed that the true balance for the Non-Entity Fund Balance With Treasury was unknown. The DFAS Indianapolis Center should determine the actual fiscal yearend balance of the Army Suspense Account as soon as possible.

Conclusion

The DFAS Indianapolis Center will continue to make large yearend general ledger adjustments to correct accounting system deficiencies and incorrect accounting practices unless each type of adjustment is analyzed and the causes of problems are identified and eliminated. If the adjustments must be made because of systemic problems that cannot be corrected in legacy accounting systems, the DFAS

Indianapolis Center should ensure that the problems are avoided in migratory accounting systems, such as the Defense Joint Accounting System - Army. Furthermore, the DFAS Indianapolis Center could avoid unnecessary status data adjustments and properly support Treasury reconciliation adjustments if it enforced existing policy and guidance. Also, the DFAS Indianapolis Center will not be able to report accurate balances for Non-Entity Fund Balance With Treasury until the correct balance for the Army Suspense Account is determined.

Recommendations for Corrective Action

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

1. Establish procedures to improve the efficiency of and control over the process used to adjust departmental general ledger data. Specific improvements should include the following:

a. Analyze all general ledger adjustments made at yearend. Where possible, identify and eliminate the causes of yearend adjustments that are due to accounting errors or system deficiencies. If the cause of a type of adjustment cannot be eliminated because of restrictions on changes to legacy accounting systems, ensure that the developers of migratory accounting systems are aware of the systemic problems that cause the adjustments so that changes can be made to the systems.

b. Determine the most accurate and efficient method for preparing general ledger adjustments that cannot be eliminated.

2. Enforce existing guidance for status data adjustments, including:

a. Reissue and enforce Department of the Treasury policy guidance requiring the correct reporting of deobligations.

b. Complete the research and documentation needed to support Department of the Treasury reconciliation adjustments before making the adjustments.

3. Determine the actual FY 1996 yearend balance of the Army Suspense Account (Appropriation 21-X-6875) and report the correct FY 1996 Non-Entity Fund Balance With Treasury as a prior-period correction.

4. Review the compilation process for the Army General Fund financial statements as part of the Defense Finance and Accounting Service self-evaluation. Appendix A gives details on the adequacy of management's self-evaluation.

Management Comments Required

The Director, Defense Finance and Accounting Service Indianapolis Center, did not comment on the draft report. We request that the Director, Defense Finance and Accounting Service Indianapolis Center, provide comments on this report.

Finding B. Adjustments to General Fund Invested Capital

Army general ledger accounts did not accurately reflect the value of assets transferred to or from the Army. This occurred because the DoD Standard General Ledger Chart of Accounts did not provide the General Ledger Accounts needed to record adjustments to General Fund invested capital. As a result, the balances of $208.4 billion recorded for assets transferred to the Army and $40.3 billion recorded for assets from the Army were not supportable, and the Army will not be able to meet changing and more detailed financial reporting requirements in FY 1998.

General Ledger Accounts

Standard General Ledgers. The U.S. Government Standard General Ledger (SGL) Chart of Accounts, published by the Department of the Treasury Financial Management Service, defines the GLACs that all Federal agencies must use when recording accounting transactions. The USD(C) issued the DoD SGL Chart of Accounts as a supplement that defines additional GLACs. The additional GLACs allow DoD accounting entities to maintain more detailed accounting records than the U.S. Government SGL alone would permit. Both the U.S. Government SGL and the DoD SGL define GLACs as accounts to be used when recording transactions ("posting accounts") or accounts to be used to summarize the contents of subordinate GLACs ("summary accounts"). Because the DoD SGL includes more detail than the U.S. Government SGL, accounts that are defined as posting accounts in the U.S. Government SGL are often defined as summary accounts in the DoD SGL.

Financial Reporting. Current instructions to Federal agencies on the use of GLACs to construct financial reports are in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as modified by Treasury Financial Manual Transmittal Letter No. S2-96-01. DoD normally issues annual interpretations of the Office of Management and Budget Bulletin. For example, the USD(C) issued its "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" in October 1996. However, the Office of Management and Budget Statement of Federal Financial Accounting Concepts Number 2, "Entity and Display," June 6, 1995, defines an entirely new set of five financial statements for all Federal agencies. Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, states that the provisions of Statement of Federal Financial Accounting Concepts Number 2 are to be implemented in the preparation of financial statements for the fiscal year ending September 30, 1998.

Adjustments to Equity Accounts

The DoD SGL does not include the GLACs necessary to record appropriated fund capital investments correctly.

Capital Investment GLACs. The U.S. Government SGL defines GLAC 3210, Capital Investments, as a posting account used to record initial investment to commence operations, results of operations, and funds returned to Treasury. The DoD SGL defines GLAC 3210 as a summary account and defines several subordinate GLACs for various types of capital investments. However, the DoD SGL does not define a subordinate capital investment GLAC for appropriated funds. The U.S. Government SGL also defines GLAC 3220 as a posting account for recording the value of assets transferred in from others without reimbursement, and GLAC 3230 as a posting account for recording the value of assets transferred out to others without reimbursement. The DoD SGL defines these accounts in the same way, except that GLAC 3230 is defined as a summary account with two subordinates, one for transfers within the Government (GLAC 3231) and one for transfers to all others (GLAC 3232).

Capital Investment Adjustments. During the compilation of the Army General Fund financial statements, DFAS Indianapolis Center personnel must often make departmental general ledger adjustments to appropriated funds invested capital. However, because the DoD SGL does not include a posting account for appropriated funds invested capital, the USD(C) directed the DFAS Indianapolis Center to make invested capital adjustments to the transfer accounts (GLACs 3220 and 3231). As a result, these two accounts are subject to large volumes of adjustments and have large balances. For FY 1996, the DFAS Indianapolis Center made 69 adjustments for about $27.4 billion to GLAC 3220 and another 75 adjustments for $29.5 billion to GLAC 3231. The ending balances for the two accounts were $208.4 billion and $40.3 billion, respectively. However, these adjustments and balances are not related to the actual transfer of assets to and from the Army. For example, while recording auditor-recommended adjustments for FY 1996, the DFAS Indianapolis Center posted about $2 billion to GLAC 3220 and about $20.1 billion to GLAC 3231. None of these adjustments was related to the transfer of assets to or from the Army. As a result of these and similar adjustments, the true balances that should be recorded in the transfer accounts cannot be determined.

Effect on Financial Statements. Because current guidance for financial statements requires that invested capital, transfers in, and transfers out to be reported on the same financial statement line, the improper use of the transfer accounts has no adverse effect on the FY 1996 financial statements. However, the practice of making unrelated adjustments to the transfer accounts has rendered the true balance of these accounts unauditable. In addition, starting in FY 1998, the provisions of Statement of Federal Financial Accounting Concepts Number 2 require that transfers in and transfers out be reported separately in the Statement of Changes in Net Position. Improper use of the transfer accounts will prevent accurate reporting and will have a material negative effect on financial reporting beginning in FY 1998.

The USD(C) should revise the DoD SGL to eliminate this problem. The DFAS Indianapolis Center should make a special study to determine the actual balances that should be recorded in the transfer accounts and make appropriate adjustments to the general ledger.

Recommendations for Corrective Action

B.1. We recommend that the Under Secretary of Defense (Comptroller) revise the DoD Standard General Ledger Chart of Accounts to permit adjustments to appropriated fund invested capital.

B.2. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, determine the correct balances to be recorded for assets transferred to and from the Army General Fund and make appropriate adjustments to the general ledger.

Management Comments Required

The Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service Indianapolis Center, did not comment on the draft report. We request that the Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service Indianapolis Center, provide comments on this report.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. We limited our audit of the compilation of the Army FY 1996 General Fund financial statements to examining the DFAS Indianapolis Center's processes for consolidating departmental status and general ledger data. These data were used to prepare the version of the Army financial statements that was submitted to the auditors on December 19, 1996. Our audit included a review of the following processes:

- establishing beginning account balances;
- reporting and certifying yearend data, including the controls over yearend status data, the Treasury trial balance, and the general ledger reconciliations;
- making adjustments directly to the Financial Statement Database file; and
- transferring the status-adjusted general ledger data to the Financial Statement Database and to the Army financial statements.

Limitations to Audit Scope. Because our audit was limited to work performed at the DFAS Indianapolis Center, we did not examine the accuracy of data that originated at DoD field accounting entities or other sources, or attempt to reconcile the data with subsidiary records maintained by field accounting entities. However, we did compare the Fund Balance With Treasury recorded by the Treasury for the Army General Fund to the Fund Balance With Treasury reported in the Army General Fund financial statements. We also reviewed the closing positions for Army General Fund appropriations for deficit balances and the general ledger trial balances for reasonableness.

To achieve the audit objective, we relied primarily on computer-processed data in the Departmental Budget and Accounting Reporting System and the General Ledger Database. We accomplished a limited assessment of the reliability of this data using the GAO systems audit approach designed for generalists. Our limited review determined that the internal controls and methods used were adequate. We also conducted tests of the data and concluded that the computer-processed data were sufficiently reliable to complete the audit objective. However, field-level systems were not included in the review; therefore, we can comment only on the reliability of data processed after receipt by the DFAS Indianapolis Center.

Audit Type, Dates, Locations, and Standards. We performed this financially related audit at the DFAS Indianapolis Center from May 1996 through August 1997. The audit was conducted in compliance with the auditing standards

established by the Comptroller General, as implemented by the Inspector General, DoD, and with Office of Management and Budget guidance. The audit included such tests of management controls and management compliance with laws and regulations as we considered necessary.

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

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of the DFAS Indianapolis Center management controls for consolidating the status and general ledger data for preparation of the Army financial statements. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Internal Controls. We identified material internal control weaknesses at the DFAS Indianapolis Center for consolidating the status and general ledger data for preparation of the Army financial statements, as defined by DoD Directive 5010.38. The DFAS Indianapolis Center internal controls were not adequate to ensure that the process of adjusting departmental general ledger data was efficient or well controlled, that unnecessary status data adjustments were avoided, that research and documentation needed to support Treasury reconciliation adjustments were completed before making the adjustments, or that the balance for Non-Entity Assets Fund Balance With Treasury was correctly determined. The internal control weaknesses that we identified, and our recommendations for improvements, are discussed in Part I. Recommendations A.1., A.2., A.3., and A.4., if implemented, will improve DFAS Indianapolis Center processes for consolidating the status and general ledger data for preparation of the Army financial statements. A copy of the report will be provided to the senior official responsible for internal controls at the DFAS Indianapolis Center.

Adequacy of Management's Self-Evaluation. Management's self-evaluation was not adequate. DFAS Indianapolis Center officials identified the components of the financial statement compilation as assessable units, but the DFAS Indianapolis Center did not perform three internal control reviews that were scheduled. The DFAS Indianapolis Center's inventory of assessable units listed four assessable units that provide critical data to the reporting process for Army General Fund financial statements. Three of the assessable units were scheduled to perform internal control reviews, but none of the reviews was performed. The DFAS Indianapolis Center reorganized and the internal control program coordinator developed a new inventory of assessable units. Because the reorganization eliminated the divisions corresponding to the three assessable units that were to perform the reviews, the internal control program coordinator determined that the reviews were no longer necessary. However,

DFAS 5010.38-R does not support this determination. Also, the Management Control Division, USD(C), has stated that the determination that reorganization eliminates the requirement to complete scheduled control reviews is not appropriate. DFAS 5010.38-R requires risk assessments of newly established assessable units. If the program coordinator had scheduled the required risk assessments and the responsible managers had conducted them, the coordinator would have determined that a single assessable unit had been established that encompassed the duties and functions of the three eliminated assessable units. The scheduled reviews should have been performed.

Appendix B. Summary of Prior Coverage

Inspector General, DoD, Report No. 96-161, "Compilation of the FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service, Indianapolis Center," June 13, 1996. The Inspector General, DoD, delegated the issuance of an audit opinion to the AAA and assisted the AAA by performing the required audit work at the DFAS Indianapolis Center. The Inspector General, DoD, concluded that the DFAS Indianapolis Center consistently and accurately compiled financial data from field entities and other sources into the FY 1995 Consolidated Financial Statements for the Army General Fund. The efficiency and internal control environment of the compilation process had significantly improved since FY 1993. However, further improvements in the compilation process were needed. The DFAS Indianapolis Center could have better explained that variances of up to $6 billion occurred in financial statement line items from year to year because FY 1995 financial data were not comparable to FY 1994 financial data. Footnotes were incomplete. Also, controls over making 15 auditor-recommended adjustments for about $19.5 billion and preparing 165 accounting adjustment vouchers needed improvement. The auditors made four recommendations to improve disclosure and footnotes and to strengthen internal control procedures. The DFAS Indianapolis Center concurred with all recommendations. As of fiscal yearend 1996, all recommended actions were complete.

Inspector General, DoD, Report No. 94-168, "Defense Finance and Accounting Service Work on the Army's FY 1993 Financial Statements," July 6, 1994. This audit combined the results of audit work on the Army FY 1993 General Fund and the Defense Business Operations Fund (DBOF) financial statements. The Inspector General, DoD, delegated the issuance of an audit opinion to the AAA and assisted the AAA by performing the required audit work at the DFAS Indianapolis Center. The Inspector General, DoD, concluded that the Army DBOF financial statements for FY 1993 were misstated by about $2.2 billion and the Army General Fund financial statements were misstated by about $2.7 billion because the DFAS Indianapolis Center failed to detect or correct errors in the financial data submitted to the Army departmental general ledger. Additionally, the DFAS Indianapolis Center did not adequately document about $9.8 billion of the status data adjustments reviewed and about $48.3 billion of the departmental general ledger adjustments reviewed. DBOF inventory accounting was not correct, and inputs and adjustments to the departmental general ledger were not properly organized and controlled. The auditors made 10 recommendations to strengthen internal control procedures and to address detection and correction procedures for general ledger accounts. The DFAS Indianapolis Center concurred with or provided acceptable alternative actions for all recommendations.

Appendix C. Process Used to Prepare the Army General Fund Financial Statements

The DFAS Indianapolis Center prepares the Army financial statements from unconsolidated financial data. However, neither the DFAS Indianapolis Center Headquarters Accounting and Reporting System nor its supporting accounting subsystems conform to the general ledger method of accounting. In addition, the financial data submitted to the DFAS Indianapolis Center were not generated by integrated, transaction-driven general ledgers. As a result, the DFAS Indianapolis Center uses a complex process to combine financial information from many accounting subsystems and to compile the Army financial statements.

Beginning Balances. To establish correct beginning balances for the general ledger accounts, the field accounting entities transfer any direct adjustments from the prior year that affected general ledger balances, such as auditor adjustments, to the General Ledger Data Base.

Yearend Status Data Certification. The status data accumulated in the Departmental Budgetary Accounting and Reporting System during the fiscal year are corrected to match certified status reports. At the end of the fiscal year, certified status of funds reports are transmitted to the Departmental Budgetary Accounting and Reporting System for all operating agencies supported by the DFAS Indianapolis Center. The certified reports are then compared to the corresponding status data, and the status data are adjusted to match the certified reports.

Reconciliation to the Treasury Trial Balance. The status data are reconciled to the net expenditures recorded by the Treasury. DFAS Indianapolis Center personnel extract current-year data on net collections and disbursements from the Departmental Budgetary Accounting and Reporting System by appropriation, creating the Balance Forward file. The same data are then obtained from the Treasury using an interactive system, the Government On-line Accounting Link System. Each month, four Government On-line Accounting Link System reports are available: all activity for each appropriation by month for receipts (Treasury Reports 6654 and 6655 Receipts); all activity for each appropriation by month for disbursements (Treasury Report 6653 Disbursements); and the ending balance for each appropriation by month for disbursements (Treasury Report No. 6654 Disbursements). Government On-line Accounting Link System reports are generally available 16 days after the end of the reporting period. DFAS Indianapolis Center personnel compare the status data to the Treasury data. All differences are researched and reconciled.

Adjustments to Status Data. DFAS Indianapolis Center personnel make departmental adjustments to the certified status data. The adjustments allow status data to show the effect of in-transit and unmatched transactions on accounts payable and accounts receivable; correct bulk errors caused by

deficiencies in accounting systems; meet special reporting requirements; and add department-level information not available to or accounted for by the field accounting systems.

Creation of the Financial Statement Database Files. DFAS Indianapolis Center personnel consolidate the financial data that are reported directly to the departmental general ledger from the field accounting activities and stored in the General Ledger Data Base in a microcomputer database, the Financial Statement Database. The Financial Statement Data Base contains two files. The first file, SOURCE21, is a summary-level database used to prepare the Army financial statements. The second file, SOURCEOA, is a more detailed database, recorded at the fiscal station and allotment level for Army General Fund appropriations, which is used only for research purposes.

Direct Adjustments. DFAS Indianapolis Center personnel make adjustments directly to the SOURCE21 database. The direct adjustments are used to enter intra-agency eliminations; estimates for future expenses, such as Worker's Compensation Act payments; information on nonfinancial resources received as hard copy or electronically from activities such as the Army Materiel Command or the National Guard Bureau; and department-level expenditures for receipt accounts. Direct adjustments are also used to change the financial information in the general ledger so that the financial resources reported in the Army statements agree with Departmental Budgetary Accounting and Reporting System and Treasury reports.

Preparation of the Basic Financial Statements. A microcomputer program known as the Comprehensive Reporting System converts the SOURCE21 file into the Army financial statements. The application uses three other files to perform the conversion: a list of appropriations to be included in the Army and Defense agency statements (the Group table); a crosswalk that directs general ledger accounts to the correct financial statement line for each set of statements (the Map table); and the fixed-text portion of each set of financial statements (the Lines table).

Production of the Initial Financial Report. DFAS Indianapolis Center personnel add footnotes, supplementary schedules, and an overview section to the basic financial statements produced by the Comprehensive Reporting System to create the initial version submitted for audit.

Production of the Audited Financial Statements. The initial version of the Army statements is subsequently modified to show adjustments caused by the audit, and to include the audit opinion and other changes. This version (Version II) then becomes the audited submission.

The DFAS Indianapolis Center has used this process to prepare the Army financial statements since FY 1993.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant 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 Finance and Accounting Service, Indianapolis Center
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

Non-Defense Federal Organizations and Individuals (cont'd)

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 Government Management, Information, and Technology, 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

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