

Audit



Report

COMPILATION OF THE FY 1997 NAVY GENERAL FUND
FINANCIAL STATEMENTS AT THE DEFENSE FINANCE
AND ACCOUNTING SERVICE CLEVELAND CENTER

Report Number 98-217

September 30, 1998

Office of the Inspector General
Department of Defense

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, home page at: www.dodig.osd.mil.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8908 (DSN 664-8908) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.osd.mil; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

| | |
|-------------|---|
| BCA | Budget Clearing Account |
| CFO | Chief Financial Officers |
| DFAS | Defense Finance and Accounting Service |
| IG | Inspector General |
| NHFS | Navy Headquarters Financial System |
| STARS - FDR | Standard Accounting and Reporting System - Financial and Departmental Reporting |



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

September 30, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Audit Report on the Compilation of the FY 1997 Navy General Fund
Financial Statements at the Defense Finance and Accounting Service
Cleveland Center (Report No. 98-217)

We are providing this report for your review and comments. The audit was performed in response to the requirement of the Chief Financial Officers Act of 1990 for financial statement audits. We considered management comments on a draft of this report in preparing the final report. We revised report Recommendation B.1. based on management comments received from the Office of the Under Secretary of Defense (Comptroller).

Management comments received from the Office of the Under Secretary of Defense (Comptroller) conformed to the requirements of DoD Directive 7650.3. The Director, Defense Finance and Accounting Service, did not comment on a draft of this report; therefore, we request the Director provide comments on this final report by October 30, 1998.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Brian M. Flynn at (703) 604-9145 (DSN 664-9145), e-mail bflynn@dodig.osd.mil, or Ms. Linda A. Pierce at (216) 522-6091, extension 234 (DSN 580-6091), e-mail lap@dodig.osd.mil. See Appendix E for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-217
(Project No. 7FI-2033.01)

September 30, 1998

Compilation of the FY 1997 Navy General Fund Financial Statements at the Defense Finance and Accounting Service Cleveland Center

Executive Summary

Introduction. This is the second of two reports on the Department of the Navy General Fund Financial Statements. The first, Report No. 98-104, "Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Navy General Fund Financial Statements for FYs 1997 and 1996," April 7, 1998, endorsed the Naval Audit Service disclaimer of opinion on the Navy General Fund Financial Statements for FYs 1997 and 1996 and included the Naval Audit Service report, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Report on Auditor's Opinion."

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards, but allows the delegation of the audit work. The Inspector General, DoD, delegated the audit of the FY 1997 Navy General Fund financial statements to the Naval Audit Service. The Inspector General, DoD, performed audit work on the compilation of the Navy financial statements at the Defense Finance and Accounting Service (DFAS) Cleveland Center, where the Navy accounting records are maintained. The FY 1997 Navy General Fund Financial Statements consisted of the Statement of Financial Position, the Statement of Operations and Changes in Net Position, the Statement of Cash Flows for the revolving fund, supporting footnotes, supplementary schedules, and a management overview. The Statement of Financial Position reported assets of \$457.5 billion and liabilities of \$15.9 billion as of September 30, 1997. The Statement of Operations and Changes in Net Position reported total revenues of \$68.1 billion, expenses of \$74.1 billion, and a balance of \$441.5 billion for FY 1997.

Audit Objective. Our objective was to determine whether the DFAS Cleveland Center, Cleveland, Ohio, and the DFAS Kansas City Center, Kansas City, Missouri, consistently and accurately compiled financial data from field activities and other sources for the FY 1997 Navy General Fund Financial Statements. We also reviewed the adequacy of the management control program as it applied to our objective.

Audit Results. Although the DFAS Cleveland Center has improved the compilation process, the overall compilation process and management controls over adjustments to the financial statements remained inadequate. Deficiencies in the manual process for posting journal voucher adjustments contributed to the disclaimer of opinion on the FY 1997 Navy General Fund Financial Statements (Finding A). We found no deficiencies in the transfer of Marine Corps financial statement data from the DFAS Kansas City Center to the DFAS Cleveland Center.

The DFAS Cleveland Center did not include all Navy deposit differences* in the FY 1997 Navy General Fund Statement of Financial Position. As a result, the Fund Balance With Treasury line item on the Navy financial statements may be misstated. On September 30, 1997, the absolute value of the unreported deposit differences was \$562 million. In addition, Navy financial managers do not have accurate deposit information necessary to make proper financial management decisions (Finding B).

For details of the audit results for Findings A and B, see Part I of this report. For a discussion of management controls over the compilation of the FY 1997 Navy General Fund Financial Statements, see Appendix A.

Summary of Recommendations. We recommend that the Director, DFAS, require the DFAS Cleveland Center to establish automated and manual controls and procedures over the off-line journal voucher adjustment process for Navy financial statements; determine historical rates for uncollectible accounts receivable; develop a method of capturing and reporting all Navy and Marine Corps deposit differences; and develop and coordinate with the Navy the implementation of a plan to reconcile all deposit differences for the financial statements in accordance with Statement of Federal Financial Accounting Standards No. 1.

We recommend that the Under Secretary of Defense, Comptroller, revise DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," to clarify the guidance on deposit differences.

Management Comments. The Office of the Under Secretary of Defense (Comptroller) agreed to clarify guidance on reporting outstanding deposit differences in the Fund Balance With Treasury line on financial statements. The Director, DFAS, did not provide comments on a draft of this report. See Part I for a discussion of management comments and Part III for the complete text of management comments received.

Audit Response. The Under Secretary of Defense (Comptroller) comments were responsive, and we revised one draft report recommendation based on those comments. No additional comments are required from the Under Secretary of Defense (Comptroller). We request that the Director, DFAS, provide comments on this report by October 30, 1998.

* Deposit differences are differences between deposits reported to Treasury by an agency disbursing office and the deposits received by financial institutions.

Table of Contents

| | |
|--|----|
| Executive Summary | i |
| Part I - Audit Results | |
| Audit Background | 2 |
| Audit Objective | 2 |
| Finding A. Compiling the FY 1997 Navy General Fund Financial Statements | 3 |
| Finding B. Reporting and Disclosing Deposit Differences | 10 |
| Part II - Additional Information | |
| Appendix A. Audit Process | |
| Scope and Methodology | 18 |
| Management Control Program | 19 |
| Appendix B. Summary of Prior Coverage | 21 |
| Appendix C. Journal Voucher Form | 22 |
| Appendix D. Deposit Differences of More Than \$5 Million Outstanding as of September 30, 1997 | 23 |
| Appendix E. Report Distribution | 24 |
| Part III - Management Comments | |
| Under Secretary of Defense (Comptroller) Comments | 28 |

Part I - Audit Results

Audit Background

Chief Financial Officers Act of 1990. Public Law 101-576, the “Chief Financial Officers Act of 1990,” as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments and agencies. The “Chief Financial Officers Act of 1990” also requires the Inspectors General (IG) to audit the financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget.

Audit of the FY 1997 Department of the Navy General Fund Financial Statements. The IG, DoD, delegated the FY 1997 audit of the Department of the Navy (Navy) General Fund financial statements to the Naval Audit Service. The IG, DoD, performed audit work on the processes used to compile the FY 1997 Navy General Fund Financial Statements at the DFAS Cleveland Center, Cleveland, Ohio, and the DFAS Kansas City Center, Kansas City, Missouri.

Role of the DFAS Cleveland and Kansas City Centers. The DFAS Cleveland and Kansas City Centers provide finance and accounting support to the Navy and the Marine Corps. The Centers maintain departmental accounting records and prepare financial statements using both consolidated and unconsolidated financial data from field organizations. The DFAS Cleveland Center prepared the FY 1997 Navy General Fund Financial Statements, which included data produced by the DFAS Kansas City Center.

The FY 1997 Navy General Fund Financial Statements. The FY 1997 Navy General Fund Financial Statements consisted of the Statement of Financial Position, the Statement of Operations and Changes in Net Position, the Statement of Cash Flows for the revolving fund, supporting footnotes, supplementary schedules, and a management overview. The Statement of Financial Position reported assets of \$457.5 billion and liabilities of \$15.9 billion as of September 30, 1997. The Statement of Operations and Changes in Net Position reported total revenues of \$68.1 billion, expenses of \$74.1 billion, and a balance of \$441.5 billion for FY 1997.

Audit Objective

Our objective was to determine whether the DFAS Cleveland and Kansas City Centers consistently and accurately compiled financial data from field activities and other sources for the FY 1997 Navy General Fund Financial Statements. We also reviewed the adequacy of the management control program as it applied to our objective. Appendix A discusses the audit scope and methodology and the management control program. Appendix B summarizes prior audit coverage related to our objective.

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

The DFAS Cleveland Center has improved the compilation process. However, the overall compilation process and management controls over adjustments to the financial statements remained inadequate. Because the Navy does not have a transaction-driven, integrated accounting system based on general ledger accounting, the DFAS Cleveland Center was required to manually process 101 journal vouchers, valued at about \$459 billion (absolute value), that directly adjusted the FY 1997 Navy General Fund Financial Statements. Deficiencies in the manual process contributed to the disclaimer of opinion on the FY 1997 Navy General Fund financial statements.

Compilation Criteria, Processes, and Systems

Criteria. Public Law 104-208, "Federal Financial Management Improvement Act of 1996," states, "Each agency shall implement and maintain financial systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level." Office of Management and Budget Circular No. A-127--Revised, "Financial Management Systems," July 23, 1993, prescribes policies and standards for Executive departments and agencies to follow in developing, evaluating, and reporting on financial management systems. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," March 16, 1993, establishes 13 key accounting requirements with which an accounting system must comply. The accounting systems that DFAS used to prepare the Navy financial statements did not comply with financial reporting requirements.

Process for Compiling Financial Statements. The DFAS Cleveland Center compiled the FY 1997 Navy General Fund Financial Statements using the same methods as the FY 1996 statements, with financial information from the Navy Headquarters Financial System (NHFS) and from data calls. In a data call, the Navy requests data from other than accounting records. The Navy provides the data to DFAS. The NHFS received financial data from feeder accounting systems. Deficiencies in the feeder systems and NHFS diminished the reliability and accuracy of data on the financial statements.

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

The DFAS Cleveland Center used a complex, predominantly manual process to transfer data from the NHFS to financial statements using Microsoft Excel spreadsheets. The financial data in the NHFS were also used to prepare budget reports such as the SF 133, "Report on Budget Execution." In addition, off-line adjustments documented on journal vouchers were used to manually input data from sources other than automated accounting systems, including data calls, error corrections, eliminating entries, and entries for closed and reopened years. Those off-line adjustments were necessary because the DFAS Cleveland Center did not have a Navy-wide transaction-driven, standard general ledger system to compile financial data. The system used by the DFAS Cleveland Center to compile the financial statements did not have subsidiary ledgers or adequate audit trails for all transactions, and did not fully comply with the established accounting requirements. After all data were entered, financial statements for each appropriation level were consolidated into the Navy financial statements.

Additional details on the compilation process used by the DFAS Cleveland and Kansas City Centers can be found in Inspector General, DoD, Report No. 98-073, "Defense Finance and Accounting Service Work on the Navy General Fund FY 1996 Financial Statements," February 12, 1998.

DFAS and Navy Accounting Systems. The DFAS and Navy accounting systems do not meet financial accounting and reporting requirements. The Naval Audit Service has been unable to render an opinion on the Navy General Fund financial statements primarily because the Navy does not have a transaction-driven standard general ledger accounting system that can accurately report the value of assets and liabilities or the status of appropriated funds. Therefore, the Navy, in conjunction with the DFAS Cleveland Center, is required to produce financial statements for audit using the existing inadequate systems.

Controls Over Adjustments to Financial Statements

Controls Established at the DFAS Cleveland Center. The DFAS Cleveland Center used a journal voucher form to document off-line (manual) adjustments. See Appendix C for an example of the journal voucher form. The directions printed on the journal voucher require that each accountant:

- complete all blocks of information;
- sign the form and also obtain a supervisor's signature;
- post the journal entry to the worksheet or the financial statements;

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

- attach supporting documentation; and
- maintain copies in the appropriation file and the journal voucher entry file for the General Fund.

Adjustments to the FY 1997 Navy General Fund Financial Statements. The DFAS Cleveland Center processed 128 journal vouchers in compiling the FY 1997 Navy General Fund Financial Statements. Of the 128 journal vouchers, 101 adjusted the financial statements. The total value of the 101 journal vouchers was about \$459 billion (absolute value). Although the DFAS Cleveland Center improved the off-line adjustment process by using journal vouchers to document those adjustments, we identified weaknesses in the journal voucher process. Supervisory reviews were not always performed, journal voucher entries were misclassified, and journal vouchers were not properly annotated when posted. Also, journal vouchers were not always needed for compiling the financial statements. Table 1 gives the results of our review of journal vouchers.

| <u>Results of Audit</u> | <u>Number of Vouchers</u> |
|--|---------------------------|
| Journal vouchers not reviewed by a supervisor | 103 |
| Misclassified journal voucher entries: without supervisory journal voucher review | 22 |
| Misclassified journal voucher entries: with supervisory journal voucher review | 9 |
| No indication of whether or not the journal voucher was posted | 115 |
| Journal voucher had no effect on Navy financial statements | 27 |

Supervisory Reviews of Journal Voucher Adjustments. Of the 128 journal vouchers prepared by the DFAS Cleveland Center, 103 vouchers did not have signatures to indicate a supervisory review. Supervisory reviews would strengthen controls over the journal voucher process and improve the accuracy and consistency of adjustments to the financial statements.

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

Misclassified Journal Voucher Entries. We identified 22 journal voucher entries that were misclassified and had no supervisory review, and 9 journal voucher entries that were misclassified although a supervisor reviewed the journal voucher. On the 22 journal vouchers without supervisory reviews, the line numbers and titles on the journal vouchers did not match the line numbers and titles on the financial statements. For example, journal voucher No. 73 indicated a \$289.4 million debit to "Accounts Receivable-Intragovernmental;" however, the journal voucher entry showed the corresponding line number as 1.a.(2). Line 1.a.(2) on the financial statements is "Investments, Net." The entry did not clearly state whether there was a \$289.4 million increase in Accounts Receivable or Investments on the financial statements.

We also found 9 journal vouchers with discrepancies, although the supervisors had approved the journal vouchers. For example, journal voucher No. 5 showed a \$413.5 million credit to "Appropriated Capital;" however, the journal voucher entry showed the corresponding line number as 7.a. Line 7.a. on the financial statements is "Unexpended Appropriations." Consequently, we could not determine which line item on the financial statements was affected by the journal voucher entry. In another example, journal voucher No.122 was approved although the title of the line item on the financial statements was not completed on the journal voucher documentation. Supervisors should thoroughly review all journal voucher entries and required data to ensure that the journal vouchers are accurate and consistent.

Posting of Journal Vouchers. Of the 128 journal vouchers prepared by the DFAS Cleveland Center, 115 journal vouchers did not have signatures indicating when they were posted. As a result, we had difficulty determining when journal vouchers were posted and whether they directly affected the Navy financial statements or claimant level financial statements.

Journal Vouchers and the Effect on Financial Statements. 101 of the 128 journal vouchers directly affected the Navy principal financial statements. The DFAS Cleveland Center also produces financial statements for individual Navy commands, although those statements are not required. In preparing journal vouchers for the principal Navy statements, some accountants prepared separate journal vouchers for the commands financial statements as well. This caused confusion about whether adjustments were posted twice. DFAS accountants showed us that for the 27 command-level journal vouchers, no duplicate journal voucher entries were made on the principal financial statements. Separate journal vouchers for command-level financial statements are unnecessary. The same journal vouchers used to adjust the Navy principal financial statements can be annotated to identify the command-level statements that should also be adjusted.

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

New Capabilities of the Standard Accounting and Reporting System. After issuing the FY 1997 Navy General Fund Financial Statements, the DFAS Cleveland Center implemented a new module of the Standard Accounting and Reporting System. In April 1998, the DFAS Cleveland Center began using the Standard Accounting and Reporting System - Financial and Departmental Reporting (STARS - FDR) module for the departmental reporting requirements, replacing the NHFS. STARS - FDR is an integrated system that supports reporting from the field level through the departmental level and can produce the Navy General Fund financial statements. When STARS - FDR is fully implemented, the DFAS Cleveland Center will no longer need to transfer financial data manually to the financial statement spreadsheets. The DFAS Cleveland Center will continue to make journal voucher adjustments to the financial statements to enter information from data calls and other financial data not supported by automated systems. STARS - FDR will bring journal vouchers into the system and include that information in the financial statements.

The DFAS Cleveland Center must establish manual and automated controls and procedures to ensure that adjustments to the Navy financial statements are consistently applied, adequately reviewed, and materially correct. Adherence to those controls will reduce the risk of errors that could cause misstatements in the Navy financial statements.

Accounts Receivable, Allowance for Estimated Uncollectible Accounts

Percentage Estimate for Uncollectible Accounts. The DFAS Cleveland Center had an inadequate method of reporting allowances for uncollectible accounts. The DFAS Cleveland Center developed a percentage estimate (4.64 percent) by dividing the actual write-offs by the balance of all receivables. The DFAS Cleveland Center applied the 4.64 percent to about \$829 million of positive non-Governmental accounts receivable balances at the claimant level. The result was an Allowance for Estimated Uncollectibles of \$38.5 million. The \$28.7 million allowance calculated for appropriation 1453, "Military Personnel, Navy," and the \$4.5 million allowance for the Marine Corps were added to the amount estimated by the DFAS Cleveland Center. The total was a \$71.7 million Allowance for Estimated Uncollectibles. The DFAS Cleveland Center processed journal vouchers to reduce the Accounts Receivable, Net,

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

Non-Federal line item by \$71.7 million. Using a percentage that is not based on historical data to determine the Allowance For Estimated Uncollectibles is an inadequate method.

Requirements for Uncollectible Accounts. Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities" (Statement No. 1), March 30, 1993, states, ". . . losses due to uncollectible amounts should be measured through a systematic methodology. The systematic methodology should be based on analysis of both individual accounts and a group of accounts as a whole." Additionally, DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 11, 1995, requires DoD Components to:

- establish allowances for uncollectible accounts,
- age delinquent accounts receivable to reflect amounts owed to the Government, and
- ensure that accounting systems provide for the formal aging of delinquent receivables.

Prior Reports and Management Action Planned. Two previous reports stated that the method used by the DFAS Cleveland Center to estimate the allowance for uncollectible receivables is neither systematic nor comprehensive. Those reports were IG, DoD, Report No. 98-073, "Defense Finance and Accounting Service Work on the Navy General Fund FY 1996 Financial Statements," February 12, 1998, and Naval Audit Service Report No. 047-98, "Department of the Navy Principal Statements for FYs 1997 and 1996: Accounts Receivable" September 18, 1998.

The DFAS Cleveland Center plans to improve the procedures for estimating the allowance for uncollectible receivables. The revised procedure includes the following requirements.

"The loss allowances should be recorded by appropriation and subhead. The loss allowance should be based on historical rates of write-offs. If historical data is not available, a preliminary rate of 3.2 percent of the total receivable balance should be used."

The DFAS Cleveland Center should establish historical rates for writing-off bad debts by appropriation or subhead. If historical rates were established at the appropriation level, the DFAS Cleveland Center would not have to apply the preliminary percentage rate of 3.2 percent against the accounts receivable balance of appropriations that have historically been written off at higher,

Finding A. Compiling the FY 1997 Navy General Fund Financial Statements

lower, or nonexistent rates. The allowance for estimated uncollectible accounts would accurately represent the accounts receivable balances on financial statements.

Conclusion

During the audit, we reviewed the process used to transfer Marine Corps financial statement data from the DFAS Kansas City Center to the DFAS Cleveland Center and found no deficiencies in the process. However, the compilation processes available to the DFAS Cleveland and Kansas City Centers and the Navy have not changed significantly from FY 1996. The systems and processes used for the FY 1997 statements are interim measures for incorporating available Marine Corps and Navy data into the consolidated Navy financial statements. The systems and processes are not adequate to produce auditable financial statements. The Navy statements will not be auditable until a transaction-driven, integrated accounting system, based on general ledger accounting, is implemented Navy-wide. Strengthening controls over the compilation process will be an improvement; however, without adequate systems, the compilation process will remain inadequate, reinforcing the disclaimers of audit opinion issued by the Naval Audit Service.

Recommendations for Corrective Action

A. We recommend that the Director, Defense Finance and Accounting Service, require the Defense Finance and Accounting Service Cleveland Center to:

1. Establish automated and manual controls and procedures to ensure that the adjustments to the Department of the Navy financial statements are consistently applied, adequately reviewed, and materially correct.
2. Determine historical rates for estimated uncollectible accounts receivable balances at the appropriation level, and avoid the use of the preliminary rate of 3.2 percent to estimate uncollectible accounts.

Management Comments Required

No management comments were received in response to the draft report. We request that the Director, DFAS, provide written comments on this report.

Finding B. Reporting and Disclosing Deposit Differences

The DFAS Cleveland Center did not capture all of the Navy deposit differences* in the FY 1997 Navy General Fund Statement of Financial Position. This occurred because the DoD Financial Management Regulation does not specifically require that all deposit differences reported by the Department of the Treasury (Treasury) be included in the Fund Balance With Treasury line item. As a result, the Fund Balance With Treasury line item on the FY 1997 Navy General Fund Financial Statements may be misstated. The absolute value of the unreported deposit differences was \$562 million on September 30, 1997. In addition, Navy financial managers do not have the accurate deposit information necessary to make proper financial management decisions.

Process for Reporting and Disclosing Deposit Differences

Reporting Requirements for FY 1997 Financial Statements. The DoD Financial Management Regulation establishes clearing accounts to temporarily hold collections and disbursements pending clearance to applicable accounts. Only the deposit differences identified by the Treasury that are more than 6 months old and less than \$5 million are posted to the Navy 17F3878 Deposit-in-Transit Budget Clearing Account (BCA). The DFAS Cleveland Center included only the net balance of \$26,000 from the BCA in the Non-Entity Fund Balance With Treasury line item on the FY 1997 Navy General Fund Statement of Financial Position.

To determine whether deposit differences exist, the Treasury performs monthly reconciliations between the deposits reported by agency disbursing offices and the deposits received by financial institutions. The Treasury records any deposit difference on the 6652 Report, Statement of Differences - Deposit Transactions (Statement of Differences). After reporting a difference for 6 months, the Treasury charges or credits the BCA for the outstanding deposit

* Deposit differences are differences between deposits reported to Treasury by an agency disbursing office and the deposits received by financial institutions.

Finding B. Reporting and Disclosing Deposit Differences

difference, unless the difference is \$5 million or more. The Treasury does not charge or credit these large differences to the BCA, but continues to report them on a monthly Statement of Differences until the Navy clears the difference.

Changes in the Process for Reporting Deposit Differences for FY 1998 Financial Statements. The Treasury Financial Manual, volume 1, part 2, chapter 3100, "Instructions for Disbursing Officers' Reports," February 6, 1997, outlines the process for reporting and reconciling deposits. The Treasury Financial Manual Bulletin No. 98-07, April 2, 1998, changed the process. Effective April 30, 1998, the Treasury will no longer charge or credit deposit differences to the BCA. According to the Treasury, all agencies are to clear their budget clearing accounts (**F3878 and **F3879) by September 30, 1998. The Treasury will continue to report new deposit differences on Statements of Differences until the agencies clear the differences, but will no longer hold any deposit differences in BCAs. Because of the change in the Treasury's process for reporting deposits, agencies must reconcile their deposit differences before issuing financial statements or include the outstanding deposit differences in the financial statements and make full disclosure in Footnote 2.

Reporting Deposit Differences in the FY 1997 Navy General Fund Financial Statements

The DFAS Cleveland Center failed to report or disclose deposit differences not included in the BCA. The Statements of Differences prepared by the Department of the Treasury do not include deposit differences charged to the BCA. On September 30, 1997, the Navy had 639 Statements of Differences outstanding. The absolute value of those differences was \$562 million. The DFAS Cleveland Center did not report or disclose those deposit differences in the FY 1997 Navy General Fund Financial Statements. Such differences can remain outstanding for years. (See Appendix D for a summary of deposit differences greater than \$5 million and outstanding for more than 1 year as of September 30, 1997.)

Standards and Implementing Guidance

Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities." Statement No. 1 states, "Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared." This means that all deposit

Finding B. Reporting and Disclosing Deposit Differences

differences are to be reconciled and corrected for the financial statements, leaving no differences outstanding. However, not all of the Navy deposit differences outstanding on the Statements of Differences as of September 30, 1997, were reconciled or corrected before the DFAS Cleveland Center issued the financial statements.

DoD Financial Management Regulation. The Regulation does not clearly state how to report deposit differences on the financial statements. The “DoD Financial Management Regulation,” volume 6, chapter 6, “Form and Content of Audited Financial Statements,” section 0612, “Instructions for the Preparation of the Principal Statements,” paragraph 061202 A. 1. a. (1), Fund Balance With Treasury - Line 1. a. (1), generally explains how to report some differences.

“This item [Fund Balance With Treasury line item] represents the aggregate amount of the entity’s accounts with the U.S. Treasury for which the entity is authorized to make expenditures and pay liabilities...To the extent that the reporting entity maintains balances in deposit, suspense, and clearing accounts that are not available to finance the entity’s activities, those balances should be reported on line 2a(1) as nonentity assets. . . Federal entities should explain any material discrepancies between fund balance with the U.S. Treasury in their general ledger accounts and the balance in the Treasury’s accounts and explain any discrepancies in Note 2.”

The DoD Financial Management Regulation requires that entities report deposit differences in the BCA on the face of the financial statements, and requires that entities disclose deposit differences in Footnote 2. The Regulation is not clear about whether the amount charged to the BCA or the total amount of all differences should be discussed in the footnote. The Regulation also does not state whether the outstanding deposit differences on the Statements of Differences should be reported. The DFAS Cleveland Center partially followed the DoD Financial Management Regulation and included the balance of the BCA (\$26,000) in line 1. a. (1), Non-Entity Fund Balance With Treasury, on the FY 1997 Navy General Fund Statement of Financial Position. However, the DFAS Cleveland Center did not disclose the deposit differences on the Statements of Differences; those differences had an absolute value of \$562 million.

DoD Implementation of Statement No. 1. The DoD Financial Management Regulation that implements Statement No. 1 does not require deposit differences to be reconciled and corrected for the financial statements, as Statement No. 1 requires. Instead, the Regulation allows differences to be

Finding B. Reporting and Disclosing Deposit Differences

reported on the financial statements and disclosed in a note. On September 30, 1997, the Navy had \$562 million (absolute value) of outstanding deposit differences not included in the BCA. Those differences were not reported or disclosed in the FY 1997 Navy General Fund Financial Statements.

Impact of Deposit Differences on Navy Resources

Deposit differences represent funds that may or may not be available for use. Table 2 shows the aging of the \$562 million (absolute value) of deposit differences that were not included in the FY 1997 Navy General Fund Statement of Financial Position.

| <u>Aging of Deposit Differences</u> | <u>Absolute Value of Deposit Differences (\$ in thousands)</u> |
|--|--|
| 1 Month | \$123,436 |
| 2-3 Months | 264,241 |
| 4-6 Months | 22,714 |
| More Than 6 Months | <u>151,515</u> |
| Total Absolute Value of all Statements of Differences | \$561,906 |

Most deposit differences in the 1-month category are due to timing differences and should clear without any intervention. After 3 months, however, the differences are likely to be an error that requires research to reconcile and correct. After 6 months, the differences are errors that require individual attention. Reconciling deposit differences is essential to maintaining an accurate Fund Balance With Treasury. Until the deposit differences are reconciled and corrected, Navy financial managers will not know whether their appropriation balances are correct. To use the funds without reconciling the differences creates the risk of violating the Antideficiency Act. Not using the funds promptly can result in the permanent loss of the funds. Navy financial managers will not be able to determine the availability of funds until the deposit differences are reconciled.

Finding B. Reporting and Disclosing Deposit Differences

Conclusion

Reconciling deposit differences is essential for proper financial management. Until DoD implements processes to reconcile all deposit differences, the Under Secretary of Defense (Comptroller) should revise the DoD Financial Management Regulation to ensure that the total amount of deposit differences is reported in the appropriate Fund Balance With Treasury line item and disclosed in Footnote 2 of the financial statements.

Recommendations, Management Comments, and Audit Response

We revised draft report Recommendation B.1. by deleting draft report Recommendation B.1.b. and including Recommendation B.1.a. in Recommendation B.1. in this final report.

B.1. We recommend that the Under Secretary of Defense, Comptroller, revise DoD Regulation 7000.14-R, the “DoD Financial Management Regulation,” volume 6, chapter 6, “Form and Content of Audited Financial Statements,” section 0612, “Instructions for the Preparation of the Principal Statements,” paragraph 061202 A. 1. a. (1), Fund Balance With Treasury - Line 1. a. (1). The Regulation should clarify guidance for entities not in compliance with the Statement of Federal Financial Accounting Standards No. 1, “Accounting for Selected Assets and Liabilities,” by requiring DoD entities with outstanding deposit differences to report the total amounts of deposit differences in the appropriate Fund Balance With Treasury line item and disclose the total amounts of deposit differences in Footnote 2 of the financial statements.

Office of the Under Secretary of Defense (Comptroller) Comments. The Principal Deputy Under Secretary of Defense (Comptroller) agreed to clarify guidance on reporting outstanding deposit differences in the Fund Balance With Treasury line on financial statements. The revised guidance will be in DoD Financial Management Regulation Form and Content guidance for the FY 1998 financial statement reporting.

B.2. We recommend that the Director, Defense Finance and Accounting Service, require the Defense Finance and Accounting Service Cleveland Center to:

a. Develop a method of capturing and reporting all deposit differences for the Navy and the Marine Corps.

Finding B. Reporting and Disclosing Deposit Differences

b. Include the total amount of outstanding deposit differences in the appropriate Fund Balance With Treasury line item on the Navy General Fund Financial Statements, and disclose the amount in Footnote 2; and

c. Develop, coordinate, and implement a plan to reconcile all deposit differences in the financial statements in accordance with Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities."

Management Comments Required. No management comments were received from the Defense Finance and Accounting Service in response to the draft report. We request that the Director, Defense Finance and Accounting Service, provide written comments on this report.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Work Performed. We examined the processes that the DFAS Cleveland and Kansas City Centers used to consolidate financial data. The data compiled by the DFAS Cleveland and Kansas City Centers were used to prepare the initial version of the Navy financial statements that was submitted to the auditors on December 15, 1997. The FY 1997 Navy General Fund Financial Statements consisted of the Statement of Financial Position, the Statement of Operations and Changes in Net Position, the Statement of Cash Flows for the revolving fund, supporting footnotes, supplementary schedules, and a management overview. The Statement of Financial Position reported assets of \$457.5 billion and liabilities of \$15.9 billion as of September 30, 1997. The Statement of Operations and Changes in Net Position reported total revenues of \$68.1 billion, expenses of \$74.1 billion, and a net position balance of \$441.5 billion for FY 1997. Our examination included:

- a limited review of the transfer of data from the NHFS to the Navy financial statements;
- a review of 128 off-line journal vouchers that reported \$459 billion (absolute value) of adjustments to the FY 1997 Navy General Fund Financial Statements, including adjustments for financial data requested during data calls;
- a review of the transfer of data from the DFAS Kansas City Center to the DFAS Cleveland Center for the FY 1997 Navy General Fund Financial Statements;
- limited testing to verify that the year-end reporting and certification process for the Fund Balance With Treasury line item, including the controls over year-end reconciliation, remained unchanged; and
- a review of the deposit reconciliation processes for \$562 million (absolute value) of deposit differences as of September 30, 1997.

Limitations to Audit Scope. We did not evaluate the accuracy of data from sources outside the DFAS Cleveland and Kansas City Centers, including the accuracy of data submitted to the DFAS Cleveland and Kansas City Centers by field accounting entities.

DoD-wide Corporate-Level Government Performance and Results Act (GPRA) Goals. In response to the GPRA, the Department of Defense has established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goals:

- **Objective:** Fundamentally reengineer DoD and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

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

- **Financial Management Functional Area. Objective:** Reengineer DoD business practices. **Goal:** Improve data standardization of finance and accounting data items. **(FM-4.4)**

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

Audit Period and Standards. We performed this financial-related audit from September 2, 1997, through July 21, 1998, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not use computer-processed data to conduct the audit.

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

Management Control Program

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

Scope of Review of the Management Control Program. We reviewed the adequacy of the DFAS Cleveland and Kansas City Centers' management controls over the compilation of the FY 1997 Navy General Fund Financial Statements. We also reviewed management's self-evaluation of those controls.

Appendix A. Audit Process

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Directive 5010.38. The DFAS Cleveland Center did not have adequate procedures to estimate the balances of uncollectible accounts receivable, to record off-line journal voucher adjustments to financial statements, and to report deposit differences on the Statement of Financial Position. Recommendations A.1., B.1., and B.2., if implemented, will improve the processes and procedures for compiling the Navy General Fund financial statements. A copy this report will be provided to senior officials responsible for management controls in the Office of the Under Secretary of Defense (Comptroller) and DFAS.

Adequacy of Management's Self-Evaluation. The DFAS Cleveland and Kansas City Centers have adequate internal management control programs. For FY 1997, the DFAS Cleveland Center's Annual Statement of Assurance reported six uncorrected material control weaknesses and one previously reported material control weakness that was corrected during FY 1997. For FY 1997, the DFAS Kansas City Center's Annual Statement of Assurance reported nine uncorrected material control weaknesses. The DFAS Cleveland Center also reported deficiencies in the accounting processes supporting the Navy. The DFAS Cleveland Center plans to take corrective actions. Those actions include the consolidation of all general fund accounting systems into the Standard Accounting and Reporting System (STARS) in FY 1998. However, the DFAS Cleveland Center did not disclose the material weakness we identified because their self-evaluation did not review the procedures used to compile Navy General Fund financial statements and the STARS modules used in FY 1997 were noncompliant accounting systems. The STARS modules used to compile the FY 1998 Navy General Fund Financial Statements will be reviewed to determine whether deficiencies have been corrected and whether the modules comply with financial reporting requirements.

Appendix B. Summary of Prior Coverage

General Accounting Office

GAO Report No. AIMD-98-56 (OSD Case No. 1548), "CFO Act Financial Audits - Programmatic and Budgetary Implications of Navy Financial Data Deficiencies," March 1998

GAO Report No. AIMD-96-7 (OSD Case No. 1050), "CFO Act Financial Audits - Increased Attention Must Be Given to Preparing Navy Financial Reports," March 1996

Inspector General, Department of Defense

IG, DoD, Report No. 98-073, "Defense Finance and Accounting Service Work on the Navy General Fund 1996 Financial Statements," February 12, 1998

IG, DoD, Report No. 97-027, "Defense Finance and Accounting Service Work on the Navy Defense Business Operations Fund FY 1995 Financial Statements," November 22, 1996

Naval Audit Service

Naval Audit Service Report No. 025-98, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Report on Auditor's Opinion," February 27, 1998

Naval Audit Service Report No. 047-98, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Accounts Receivable" September 18, 1998

Naval Audit Service Draft Report No. 98-0096, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Financial Statement Preparation, Presentation, and Disclosure," July 17, 1998

Appendix D. Deposit Differences of More Than \$5 Million Outstanding as of September 30, 1997

| <u>DSSN*</u> | <u>Location</u> | <u>Month</u> | <u>Net Amount</u> | <u>Absolute Value</u> |
|--------------|--|-------------------|--------------------------|-------------------------|
| 6102 | DFAS Kansas City Kansas City, MO | December 1995 | (\$6,398,123.60) | \$6,398,123.60 |
| 6102 | DFAS Kansas City Kansas City, MO | January 1996 | (6,209,154.51) | 6,209,154.51 |
| 6102 | DFAS Kansas City Kansas City, MO | August 1996 | (25,807,734.60) | 25,807,734.60 |
| 7150 | US Navy Personnel Support Activity Detachment Guantanamo Bay, Cub | December 1994 | 6,921,469.26 | 6,921,469.26 |
| 7150 | US Navy Personnel Support Activity Detachment Guantanamo Bay, Cuba | December 1995 | (6,928,464.38) | 6,928,464.38 |
| 8347 | DFAS Charleston Operating Location Charleston, SC | August 1996 | (49,625,641.27) | 49,625,641.27 |
| 8347 | DFAS Charleston Operating Location Charleston, SC | September 1996 | <u>49,624,053.53</u> | <u>49,624,053.53</u> |
| Total | | | (\$38,423,595.57) | \$151,514,641.15 |

* Disbursing Station Symbol Number

Appendix E. 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 Cleveland Center
Director, Defense Finance and Accounting Service Kansas City 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

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

Part III – Management Comments

Under Secretary of Defense (Comptroller) Comments

Final Report
Reference



COMPTROLLER

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

SEP 22 1998



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

SUBJECT: Draft Audit Report on "Compilation of the FY 1997 Navy General Fund Financial Statements at the Defense Finance and Accounting Service Cleveland Center" (Project No. 7FI-2033.01)

This is in response to the subject draft audit report. Specifically, this office provides the following comments regarding Recommendation B.1.

Recommendation B.1 recommends that the Under Secretary of Defense (Comptroller) (USD(C)) revise the DoD 7000.14R, DoD Financial Management Regulation, volume 6, chapter 6, "Form and Content of Audited Financial Statements," section 0612, "Instructions for the Preparation of the Principal Statements," paragraph 061202 A.1.a.(1), "Fund Balance With Treasury - Line 1.a.(1)," to clarify guidance for entities not in compliance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 1, "Accounting for Selected Assets and Liabilities," by:

a. Requiring DoD entities with outstanding deposit differences to report the total amounts of deposit differences in the appropriate "Fund Balance With Treasury" line item and disclose the total amounts of deposit differences in Footnote 2 of the financial statements.

b. Requiring any DoD entity with outstanding deposit differences to state in Footnote 2 of the financial statements that the entity is in noncompliance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities."

This office concurs with recommendation B.1.a and is in the process of incorporating the recommended change into Chapter 6B, "Form and Content of Audited Financial Statements," of the DoD Financial Management Regulation ("DoDFMR"). The revised guidance, when issued, will be applicable to FY 1998 financial statement reporting. A draft of this guidance, currently in coordination, contains instructions to assure compliance with the reporting and footnote disclosure objectives of SFFAS No. 1 which are inherent in this recommendation, and can be found at <http://www.dtic.mil/comptroller/fmr/> on the USD(C) web site. Paragraph 040203.A.1. of that draft guidance requires disclosure of the amounts of deposit differences in the financial statements of DoD entities.

Recommendation B.1.
Revised
Page 14

Deleted B.1.b.

Under Secretary of Defense (Comptroller) Comments

This office does not concur with recommendation B.1.b. SFFAS No. 1 does not direct that the reporting entity include in its footnotes a condition of "noncompliance" as a result of reporting outstanding deposit differences. Paragraph 39 of the SFFAS No. 1, states: "Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared.)" Furthermore, Chapter 5, "Deposit and Transfer of Public Funds," of the "DoDFMR," supplemented by the Defense Finance and Accounting Service Interim Change Advisory 5-98, dated August 4, 1998, requires timely accounting, reconciliation and correction of errors, as they pertain to reconciling deposit differences with the U. S. Treasury. This office recommends deletion of recommendation B.1.b.

The point of contact on this matter is Mr. Peter Cirafici. He may be reached by e-mail: ciraficp@osd.pentagon.mil or by telephone at (703) 697-8282.



Alice C. Maroni
Principal Deputy Under Secretary
of Defense (Comptroller)

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

F. Jay Lane
Salvatore D. Guli
Richard B. Bird
Brian M. Flynn
Linda A. Pierce
Edward A. Blair
Mark A. Krulikowski
Susanne M. Williams
William E. Hosick
Susanne B. Allen

