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DEPARTMENT-LEVEL ACCOUNTING ENTRIES FOR FY1999

Report No. D-2000-179

August 18, 2000

Office of the Inspector General
Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
ODO	Other Defense Organizations
WCF	Working Capital Fund



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August 18, 2000

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

SUBJECT: Audit Report on Department-Level Accounting Entries for FY 1999
(Report No. D-2000-179)

We are providing this report for your information and use. We conducted the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report when preparing the final report.

The Under Secretary of Defense (Comptroller) comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Richard B. Bird at (703) 604-9159 (DSN 664-9159) (rbird@dodig.osd.mil) or Ms. Cindi M. Miller at (317) 510-3855 (DSN 699-3855) (cmiller@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink that reads "Robert J. Lieberman".

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-179

(Project No. D2000FI-0063.004)

(formerly Project No. 0FI-2115.04)

August 18, 2000

Department-Level Accounting Entries for FY 1999

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare annual audited financial statements. This is the third in a series of reports related to the DoD Agency-Wide financial statements for FY 1999. In Inspector General, DoD, Report No. D-2000-091, "Internal Controls and Compliance With Laws and Regulations for the DoD Agency-Wide Financial Statements for FY 1999," February 25, 2000, we identified \$6.9 trillion of department-level accounting entries. An additional \$0.7 trillion identified after the issuance of the first report, bringing the total to \$7.6 trillion. On February 16, 2000, we issued a disclaimer of opinion on the DoD Agency-Wide financial statements for FY 1999.

The Military Departments, Defense agencies, and the Defense Finance and Accounting Service (DFAS) are responsible for the reliable processing of financial management data reported on the DoD financial statements. When DoD Components input data into the finance and accounting systems, the reliability of the data as they are further processed becomes the responsibility of DFAS. The DFAS centers provide finance and accounting support to DoD organizations, including maintaining department-level accounting records and preparing financial statements. The DFAS centers use amounts reported through the accounting systems and information collected from data calls and from other sources to compile the annual financial statements for DoD. The compilation process is complicated because much of the financial data submitted to the DFAS centers are not generated by integrated, transaction-driven, general ledger accounting systems.

Objectives. Our overall objective was to determine whether the DoD Agency-Wide financial statements for FY 1999 were prepared in accordance with Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 2000. In support of the objective, we identified the department-level accounting entries made to the DoD Component financial data that were used to prepare departmental reports and the DoD financial statements for FY 1999. We also reviewed the management control program as it related to the audit objective. This audit was originally announced under Project No. 0FI-2115.04.

Results. The DFAS centers processed approximately \$7.6 trillion in department-level accounting entries to DoD Component financial data used to prepare departmental reports and DoD financial statements for FY 1999. Of the \$7.6 trillion in department-level accounting entries, \$3.5 trillion were supported with proper research, reconciliation, and audit trails. However, department-level accounting entries of \$2.3 trillion were made to force financial data to agree with various sources of financial data without adequate research and reconciliation, were made to force buyer and seller data to agree in preparation for eliminating entries, did not contain adequate documentation and audit trails, or did not follow accounting principles. We identified but did not have adequate time or staff to review another \$1.8 trillion in department-level accounting entries. The DoD Agency-Wide financial statements for FY 1999 were subject to a high risk of material misstatement. The sheer magnitude of department-level accounting entries required to compile the DoD financial statements for FY 1999 highlights the difficulties and problems that DoD encountered in attempting to produce accurate and reliable financial information using existing systems and processes. The largest number of department-level accounting entries were made for the Navy General Fund because DFAS Cleveland Center processed both monthly and year-end department-level accounting entries for the Navy General Fund. For details of the audit results, see the Finding section of the report. See Appendix A for details of the management control program as it relates to the processing of department-level accounting entries.

Recommendation. We recommend that the Under Secretary of Defense (Comptroller) establish an implementation strategy to eliminate unsupported department-level accounting entries and to minimize other department-level accounting entries to the data used to compile the DoD financial statements.

Management Comments. The Under Secretary of Defense (Comptroller) agreed that DoD lacked integrated financial and non-financial feeder systems that would minimize the need for department-level accounting entries to prepare financial statements. He stated that DoD has drafted an implementation strategy to address the issue of unsupported accounting entries during the preparation of financial statements. He also stated that the \$1.4 trillion of accounting entries for the Navy General Fund were related to Marine Corps budgetary data that are entered and later reversed, and the data have no impact on the official Navy General Fund financial statements. See the Finding section for a discussion of management comments, and the Management Comments section for the text of the comments.

Audit Response. The Under Secretary of Defense (Comptroller) comments on the recommendation are responsive, but the statement regarding the \$1.4 trillion of Navy General Fund accounting entries is incorrect. Only approximately \$948 billion of the accounting entries were related to Marine Corps appropriations, and not all of the accounting entries affecting Marine Corps appropriations came from budgetary data. DFAS Cleveland Center was given the opportunity to provide evidence documenting the reversal of the accounting entries and was not able to do so. Our audit of accounting entries for the FY 2000 financial reporting cycle will include a more detailed review of the process the DFAS Cleveland Center uses to make accounting entries for the Marine Corps budgetary data.

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Background

The audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. This report is the third in a series of audit reports related to the FY 1999 DoD financial statements. The first report discusses the internal controls and compliance with laws and regulations for DoD and includes audit results of our review of department-level accounting entries. The second report discusses the preparation of the DoD Agency-Wide and DoD Components' Statements of Net Cost and the reporting of performance measures in the Overview section of the DoD financial statements. This report discusses the department-level accounting entries for FY 1999 and incorporates the results of additional audit work completed since the issuance of the first report.

Chief Financial Officers Act. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to annually prepare audited financial statements. For FY 1999, DoD prepared financial statements for the following reporting entities: the Army, Navy, and Air Force General Funds; the Army, Navy, and Air Force Working Capital Funds (WCFs); the Army Corps of Engineers, Civil Works Program; and the Military Retirement Fund. Those financial statements, as well as accounting data from Other Defense Organizations (ODO) General Funds and WCFs, were used to produce the DoD financial statements for FY 1999.

Responsibility for Reliable Financial Management Data. The Military Departments, Defense agencies, and the Defense Finance and Accounting Service (DFAS) are responsible for the reliability of financial management data reported on the FY 1999 financial statements. DFAS reported that approximately 80 percent of the data on the financial statements originated in the mixed systems owned by the Military Departments and Defense agencies. Mixed systems contain the day-to-day operating information to be translated into financial information and processed in finance and accounting systems to be useful for financial managers. Some examples of mixed systems are the acquisition and logistics systems. The reliable input, processing, and eventual reporting of financial data into the finance and accounting systems are the responsibility of the Military Departments and Defense agencies. When data are supplied to the finance and accounting systems, the reliability of the data as they are further processed becomes the responsibility of DFAS.

Role of the DFAS Centers. The DFAS centers provide finance and accounting support to DoD organizations. Support includes maintaining department-level accounting records and preparing financial statements from general ledger trial balances and other financial data submitted by DoD field accounting entities and other sources. DFAS uses amounts reported through the accounting systems and information collected from data calls and from other sources to compile the annual financial statements. The compilation process is complicated because much of the financial data submitted to the DFAS centers are not generated by integrated, transaction-driven, general ledger accounting systems.

The DFAS centers processed department-level accounting entries for the DoD reporting entities and ODO financial data. The DFAS centers did not prepare

accounting entries directly to the DoD financial statements for FY 1999. Accounting entries were processed into the DFAS accounting systems both by manual entries and system-generated entries.

Previous Fiscal Year Review of Department-Level Accounting Entries. In FY 1998, DFAS processed department-level accounting entries to make financial data agree with various data sources and to add new data. DFAS made department-level accounting entries without properly researching and reconciling differences between the accounting data and other data sources or providing adequate audit trails. We identified \$1.7 trillion in department-level accounting entries that were not supported by proper research, reconciliation, or adequate audit trails. Department-level accounting entries were made to the financial data for the Army General Fund, the Army WCF, the Navy General Fund, the ODO General Fund, and the Defense Logistics Agency WCF.

DoD Financial Statements for FY 1999. The DoD financial statements for FY 1999 reported \$599 billion in total assets, \$999 billion in total liabilities, \$378 billion in total net cost of operations, and \$628 billion in total budgetary resources. On February 16, 2000, we issued a disclaimer of opinion on the DoD financial statements for FY 1999.

Implementation Strategies. DoD acknowledged that financial management system deficiencies prevent it from producing auditable financial data. As an interim solution until compliant financial management and mixed systems are in place, DoD has been improving other aspects of its financial management through the development of DoD implementation strategies. In May 1998, the Deputy Chief Financial Officer began developing implementation strategies to achieve a favorable audit opinion on the DoD financial statements until compliant financial management and mixed systems were in place. As of January 2000, DoD had developed and approved a total of 12 implementation strategies.

Objectives

Our overall objective was to determine whether the DoD Agency-Wide financial statements for FY 1999 were prepared in accordance with Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 2000. In support of the objective, we identified the department-level accounting entries made to the DoD Component financial data used to prepare departmental reports and the DoD financial statements for FY 1999. In addition, we categorized the department-level accounting entries based on the reason for the entry. We also reviewed the management control program as it related to the audit objective. See Appendix A for a discussion of the audit process and our review of the management control program at the DFAS centers. See Appendix B for a list of prior audits at the DFAS centers related to the audit objectives.

Department-Level Accounting Entries

During FY 1999, the DFAS centers processed approximately \$7.6 trillion in department-level accounting entries to DoD Component financial data used to prepare departmental reports and the DoD financial statements for FY 1999. Of the \$7.6 trillion, \$3.5 trillion were supported, \$2.3 trillion were unsupported or posted to invalid general ledger accounts, and \$1.8 trillion were identified but not reviewed. Although some department-level accounting entries will always be necessary through the normal course of accounting operations and because of the complexity of DoD business practices, there are major concerns about the accounting entries because:

- The DFAS centers had to process 451 department-level accounting entries, valued at \$1,525 billion, to add new data. Many entries were made because DoD did not have adequate integrated systems for compiling accurate and reliable financial data.
- The DFAS centers processed 360 department-level accounting entries, valued at \$602.7 billion, to correct errors.
- The DFAS centers processed 10,161 accounting entries, valued at \$2,306 billion, for which DoD did not perform proper research and reconciliation, maintain adequate documentation and audit trails, and follow accounting principles.

As a result, the DoD financial statements for FY 1999 were subject to a high risk of material misstatement. The sheer magnitude of department-level accounting entries required for FY 1999 highlights the significant problems that DoD encountered in attempting to produce more accurate and reliable financial information using existing systems and processes.

Guidance

Section 35, Title 31, United States Code. The requirements of the Federal Managers' Financial Integrity Act of 1982 for an agency's internal accounting and administrative controls were incorporated in section 3512, title 31, United States Code (31 U.S.C. 3512). That section requires DoD to establish and to implement internal accounting and administrative controls to provide reasonable assurance that ". . . revenues and expenditures applicable to agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained." In addition, 31 U.S.C. 3512 requires DoD to assess the effectiveness of the internal accounting and administrative controls established and implemented.

Office of Management and Budget Circular No. A-123. Office of Management and Budget Circular No. A-123, “Management Accountability and Control,” June 21, 1995, provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls. Office of Management and Budget Circular No. A-123 requires Federal managers to promptly record, properly classify, and account for transactions to prepare timely and reliable accounts and reports.

General Accounting Office “Standards for Internal Control in the Federal Government.” The General Accounting Office publication, “Standards for Internal Control in the Federal Government,” November 1999, provides an overall framework for internal control. The standards state the following:

Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation of related records which provide evidence of execution of these activities as well as appropriate documentation.

In addition, the standards require clear documentation of all transactions and other significant events, and the documentation should be readily available for examination.

DoD Guidance. DoD has issued guidance for the proper execution of department-level accounting entries. The DoD Financial Management Regulation, DoD Regulation 7000.14-R, volume 6A, “Reporting Policy and Procedures,” January 1998, addresses documentation and audit trails necessary to support department-level accounting entries. In addition, DFAS headquarters policy guidance issued in October 1999 established requirements for processing department-level accounting entries.

Department-Level Accounting Entries

Department-Level Accounting Entries for FY 1999. The DFAS centers processed approximately \$7.6 trillion in department-level accounting entries to the DoD Components’ financial data used to prepare departmental reports and the DoD Agency-Wide financial statements for FY 1999. The department-level accounting entries were processed to force financial data to agree with various data sources, to correct errors, and to add new data. Of the \$7.6 trillion, proper research, reconciliations, and adequate audit trails supported \$3.5 trillion of the department-level accounting entries. However, accounting entries of \$2.3 trillion were made to force financial data to agree with various sources without adequate research and reconciliation, were made to force buyer and seller data to agree in preparation for eliminating entries, did not contain adequate audit trails and documentation, or did not follow accounting principles. Because of time and staff constraints, we identified but did not review \$1.8 trillion of accounting entries and, therefore, we did not determine whether they were adequately supported. The following table identifies the results of our

review of department-level accounting entries made to the DoD Components' financial data. The data contained in the table have been updated to incorporate the results of our additional audit work completed since the issuance of Inspector General, DoD, Report No. D-2000-091, "Internal Controls and Compliance With Laws and Regulations for the DoD Agency-Wide Financial Statements for FY 1999," February 25, 2000. That report addresses \$6.9 trillion in entries, which consisted of \$2.6 trillion of supported accounting entries, \$2.3 trillion of unsupported accounting entries, and \$2.0 trillion of unreviewed entries.

Department-Level Accounting Entries for FY 1999				
(dollars in billions)				
Department-Level Accounting Entries	Supported (entries)	Unsupported or Invalid (entries)	Not Reviewed (entries)	Total (entries)
Army General Fund	\$ 175.4 (176)	\$ 290.2 (192)	\$ 4.1 (12)	\$ 469.7 (380)
Army Working Capital Fund	54.0 (90)	127.8 (105)	0 (0)	181.8 (195)
Navy General Fund	158.9 (276)	1,463.2 (9,348)	1,781.5 (4,789)	3,403.6 (14,413)
Navy Working Capital Fund	549.5 (35)	48.0 (39)	7.3 (159)	604.8 (233)
Air Force General Fund	1,156.1 (363)	66.6 (89)	0 (0)	1,222.7 (452)
Air Force Working Capital Fund	90.5 (293)	79.1 (245)	11.2 (32)	180.8 (570)
ODO General Fund	557.9 (62)	179.9 (24)	0.5 (19)	738.3 (105)
ODO Working Capital Fund	65.7 (77)	51.0 (119)	4.7 (4)*	121.4 (200)*
Military Retirement Fund	661.7 (1)	0 (0)	0 (0)	661.7 (1)
Total	\$3,469.7 (1,373)	\$2,305.8 (10,161)	\$1,809.3 (5,015)	\$7,584.8 (16,549)

*The scope of accounting entries reviewed for the ODO WCF was limited to Defense Logistics Agency entries processed by the DFAS Columbus Center (\$12.2 billion) and ODO WCF entries processed by the DFAS Denver Center (\$109.2 billion). Therefore, the total amount of accounting entries to the ODO WCF financial statements is unknown.

The reason the number and value of accounting entries for the Navy General Fund is so much larger than for the other reporting entities was in part because of the way financial data are processed by DFAS Cleveland Center. DFAS Cleveland Center uses general ledger accounts and posts Navy financial data, some of which impact the financial statements, every month and at year-end in preparation for monthly and year-end reporting. The process used to prepare financial statements varies from center to center and thus by Service and fund. As a result, the number of department-level accounting entries processed by

each of the centers varies significantly. Monthly posting of financial data is in fact preferable to a once-a-year summary process as it provides an opportunity to adjust accounting reports to reflect the most current data.

Comparison of Audit Work Performed for FYs 1998 and 1999. We reviewed portions of the department-level accounting entries for DoD reporting entities and identified approximately \$1.7 trillion in unsupported entries made to selected reporting entities for FY 1998. Because of problems noted, we expanded the scope of our audit work for FY 1999. The DFAS Indianapolis Center made progress in reducing the unsupported department-level accounting entries that affect the Army General Fund financial statements. The DFAS Indianapolis Center decreased the amount of unsupported department-level accounting entries processed into the financial data used to compile the Army General Fund financial statements from \$673 billion in FY 1998 to \$290 billion in FY 1999.

For FY 1999, we attempted to identify all the department-level accounting entries that the DFAS centers made. However, because of resource constraints and other accounting classification issues, we were not able to identify the total number of department-level accounting entries and their dollar values that the DFAS centers made to DoD Component financial data used to prepare departmental reports and the DoD financial statements for FY 1999.

Supported Department-Level Accounting Entries

The DFAS centers processed 1,373 department-level accounting entries, valued at \$3,470 billion, for which proper research and reconciliations were performed and adequate audit trails existed. The department-level accounting entries were made to do the following:

- enter new data into the accounting records,
- correct errors, and
- meet the requirements of accounting principles and other guidance.

Data Entries. The DFAS centers processed 451 department-level accounting entries, valued at \$1,525 billion, to add new data into the accounting records. The DFAS centers were required to process some department-level accounting entries, such as actuarial estimates, that could not be generated through transaction-driven integrated accounting systems. The data came from outside sources over which the DFAS centers had little or no direct influence. For example, DFAS processed a department-level accounting entry for \$661.7 billion to record the liability for military retirement pensions. The department-level accounting entry was properly supported, and we verified that the amount was accurate. Although some department-level accounting entries were properly supported, they could not be verified through audit. For example, the DFAS centers processed department-level accounting entries, valued at \$79.7 billion, to record environmental liabilities based on documentation that the Military Departments provided. However, because of

insufficient controls that DoD used to develop the estimates, auditors could not verify the accuracy of the reported amount. Also, DFAS processed a department-level accounting entry to record the \$196 billion Military Retirement Health Benefits Liability. The Assistant Secretary of Defense (Health Affairs) acknowledged that the reported amount was unreliable.

The DFAS centers also processed department-level accounting entries to add new data into the accounting records that normally should be generated through a transaction-driven integrated financial management system. Instead, the DFAS centers were forced to prepare data calls for field organizations to obtain amounts to be reported on line items such as property, plant, and equipment and inventory because the current financial management systems were not capable of generating that information. The information should be available to DoD managers throughout the year, not just reported through data calls conducted once a year. DoD developed long-term plans to correct all critical financial management system deficiencies. We will assess the adequacy of DoD long-term plans in separate audit reports. Therefore, we are not making recommendations in this report regarding DoD plans to correct financial management system deficiencies.

Corrections of Errors. The DFAS centers processed 360 department-level accounting entries, valued at \$602.7 billion, to correct accounting errors. Errors were created by field and department-level personnel and by deficiencies in automated systems. Errors should be minimized to ensure the integrity of the data used to prepare the financial statements. DoD should establish an implementation strategy addressing department-level accounting entries, including minimizing errors.

Entries Required by Guidance. The DFAS centers processed 562 department-level accounting entries, valued at \$1,342 billion, to record entries required by guidance. They included department-level accounting entries that were required by the DoD Financial Management Regulation and were properly supported. For example, the DoD Financial Management Regulation volume 11, chapter 55, requires that DoD inventory be valued at the latest acquisition cost for financial statement presentation. However, to record inventory on the financial statements at latest acquisition cost, DoD organizations that maintain inventory values at the selling price adjust the inventory values to latest acquisition cost by removing operating cost recovery amounts.

Unsupported or Invalid Department-Level Accounting Entries

The DFAS centers processed 10,161 unsupported or invalid department-level accounting entries, valued at \$2,306 billion. The department-level accounting entries were unsupported or invalid because of the following:

- they were made to force general ledger data to agree with data from other sources without adequate research and reconciliation;
- they were made to force buyer and seller data to agree in preparation for eliminating entries; and

-
- they did not follow accounting principles, did not contain adequate supporting documentation, or did not contain adequate audit trails.

Entries to Force Financial Data to Agree With Various Sources. The DFAS centers processed department-level accounting entries, valued at \$431 billion, to force financial data from various sources to agree without performing the proper research and reconciliations. DFAS headquarters guidance requires that, when accounting personnel process accounting entries made to force financial data from various sources to agree, they must document the reason for the discrepancy and explain how they determined the proper source to be correct. For example, DFAS Indianapolis Center identified \$148.5 billion of differences between various financial data sources used to prepare the Army General Fund financial statements. Instead of conducting the proper research to identify the correct amount to be reported, the DFAS Indianapolis Center processed 51 department-level accounting entries to force the various amounts to agree without performing the proper reconciliations. Without proper research and reconciliation, management's ability to support the financial data is impaired. Proper research and reconciliation are important management responsibilities and control required by the Office of Management and Budget and the General Accounting Office.

Entries to Force Buyer and Seller Data to Agree. In FY 1999, DoD conducted \$111 billion worth of business between DoD Components. When DoD prepared the DoD Agency-Wide financial statements for FY 1999, it eliminated the effects of financial transactions among the DoD Components. Amounts reported for revenues, expenses, assets, and liabilities should be reported based on transactions with outside parties. Guidance that the Office of the Under Secretary of Defense (Comptroller) issued requires that the DFAS centers, in conjunction with the DoD Components, accumulate seller data and use them to adjust the buyer accounts at the reporting entity level. We identified department-level accounting entries, valued at approximately \$140 billion, that the DFAS centers processed to force buyer data to match seller data in preparation for the eliminations on the DoD financial statements for FY 1999 without conducting the proper research and reconciliations. The Office of the Under Secretary of Defense (Comptroller) stated that the guidance requiring the buyer and seller data to match was the result of U.S. Treasury requirements. Even though DoD was making the entries as a result of requirements over which it had no control, it made the entries without performing the proper reconciliations as required by the Office of Management and Budget and the General Accounting Office. Further details on entries to force the buyer and seller data to agree and eliminations will be addressed in a separate report.

Other Unsupported or Invalid Department-Level Accounting Entries. The DFAS centers processed 9,755 department-level accounting entries, valued at \$1,735 billion, that did not follow accounting principles, did not contain adequate supporting documentation, or did not contain adequate audit trails. For example, DFAS Cleveland Center processed 9,348 department-level accounting entries, valued at \$1.5 trillion, that posted transactions to invalid general ledger accounts. The transactions were not logical accounting and did not follow accounting principles. Additional information on the entries to invalid general ledger accounts is contained in Inspector General, DoD, Report No. D-2000-137, "Accounting Entries and Data Processing for the FY 1999

Department of the Navy General Fund Financial Statements,” June 1, 2000. In addition, we identified numerous examples of documentation and audit trail problems. For example, DFAS Denver Center processed a department-level accounting entry for the Air Force WCF for which no documentation was attached to support the entry. Another example involved a department-level accounting entry that DFAS Cleveland Center processed for the Navy WCF that also did not have supporting documentation of any kind.

DoD Implementation Strategies

As an interim solution until compliant financial management and mixed systems were in place, DoD was improving other aspects of its financial management through various initiatives. One such initiative was the development of DoD implementation strategies for financial management areas needing improvement. The implementation strategies are a step toward achieving a favorable audit opinion. However, the Inspector General, DoD; the Under Secretary of Defense (Comptroller); the Office of Management and Budget; and the General Accounting Office believe that the long-term plan needs to address additional areas related to financial management systems and processes. Although DoD developed 12 implementation strategies for various financial management areas needing improvement, it did not address department-level accounting entries. The department-level accounting entries is an area that DoD should address.

Summary

DoD will always make some department-level accounting entries to reflect needed adjustments to the accounting data. However, DoD made many of the accounting entries to add new data into the accounting records because DoD lacked integrated financial management systems that meet Federal financial management system requirements and accounting principles. DoD acknowledged that deficiencies exist and developed long-term plans to correct all critical financial management systems.

Although DFAS adequately supported \$3.5 trillion of accounting entries, many could not be verified through audit, and \$602.7 billion in entries were made to correct errors. In addition to its long-term system correction plans, DoD should focus efforts on improving the accuracy of accounting entries made and minimizing error corrections.

DoD did not perform proper research and reconciliations, did not follow accounting principles in making accounting entries, and did not maintain adequate documentation and audit trails for \$2.3 trillion of department-level accounting entries. The accounting entries indicate potential problems in DoD financial management systems and processes. Until compliant financial management systems are in place, DoD could improve the accuracy of its financial data by following accounting principles and including the proper support for any accounting entries made to the accounting records.

As a result of processing \$7.6 trillion of department-level accounting entries, of which \$2.3 trillion could not be supported or were made to invalid general ledger accounts, the DoD Agency-Wide financial statements for FY 1999 were subject to a high risk of material misstatement. The lack of research, reconciliation, and audit trails impaired the auditors' ability to validate the department-level accounting entries. The magnitude of department-level accounting entries required to compile the DoD financial statements highlights the significant problems that DoD had in producing accurate and reliable financial statements with existing systems and processes.

Management Comments on Finding and Audit Response

Management Comments. The Under Secretary of Defense (Comptroller) stated that the \$1.4 trillion of department-level accounting entries for the Navy General Fund were related to the process that DoD used to reflect the Marine Corps budgetary data on monthly budgetary reports and that none of the \$1.4 trillion was used to prepare the Navy General Fund financial statements. In addition, the Under Secretary of Defense (Comptroller) stated that the discussion of the accounting entries to record environmental liabilities and the Military Retirement Health Benefits Liability was contradictory and a source of confusion because the entries were classified as supported and suggested that we delete the discussion from this report.

Audit Response. The Under Secretary of Defense (Comptroller) statement that the \$1.4 trillion of Navy General Fund department-level accounting entries were related to Marine Corps budgetary data is incorrect. Only approximately \$948 billion of the department-level accounting entries were related to Marine Corps appropriations, and based on our review of accounting during FY 2000, not all of the entries affecting Marine Corps appropriations that DFAS Cleveland Center entered came from the Marine Corps budgetary data. DFAS Cleveland Center was given the opportunity during the audit to provide evidence documenting the reversal of the department-level accounting entries for the Marine Corps budgetary data and was not able to do so. Our audit of department-level accounting entries for the FY 2000 financial reporting cycle for the Navy General Fund will emphasize a review of the process the DFAS Cleveland Center uses to make department-level accounting entries for the Marine Corps budgetary data.

The \$1.4 trillion in department-level accounting entries for the Navy General Fund are discussed in Inspector General, DoD, Report No. D-2000-137, "Accounting Entries and Data Processing for the FY 1999 Department of the Navy General Fund Financial Statements," June 1, 2000.

All of the \$1.4 trillion of unsupported accounting entries that DFAS Cleveland Center processed for the Navy were made to invalid general ledger accounts. We classified the entries as "unsupported" because they were made to invalid general ledger accounts, and because DFAS Cleveland Center did not provide supporting documentation for the accounting entries. DFAS Cleveland Center has begun to initiate changes in how it processes and explains accounting

adjustments for FY 2000 department-level accounting entries. We are also working with DFAS Cleveland and Kansas City centers to eliminate the need for using invalid general ledger accounts.

The amounts included on the financial statements for environmental liabilities and the Military Retirement Health Benefits Liability were estimates developed by outside sources, such as the Military Departments, and provided to DFAS. DFAS then processed the accounting entries using the correct debits and credits. However, because of insufficient controls used to develop the estimates, auditors were unable to verify whether the estimates provided to DFAS were accurate. It is significant to note the issues in this report because although DFAS followed proper procedures to record the liabilities, it had no certainty that the estimates themselves were reliable.

Recommendation and Management Comments

We recommend that the Under Secretary of Defense (Comptroller) establish an implementation strategy to eliminate unsupported department-level accounting entries and to minimize department-level accounting entries to the data used to compile the DoD Component and DoD financial statements. The implementation strategy should include, but not be limited to the following:

- **review and clarification of policies related to department-level accounting entries,**
- **review of financial management system plans to ensure requirements are included to eliminate unsupported and minimize other department-level accounting entries, and**
- **development of a metric to measure progress in eliminating unsupported and minimizing other department-level accounting entries.**

Management Comments. Although the comments from the Under Secretary of Defense (Comptroller) did not state specific concurrence with the recommendation, the Under Secretary of Defense (Comptroller) drafted an implementation strategy to address the issue of unsupported accounting entries during the preparation of financial statements. The Under Secretary of Defense (Comptroller) stated that DFAS; the Inspector General, DoD; and other DoD Components will meet to attempt to address the level of documentation to support accounting entries. In an attempt to reduce the number of unsupported accounting entries, the draft strategy requires that guidance be developed requiring approving officials to certify all categories of accounting entry vouchers.

The Under Secretary of Defense (Comptroller) stated that the current process used to prepare the financial statements relies heavily on department-level accounting entries because the systems used to generate the financial data are not integrated. As system improvements are made, the financial statement process will become less dependent on department-level accounting entries.

To measure progress in eliminating unsupported and minimizing other department-level accounting entries, DFAS intends to use the Defense Departmental Reporting System to produce the FY 2000 financial statements and to identify the number and types of accounting entries processed.

Appendix A. Audit Process

Scope

Work Performed. We reviewed \$5.8 trillion of the \$7.6 trillion department-level accounting entries that the DFAS centers processed. The department-level accounting entries adjusted financial data used to prepare the DoD Component financial reports and financial statements for FY 1999. We reviewed guidance requiring or resulting in department-level accounting entries in addition to guidance on the documentation necessary to support the entries. We developed categories for use in classifying the department-level accounting entries that the DFAS centers processed and identified the type and scope of department-level accounting entries for FY 1999. We reviewed the department-level accounting entries to determine whether they were adequately supported, maintained adequate audit trails, and were in compliance with accounting principles.

Limitations to Audit Scope. We attempted to identify all the department-level accounting entries made by the DFAS centers that impacted the DoD financial report and financial statements for FY 1999. However, because of resource constraints and other accounting classification issues, we were not able to identify the total number of department-level accounting entries and their dollar values made by the DFAS centers that may have impacted the DoD financial statements for FY 1999.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures.

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. **(01-DoD-2.5.1.)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2.)**

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 objectives and goals.

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

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

Methodology

Use of Computer-Processed Data. We could not rely on the computer-processed data used to prepare the DoD Component and DoD Agency-Wide financial statements for FY 1999. DoD financial management systems were unreliable. DoD candidly addressed deficiencies in its financial management systems in the Annual Statement of Assurance, the DoD Financial Management Improvement Plan, and the management representation letter for the DoD financial statements for FY 1999. Unreliable computer-processed data were used in preparing the departmental entries, the financial statements, and this report because they were the only data available. We planned to continue to review the adequacy of existing and proposed financial management systems.

Audit Type, Dates, and Standards. We performed this financial-related audit at the DFAS centers from July 13, 1999, through April 12, 2000. The audit was made in compliance with auditing standards established by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and with Office of Management and Budget guidance; however, we limited our scope as noted in this appendix. The audit included tests of management controls as we considered necessary.

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

Management Control Program

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 management controls over the DFAS centers' processes and procedures for

recording department-level accounting entries into the financial data used to compile the DoD Component and the DoD financial statements for FY 1999. We also reviewed management's self-evaluation of controls over the DFAS centers' processes and procedures for department-level accounting entries.

Adequacy of Management Controls. We identified a material management control weakness as defined in DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. Management controls at the DFAS centers were not adequate to ensure that all department-level accounting entries were adequately supported. The details and results of management control reviews at each of the DFAS centers will be addressed in the reports on the financial statement compilation process at the individual DFAS centers. The control weakness identified and our recommendation for improvements are discussed in the finding in this report. The recommendation, if implemented, will improve the controls over processing and adequately supporting department-level accounting entries. A copy of this report will be provided to the senior official responsible for management controls at the DFAS centers.

Adequacy of Management's Self-Evaluation. DoD identified in the Annual Statement of Assurance for FY 1999 inadequacies in its accounting processes and systems. However, the Annual Statement of Assurance does not specifically address processing of department-level accounting entries. The adequacy of management's self-evaluation over the processes and procedures for department-level accounting entries at each of the DFAS centers will be addressed in the reports on the financial statement compilation process at the individual DFAS centers.

Appendix B. Prior Coverage

Inspector General

Inspector General, DoD, Report No. 99-258, "Compilation of the FY 1998 Army Working Capital Fund Financial Statements," September 23, 1999.

Inspector General, DoD, Report No. 99-191, "Compilation of the FY 1998 Financial Statements for Other Defense Organizations," June 24, 1999.

Inspector General, DoD, Report No. 99-180, "Journal Voucher Adjustments and Processing of Data for the FY 1998 Navy General Fund Financial Statements," June 7, 1999.

Inspector General, DoD, Report No. 99-153, "Compilation of the FY 1998 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," May 12, 1999.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director for Accounting Policy
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Cleveland Center
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Finance and Accounting Service Indianapolis Center

Non-Defense Federal Organizations and Individuals

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

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International
Relations, Committee on Government Reform

Under Secretary of Defense (Comptroller) Comments



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

JUN 23 2000

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

SUBJECT: Office of the Inspector General, Department of Defense Draft Audit Report,
"Department-Level Accounting Entries Impacting the DoD Financial Statements
for FY 1999," Dated April 12, 2000 (Project No. D2000FI-0063.004)

This is in response to the subject Office of the Inspector General, Department of Defense draft report.

The process of preparing financial statements for the Department is dependent on department-level accounting entries. Currently, the Department's financial and nonfinancial feeder systems lack the integration that would minimize the need for these accounting entries. The Department has drafted an implementation strategy that has the objective of better ensuring accounting entries are supported by appropriate documentation. Detailed comments on the finding and recommendation contained in the report are provided in the attachment.

The point of contact for this matter is Ms. Barbara Zientek. She may be reached by e-mail: zientekb@osd.pentagon.mil or by telephone at (703) 697-8618 (DSN 227-8618).

A handwritten signature in cursive script that reads "Nelson Toye".

Nelson Toye
Deputy Chief Financial Officer

Attachment

OFFICE OF THE INSPECTOR GENERAL DRAFT AUDIT REPORT
"DEPARTMENT-LEVEL ACCOUNTING ENTRIES IMPACTING THE DOD
FINANCIAL STATEMENTS FOR FY 1999"
DATED APRIL 12, 2000
(PROJECT NO. D2000FI-0063.004)

COMMENTS ON THE FINDING

Finding page 5: The table on page 5 shows that the Navy General fund has \$1,463.2 billion in unsupported accounting entries. Page 5 also contains the following statement regarding these accounting entries: "DFAS Cleveland uses general ledger accounts and posts Navy financial data which impacts the financial statements every month and at year-end in preparation for monthly and year-end reporting."

Management Comments: The \$1.463.2 billion reported as unsupported accounting entries for the Navy General fund are related to the process that the Department of Defense (DoD) used to reflect the Marine Corps budgetary data on monthly Department of the Navy (DoN) budgetary reports. The Defense Finance and Accounting Service (DFAS) Cleveland Center prepares consolidated departmental reports for the DoN that include both Navy and Marine Corps data. Marine Corps data is prepared by the DFAS Kansas City Center. At the DFAS Cleveland Center, hard copy Marine Corps Report on Budget Execution (SF 133) data is used to prepare the Navy SF 133. The Marine Corps SF 133 budgetary data input from the DFAS Kansas City Center is entered via a journal voucher process and then reversed after the SF 133 report preparation. About three or four days later, the DFAS Kansas City Center provides the DFAS Cleveland Center a detailed electronic budgetary trial balance dataset at the level necessary to produce the Appropriation Status by Fiscal Year Program and Subaccounts (DD Form 1002). Therefore, the data from the SF 133 is replaced by the detailed data when it becomes available. Since the SF 133 data is replaced, it has no impact on the financial statements. The annual audited financial statements are prepared using the detail-level year-end amounts. Therefore, none of the referenced \$1.463.2 billion was used to prepare the Navy's official financial statements.

This office does not agree that the entries were unsupported. The Office of the Inspector General (OIG), DoD claimed that all of these entries were unsupported because (1) there was not a fully integrated system to enter budgetary trial balance data from the DFAS Kansas City Center to the DFAS Cleveland Center departmental system, and (2) the DFAS Cleveland Center used a pseudo general ledger account in the journal voucher process to establish budgetary accounts based on the SF 133 data. The entries were supported by the hard copy SF 133s provided by the DFAS Kansas City Center. The use of a pseudo general ledger account had no effect on the Marine Corps SF 133 data reflected in the Navy departmental SF 133. This office agrees that the use of the hardcopy SF 133 and the journal voucher process is not the most efficient process to enter Marine Corps data into the Navy SF 133. The DFAS is reviewing the process and plans to have

Attachment

a better procedure in place before the end of FY 2000 for the DFAS Kansas City Center to provide budgetary trial balance data to the DFAS Cleveland Center departmental system.

The accounting entries had no effect on the published annual financial statements. The summary entries only affected the monthly SF 133. All the entries had been reversed before preparing the annual financial statements. The Navy's Statement of Budgetary Resources was compiled using the detailed electronic dataset that has all the DFAS Kansas City Center trial balance data, not the summary information.

Finding pages 6 and 7: Supported Department-Level Accounting Entries. "Although some department-level accounting entries were properly supported, they could not be verified through audit. For example, the DFAS Centers processed departmental-level accounting entries, valued at \$79.7 billion, to record environmental liabilities based on documentation that the Military Departments provided. However, because of insufficient controls that the DoD used to develop the estimates, auditors could not verify the accuracy of the reported amount. Also, the DFAS processed a department-level accounting entry to record the \$196 billion Military Retirement Health Benefits Liability. The Assistant Secretary of Defense (Health Affairs) acknowledged that the reported amount was unreliable."

Management Comments: The sentences appear contradictory and are a source of confusion. This office recommends that they be deleted. Since the OIG, DoD has determined that these entries were supported entries, addressing them in this context unnecessarily complicates the discussion of the need for improved processing controls and documentation for department-level accounting entries.

COMMENTS ON RECOMMENDATIONS

RECOMMENDATION 1: The OIG, DoD recommended that the Under Secretary of Defense (Comptroller) (USD(C)) establish an implementation strategy to eliminate unsupported department-level accounting entries and to minimize department-level accounting entries to the data used to compile the DoD Component and DoD financial statements. The implementation strategy should include, but not be limited to the following:

- Review and clarification of policies related to department-level accounting entries,
- Review of financial management system plans to ensure requirements are included to eliminate unsupported and minimize other department-level accounting entries, and
- Development of a metric to measure progress in eliminating unsupported and minimizing other department-level accounting entries.

OUSD(C) Response: An implementation strategy which addresses the issue of unsupported accounting entries during the preparation of financial statements has been drafted. The draft implementation strategy states that the DFAS; the OIG, DoD; and other DoD Components will

Attachment

meet to attempt to address the level of documentation that is desired by the OIG, DoD in order to state that applicable accounting entries are supported. The draft implementation strategy states that guidance will be developed requiring all categories of accounting entry vouchers to be certified by approving officials. This control is expected to significantly reduce the number of alleged unsupported accounting entries.

The current process used to prepare financial statements is dependent on department-level accounting entries because financial and nonfinancial feeder systems are not integrated. Therefore, the only way to compile the information necessary to produce financial statements is through department-level accounting entries. As system improvements are implemented, the financial statement process will become increasingly less dependent on the department-level accounting entries. However, it should be noted that accounting entries are normal in the preparation of financial statements for both government entities and private sector companies and always will be part of the process.

With regard to the alleged unsupported adjustments, one reason that a full audit trail may not exist is that the detail data that is desired by the auditors may not be available in the current systems. As a result, management estimates are used in some cases to allocate amounts for which the lower level of detail is not available. As improved systems are implemented, more detailed data and better audit trails will become available.

For fiscal year 2000, audited financial statements are expected to be produced using the Defense Departmental Reporting System (DDRS). The DDRS is expected to capture transaction information in such a manner that the DFAS should be able to determine how many accounting entries were processed individually through the DDRS. Additionally, the DDRS will require that each accounting entry be classified into one of the following categories: identified errors and reasonableness checks, reconciliation of trial balance and budget execution reports, balancing entries for eliminations, supply management inventory, reclassification of accounts, audit recommended journal vouchers, customer requested journal vouchers, data call entry, recognition of undistributed disbursements and collections, and other accruals and reversals. Based on the information provided by the DDRS and management reviews, the DFAS is expected to be able to measure the progress in eliminating any unsupported entries, as well as minimizing other department-level accounting entries.

Attachment

Audit Team Members

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

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