Audit Report

OFFICE OF THE INSPECTOR GENERAL

NAVY AND MARINE CORPS RESERVE
FINANCIAL REPORTS ON THE NATIONAL GUARD
AND RESERVE EQUIPMENT APPROPRIATION

Report No. 97-201
July 30, 1997

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Acronyms

DFAS
Defense Finance and Accounting Service
KAR
Key Accounting Requirement
NAVAIR
Naval Air Systems Command
NGREA
National Guard and Reserve Equipment Appropriation
MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE


We are providing this audit report for review and comment. We performed this audit in response to the Chief Financial Officers Act of 1990 and the Federal Financial Management Act of 1994. We considered the comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Director, Defense Finance and Accounting Service, reconsider his position on the final report. We request that additional comments on Recommendation 2 be provided by September 30, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9426 (DSN 664-9426) or Ms. Dianna J. Pearson, Audit Project Manager, at (703) 604-9424 (DSN 664-9424). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General for Auditing
Office of the Inspector General, DoD

Report No. 97-201                        July 30, 1997
(Project No. 7RE-2002.01)

Navy and Marine Corps Reserve Financial Reports on the
National Guard and Reserve Equipment Appropriation

Executive Summary

Introduction. The audit was performed in compliance with the Chief Financial Officers
(Public Law 103-356). Public Law 103-356 requires DoD and other Government
agencies to prepare consolidated financial statements for FY 1996 and each succeeding
year. On June 6, 1995, the DoD Deputy Chief Financial Officer advised the DoD
Components of the requirement to prepare and submit financial statements in accordance

In 1981, Congress established the National Guard and Reserve Equipment Appropriation
to provide the equipment needed to maintain the readiness of the National Guard and
Reserve units. In FY 1996, the Navy and Marine Corps Reserves received a total of $140
million for miscellaneous equipment and aircraft. The Assistant Secretary of the Navy
(Financial Management and Comptroller) allocated Navy and Marine Corps Reserve
National Guard and Reserve Equipment Appropriation funds to the organizations
responsible for obtaining miscellaneous equipment and aircraft for the Navy and Marine
Corps Reserves.

Audit Objectives. The overall audit objective was to evaluate the FY 1996 Navy and
Marine Corps Reserve reports on budget execution and trial balances for the National
Guard and Reserve Equipment Appropriation. Also, we determined the effect of
noncompliant actions on the FY 1997 financial statements, assessed compliance with laws
and regulations, and reviewed the management control program as it related to the overall
objective.

Audit Results. The FY 1996 reports on budget execution for the Navy and Marine Corps
Reserve National Guard and Reserve Equipment Appropriation are not fully supported
with source documentation. As a result, reports on budget execution for the National
Guard and Reserve Equipment Appropriation could not be verified, and the FY 1996
Navy and Marine Corps Reserves ending trial balances may be unreliable. Further, if the
Defense Finance and Accounting Service Cleveland Center does not reconcile financial
reports with source documents, the FY 1997 financial statements may also be unreliable.

Summary of Recommendations. We recommend that the Director, Defense Finance and
Accounting Service Cleveland Center, document the audit trail process for report
preparation in accordance with Key Accounting Requirement No. 8, reconcile
discrepancies between source documents and Marine Corps Reserve National Guard and Reserve Equipment Appropriation transactions at the Naval Air Systems Command for FY 1996, and provide the Defense Finance and Accounting Service Kansas City Center access to and a method for identifying Marine Corps Reserve transactions within the Defense Finance and Accounting Service Cleveland Center accounting system. We also recommend that the Director, Defense Finance and Accounting Service Kansas City Center, provide complete financial data for the Marine Corps Reserves National Guard and Reserve Equipment Appropriation after obtaining access to Marine Corps Reserve transactions in the Defense Finance and Accounting Service Cleveland Center accounting system.

Management Comments. The Defense Finance and Accounting Service concurred with the intent of all the recommendations and indicated that corrective actions are being taken. The Defense Finance and Accounting Service Cleveland Center is preparing procedures to fully document the process for preparation of the Navy Reserve report on budget execution. The Defense Finance and Accounting Service Cleveland Center is also reconciling discrepancies between the source documents and Marine Corps Reserve transactions for FY 1996 at the Naval Air Systems Command. Furthermore, the Defense Finance and Accounting Service Kansas City Center will obtain access to the Defense Finance and Accounting Service Cleveland Center Standard Accounting and Reporting System.

The Defense Finance and Accounting Service partially concurred with the recommendation to delegate additional reporting responsibilities to the Defense Finance and Accounting Service Kansas City Center. The Defense Finance and Accounting Service agreed that the Director, Defense Finance and Accounting Service Kansas City Center, should assume complete financial reporting responsibilities for the Marine Corps Reserve National Guard and Reserve Equipment Appropriation. However, the Defense Finance and Accounting Service also stated that the Defense Finance and Accounting Service Kansas City Center must rely on the Standard Accounting, Budgeting, and Reporting System to perform its increased financial reporting responsibilities, rather than using the access to the Defense Finance and Accounting Service Cleveland Center Standard Accounting and Reporting System. See Part I for a complete discussion of management comments and Part III for the complete text of the management comments.

Audit Response. The Defense Finance and Accounting Service concurred with the intent of the recommendation to delegate complete financial reporting responsibilities to the Director, Defense Finance and Accounting Service Kansas City Center. However, the Standard Accounting, Budgeting, and Reporting System will not provide the complete financial reporting capability required. Therefore, we ask that the Director, Defense Finance and Accounting Service, provide additional comments on the final report by September 30, 1997, identifying specific actions that will provide the Defense Finance and Accounting Service Kansas City Center with the complete financial reporting capability for the Marine Corps Reserve National Guard and Reserve Equipment Appropriation.
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Part I - Audit Results
Audit Background

The audit was performed in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, the Federal Financial Management Act of 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The consolidated DoD financial statements for FY 1996 will include the financial statement for the reporting entity entitled Other Defense Organizations. The Other Defense Organizations entity includes the financial statements for that portion of Department 97\(^1\) funds, to include the National Guard and Reserve Equipment Appropriation (NGREA), which is allocated to the Military Departments.

Purpose of the NGREA. In 1981, Congress established the NGREA to provide the equipment needed to maintain the readiness of the National Guard and Reserve units. Congress specifies the amount of NGREA funds each Military Department should receive. The Chiefs of the Reserve and National Guard components within each of the Military Departments manage their respective portions of the NGREA. The following six components comprise the National Guard and Reserve:

- Army National Guard,
- Air National Guard,
- Army Reserve,
- Navy Reserve,
- Air Force Reserve, and
- Marine Corps Reserve.

Fund Allocation Process. The Office of the Under Secretary of Defense (Comptroller) allocates all Navy and Marine Corps Reserve NGREA funds to the Assistant Secretary of the Navy (Financial Management and Comptroller). The Assistant Secretary of the Navy (Financial Management and Comptroller) then allocates Navy Reserve funds for miscellaneous equipment and aircraft to Navy organizations. The Assistant Secretary of the Navy (Financial Management and Comptroller) allocates Marine Corps Reserve funds for miscellaneous equipment to the Marine Corps Systems Command and allocates miscellaneous equipment and aircraft funds to the Naval Air Systems Command (NAVAIR). See Appendix B for a more detailed discussion on the Navy Reserve and Marine Corps Reserve NGREA.

\(^1\)The Department of the Treasury uses department code “97” to identify appropriations for the Office of the Secretary of Defense. The Military Departments also receive Department 97 appropriations, including the National Guard and Reserve Equipment Appropriation.
NGREA Accounting Responsibilities. The Under Secretary of Defense (Comptroller) made the Defense Finance and Accounting Service (DFAS) responsible for accounting support within DoD. The DFAS Cleveland Center provides accounting support for Navy Reserve NGREA funds and Marine Corps Reserve NGREA funds allocated to NAVAIR. The DFAS Kansas City Center provides accounting support for Marine Corps Reserves NGREA funds allocated to the Marine Corps Systems Command.

The Report on Budget Execution. Office of Management and Budget Circular A-34 requires Government agencies to submit reports on budgetary status and related financial data. The Report on Budget Execution, DD Form 1176, is a monthly report designed to show, on a consistent basis and in practicable detail, the status of budgetary resources and related financial data. The DFAS centers prepare the report on budget execution for all appropriated funds. The report on budget execution shows the current status of funds for each appropriation.

Financial Reporting for the Navy and Marine Corps Reserves NGREA. The DFAS Cleveland Center prepares the report on budget execution for the Navy Reserve NGREA. The DFAS Kansas City Center prepares the report on budget execution for the Marine Corps Reserve NGREA funds allocated to the Marine Corps Systems Command. Subsequently, the DFAS Kansas City Center submits its reports on budget execution to the DFAS Cleveland Center, which uses manual spreadsheets and systems inquiries to determine Marine Corps Reserve NGREA transactions for the miscellaneous equipment and aircraft funds allocated to NAVAIR. The DFAS Cleveland Center combines the DFAS Kansas City Center reports on budget execution and the DFAS Cleveland Marine Corps Reserve transactions to prepare the Marine Corps Reserve NGREA report on budget execution. The DFAS Cleveland Center submits both the Navy and Marine Corps Reserves reports on budget execution to the DFAS Indianapolis Center, which prepares the DoD financial statements.

Trial Balance. The DFAS Cleveland Center submits monthly trial balances using the DoD uniform chart of accounts to the DFAS Indianapolis Center. Before the DFAS Cleveland Center submits the trial balance to the Indianapolis Center, the DFAS Cleveland Center ensures that the report on budget execution crosswalks to the trial balance.

\(^2\)A method that uses formulas to verify and adjust, if necessary, trial balance accounts to the yearend report on budget execution.
Audit Results

Audit Objectives

The overall audit objective was to evaluate the FY 1996 Navy Reserve and Marine Corps Reserve reports on budget execution and trial balances for the NGREA. Also, we determined the effect of noncompliant actions on FY 1997 financial statements, assessed compliance with laws and regulations, and reviewed the management control program as it related to the overall audit objective. See Appendix A for a discussion of the audit scope and methodology and the review of the management control program.
Financial Reports for the National Guard and Reserve Equipment Appropriation for the Navy and Marine Corps Reserves

The FY 1996 reports on budget execution for the Navy and Marine Corps Reserves NGREA are not fully supported with source documentation. The reports on budget execution are not fully supported because the DFAS Cleveland Center did not maintain adequate documentation or source records as required by Key Accounting Requirement No. 8, “Audit Trails.” As a result, reports on budget execution for the NGREA could not be verified, and the FY 1996 Navy and Marine Corps Reserves ending trial balances may be unreliable. Further, if the DFAS Cleveland Center does not reconcile the FY 1996 financial reports with source documents, the FY 1997 financial statements may also be unreliable.

DoD Financial Management Requirements

DoD 7000.14-R, “DoD Financial Management Regulation,” volume 1, “General Financial Management Information, Systems, and Requirements,” May 1993, requires DoD accounting systems to comply with 13 key accounting requirements (KARs). The KARs are composites of requirements of the General Accounting Office, the Office of Management and Budget, the Department of the Treasury, and DoD.

General Ledger Accounting Control. KAR No. 1, “General Ledger Control and Financial Reporting,” requires that accounting systems have general ledger control and maintain an appropriate account structure approved by DoD. The DFAS Cleveland Center uses report on budget execution data to verify the Navy Reserve and Marine Corps Reserve trial balances because supporting accounting systems are not complete general ledger accounting control systems. The need for complete general ledger accounting control systems is discussed further in Inspector General, DoD, Audit Report No. 97-017, “Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations,” October 31, 1996.

The DFAS FY 1996 Annual Statement of Assurance, November 12, 1996, identifies a material weakness related to inadequate general ledger control and unreliable financial reporting. Similarly, the DFAS Cleveland Center FY 1996 Annual Statement of Assurance, October 10, 1996, recognizes that because systems and processes are not fully compliant with regulatory and statutory
requirements, financial information and statements do not provide management with a high degree of reliability. The DFAS Cleveland Center has begun to address the significant issues and has targeted FY 1998 for compliance.

Audit Trails. KAR No. 8, "Audit Trails," states that a compliant system must account for financial transactions with adequately supported pertinent documents and source records. Audit trails enable the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source. A key test of the adequacy of an audit trail is the ability to trace the transaction from source documents to the resulting record or report to permit verification of the amount recorded or reported. We considered source documents to be the DFAS Cleveland Center NGREA summary report on budget execution, the DFAS Cleveland Center manual spreadsheets and system inquiries, and the DFAS Kansas City Center report on budget execution. See Appendix C for the complete text of KAR No. 8.

Financial Reporting Process for the Navy Reserve

Navy Reserve Report on Budget Execution. The DFAS Cleveland Center prepared the Navy Reserve NGREA report on budget execution based on source documentation extracted from the DFAS Cleveland Center Standard Accounting and Reporting System. The source documentation, which is the NGREA summary report on budget execution, includes:

- transactions for Navy Reserve NGREA funds allocated to Navy organizations, and
- transactions for Marine Corps Reserve NGREA funds allocated to NAVAIR.

To prepare the Navy Reserve NGREA report on budget execution, the DFAS Cleveland Center subtracted the Marine Corps Reserve NGREA transactions at NAVAIR based on manual spreadsheets and system inquiries. Figure 1 shows the process that the DFAS Cleveland Center used to prepare the Navy Reserve NGREA report on budget execution.
Summary Report on Budget Execution
- Navy Reserve NGREA transactions
- Marine Corps Reserve NGREA transactions allocated to NAVAIR

Marine Corps Reserve NGREA transactions (based on manual spreadsheets and system inquiries) allocated to NAVAIR

Navy Reserve NGREA report on budget execution

Figure 1. Preparation of the Navy Reserve NGREA Report on Budget Execution

Financial Reporting Process for the Marine Corps Reserve

**Marine Corps Reserve Report on Budget Execution.** The DFAS Kansas City Center prepared a report on budget execution that shows the status of miscellaneous equipment funds allocated to the Marine Corps Systems Command. The DFAS Cleveland Center uses manual spreadsheets and computer system inquiries to identify reportable Marine Corps Reserve transactions for NGREA funds allocated to NAVAIR. However, the DFAS Cleveland Center does not prepare a report on budget execution to show the status of the Marine Corps Reserve funds at NAVAIR. Therefore, the source documentation for the Marine Corps Reserve NGREA report on budget execution includes:

- the DFAS Kansas City report on budget execution for the Marine Corps Systems Command, and
- the manual spreadsheets and system inquiries for NAVAIR.
Figure 2 shows the process the DFAS Cleveland Center used to prepare the Marine Corps Reserve NGREA report on budget execution.

Figure 2. Preparation of the Marine Corps Reserve NGREA Report on Budget Execution.

Differences in the Amount for the Marine Corps Reserve NGREA Funds Allocated to NAVAIR Based on the Navy Reserve and Marine Corps Reserve Reports on Budget Execution

The amount of Marine Corps Reserve NGREA at NAVAIR, which was deducted from the DFAS Cleveland Center NGREA summary report on budget execution, did not match the amount added to the DFAS Kansas City report on budget execution. In both cases, the amount should have reflected the Marine Corps Reserve transactions for NGREA funds allocated to NAVAIR, and accordingly, should have been the same. The DFAS Cleveland Center did not have pertinent documents or source records on the process it used to prepare the Navy Reserve or Marine Corps Reserve NGREA reports on budget execution. Therefore, we could not verify the accuracy and completeness of the reports. Table 1 shows the differences in amounts for the Marine Corps Reserve NGREA at NAVAIR based on the Navy Reserve and Marine Corps Reserve reports on budget execution.
Table 1. Comparison of Marine Corps Reserve NGREA Transaction Amounts at NAVAIR Based on the Navy Reserve and Marine Corps Reserve Reports on Budget Execution

<table>
<thead>
<tr>
<th>Report on Budget Execution</th>
<th>MCR(^1) NGREA at NAVAIR Based on NR(^2) Reports</th>
<th>MCR NGREA at NAVAIR Based on MCR Reports</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Line 6, Total Budgetary Resources</td>
<td>$22.9</td>
<td>$139.2</td>
<td>($116.3)</td>
</tr>
<tr>
<td>Line 7, Total Obligations Incurred</td>
<td>(1.1)</td>
<td>116.7</td>
<td>(117.8)</td>
</tr>
<tr>
<td>Line 8A, Commitments Outstanding</td>
<td>4.8</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Line 11A, Gross Unpaid Obligations</td>
<td>163.0</td>
<td>237.8</td>
<td>(74.8)</td>
</tr>
<tr>
<td>Line 13A1, Undelivered Orders</td>
<td>103.2</td>
<td>207.8</td>
<td>(104.6)</td>
</tr>
<tr>
<td>Line 16, Total Accrued Expenditures</td>
<td>175.3</td>
<td>145.6</td>
<td>29.7</td>
</tr>
</tbody>
</table>

\(^1\)Marine Corps Reserve.
\(^2\)Navy Reserve.

Depending on whether the Navy Reserve NGREA reports or the Marine Corps Reserve NGREA reports are used, the amount of Marine Corps Reserve NGREA at NAVAIR differs. The amount should be the same, regardless of which report is used. The differences above indicate that the amount of Marine Corps Reserve NGREA at NAVAIR is unreliable.

After notification of the differences, the DFAS Cleveland Center attempted to resolve them by providing additional status of fund information. However, the additional information did not resolve the differences in the amount for the Marine Corps Reserve NGREA at NAVAIR.
Effects of Reports on Budget Execution on the Trial Balance

The FY 1996 report on budget execution crosswalks to specific accounts on the FY 1996 trial balance. The crosswalk requires the use of FY 1996 trial balance totals to calculate FY 1997 trial balance totals. Therefore, the accuracy of the FY 1996 reports on budget execution will affect the accuracy of the FY 1996 NGREA ending trial balance and, ultimately, the FY 1997 financial reports. Unverifiable reports on budget execution lead to unreliable trial balances. Table 2 shows the calculations the DFAS Cleveland Center used to crosswalk lines on the reports on budget execution to the trial balance.

Table 2. Calculations to Crosswalk Lines in the Report on Budget Execution to the NGREA Trial Balance

<table>
<thead>
<tr>
<th>Calculation</th>
<th>Trial Balance Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add lines 8, 9, and 13, and subtract canceled years</td>
<td>Account 1010 Fund Balance With Treasury</td>
</tr>
<tr>
<td>Subtract line 13a3.4 from line 13b1.2, and subtract canceled years</td>
<td>Account 1311 Accounts Receivable-Government-Current</td>
</tr>
<tr>
<td>Subtract line 13a3.3 from line 13b1.1, and subtract canceled years</td>
<td>Account 1313 Accounts Receivable-Public-Current</td>
</tr>
<tr>
<td>Subtract canceled years from line 13a2</td>
<td>Account 2111 Accounts Payable-Government-Current</td>
</tr>
<tr>
<td>Add lines 8, 9, and 13a1, and subtract line 13b3 and canceled years</td>
<td>Account 3100 Appropriated Capital</td>
</tr>
<tr>
<td>Line 16</td>
<td>Account 5700 Appropriated Capital Used</td>
</tr>
</tbody>
</table>
Financial Reporting for the Marine Corps Reserve NGREA Funds

The DFAS Kansas City Center is responsible for providing accounting support and financial reporting for the Marine Corps. However, for FY 1996, the DFAS Kansas City Center accounted for only about 17 percent of the Marine Corps NGREA funds used by the Marine Corps Systems Command. To provide complete accounting information and financial reporting for the Marine Corps, the DFAS Kansas City Center must rely on the DFAS Cleveland Center to calculate the Marine Corps Reserve funds used by NAVAIR. NAVAIR reports the Marine Corps NGREA status of funds through the DFAS Cleveland Center. But, the DFAS Cleveland Center is not responsible for Marine Corps reporting and does not prepare a report on budget execution on the NAVAIR portion of the Marine Corps Reserve NGREA, even though NAVAIR received about 83 percent of the Marine Corps NGREA funds from FY's 1992 through 1996 (see Appendix B).

DFAS Cleveland Center officials stated that they could provide the DFAS Kansas City Center access to the DFAS Cleveland Center Standard Accounting and Reporting System. This access would give the DFAS Kansas City Center the capability to extract the Marine Corps Reserve transactions from the NAVAIR accounts. Additionally, with access to the DFAS Cleveland Center Standard Accounting and Reporting System, the DFAS Kansas City Center would be better able to satisfy its responsibility to provide accounting support and financial reporting for the Marine Corps Reserve.

Summary

In accordance with KAR No. 8, transactions reported on the financial records should be traceable through audit trails to amounts on the report on budget execution. Because the amount of Marine Corps Reserve NGREA at NAVAIR cannot be verified to source documents or to report on budget execution amounts, the FY 1996 NGREA reports on budget execution for the Navy and Marine Corps Reserve are not reliable. Similarly, the trial balances, which are adjusted to specific lines on the reports on budget execution, also are not reliable.

Financial reports must have documented audit trails that can be reconciled to source documents. Differences between the source documents and the Marine Corps Reserve NGREA transactions at NAVAIR must be resolved, if the financial reports are to be relied on by DoD and Government management.
Further, to assist managers in making sound business decisions based on the financial reports, the DFAS centers must provide the managers with complete financial information on NGREA.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service Cleveland Center:

   a. Document the audit trail process for the preparation of the Navy Reserve report on budget execution, as required by Key Accounting Requirement No. 8, “Audit Trails.”

   b. Reconcile discrepancies between the source documents and Marine Corps Reserve transactions for FY 1996 at the Naval Air Systems Command.

   c. Establish a date for providing the Defense Finance and Accounting Service Kansas City Center access to the Defense Finance and Accounting Service Cleveland Center Standard Accounting and Reporting System.

Management Comments. The DFAS concurred with Recommendations 1.a., 1.b., and 1.c. The DFAS Cleveland Center will complete draft procedures to fully document the process for preparation of the Navy Reserve report on budget execution by September 30, 1997. The DFAS Cleveland Center also agrees that there are discrepancies between the amounts appearing on the source documents and Marine Corps Reserve transactions for FY 1996 at the Naval Air Systems Command. The DFAS Cleveland Center will adjust the reports as required to reflect correct beginning balances for FY 1998. Additionally, the DFAS Cleveland Center will provide access and training on the use of the Standard Accounting and Reporting System - Headquarters Claimant Module to the DFAS Kansas City Center by August 30, 1997. DFAS will then adjust reporting procedures as appropriate.
2. We recommend that the Director, Defense Finance and Accounting Service Kansas City Center, provide complete financial reporting for the Marine Corps Reserve National Guard and Reserve Equipment Appropriation after obtaining access to Marine Corps Reserve transactions within the Defense Finance and Accounting Service Cleveland Center Standard Accounting and Reporting System.

Management Comments. The DFAS partially concurred with Recommendation 2. The DFAS agreed that the Director, DFAS Kansas City Center, should assume complete financial reporting responsibilities for the Marine Corps Reserve NGREA. However, the DFAS disagreed that the DFAS Kansas City Center should use the access to the Standard Accounting and Reporting System to report on Marine Corps Reserve transactions. The DFAS stated that data entered into the Standard Accounting, Budgeting, and Reporting System would provide complete financial reporting for the Marine Corps Reserve NGREA.

Audit Response. The DFAS concurred with the intent of the recommendation, to delegate complete financial reporting responsibilities to the Director, DFAS Kansas City Center. However, the Standard Accounting, Budgeting, and Reporting System will not provide the complete financial reporting capability required. The Navy received 83 percent of Marine Corps Reserve NGREA, which is accounted for within the Standard Accounting and Reporting System. Unless the Navy inputs all of its Marine Corps NGREA transactions into the Standard Accounting, Budgeting, and Reporting System, the solution provided can only fully account for and report on the remaining 17 percent. Therefore, we ask that the DFAS provide additional comments in response to the final report identifying specific actions that will provide the DFAS Kansas City Center with the complete financial reporting capability for the Marine Corps Reserve NGREA.
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Part II - Additional Information
Appendix A. Audit Process

Scope and Methodology

Scope. We reviewed the FY 1996 Navy Reserve and Marine Corps Reserve reports on budget execution submitted for the National Guard and Reserve Equipment Appropriation (NGREA). We performed the audit in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget.

Methodology. We reviewed the process the DFAS Cleveland Center used to prepare the reports on budget execution for the Navy Reserve and Marine Corps Reserve NGREA. To evaluate the DFAS centers' compliance with KAR No. 8, we compared the FY 1996 Navy and Marine Corps Reserve reports on budget execution to summary reports identified by the DFAS Cleveland Center as the source documents for the financial reports. We did not verify the validity or accuracy of the source documents provided by DFAS Cleveland Center staff.

Use of Computer-Processed Data. We relied on computer-processed data from the DFAS Cleveland Center Standard Accounting and Reporting System and the DFAS Kansas City Center Headquarters Accounting System without confirming the reliability of the data. We did not establish the reliability of the data because we evaluated the process that the DFAS Cleveland Center used to prepare the FY 1996 Navy and Marine Corps Reserve reports on budget execution for the NGREA. Therefore, not establishing the reliability of the financial data did not materially affect the results of our audit.

Summary of Prior Coverage. In the last 5 years, no prior financial audits or other reviews have been completed on the Navy or Marine Corps Reserve NGREA.

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

Audit Period, Standards, and Locations. We performed this financial-related audit from October 1996 through April 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary.
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 provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls.

Scope of Review of the Management Control Program. We reviewed the management controls over the process the DFAS Cleveland Center used to prepare the Navy and Marine Corps Reserve NGREA reports on budget execution and trial balances. Specifically, we reviewed the process the DFAS Cleveland Center used to prepare reports on budget execution. We also reviewed management's self-evaluation applicable to the controls over that process.

Adequacy of Management Controls. We identified a material management control weakness, as defined by DoD Directive 5010.38, for the DFAS Cleveland Center. The DFAS Cleveland Center had not implemented management controls to comply with KAR No. 8, which requires adequate audit trails. The source documents for the reports on budget execution did not provide an adequate audit trail for trial balance reporting. Recommendation 1., if implemented, will provide a complete audit trail from the source documents to the report on budget execution and trial balance. We will provide a copy of the report to the senior official in charge of management controls for the DFAS Cleveland Center.

Adequacy of Management's Self-Evaluation. The DFAS Cleveland Center identified accounting and reporting for the NGREA as part of an assessable unit. However, the DFAS Cleveland Center did not perform the required evaluation of the applicable management controls and, as a result, did not identify the material management control weakness identified by the audit. DFAS Cleveland Center officials stated that they did not perform the required evaluation because of multiple reorganizations occurring within the DFAS Cleveland Center. For FY 1997, the DFAS Cleveland Center has scheduled a management control review to be completed by the end of June 1997.
Appendix B. The National Guard and Reserve Equipment Appropriation

The NGREA is a multiyear DoD procurement appropriation available for obligation in the first 3 fiscal years. The NGREA allows an additional 5 years to disburse the obligations incurred during the first 3 years. For the reporting period that ended September 30, 1996 (consisting of FYs 1989 through 1996), Congress appropriated a total of $2.8 billion in NGREA funds to the Navy Reserve and Marine Corps Reserve. Table B-1 shows the NGREA funds appropriated to the Navy and Marine Corps Reserves for the FY 1996 reporting period.

Table B-1. NGREA Funds for the Navy and Marine Corps Reserves (Dollars in millions)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Navy Reserve</th>
<th>Marine Corps Reserve</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>$144.6</td>
<td>$81.8</td>
<td>$226.4</td>
</tr>
<tr>
<td>1990</td>
<td>148.8</td>
<td>118.6</td>
<td>267.4</td>
</tr>
<tr>
<td>1991</td>
<td>658.8</td>
<td>160.0</td>
<td>818.8</td>
</tr>
<tr>
<td>1992</td>
<td>380.5</td>
<td>158.0</td>
<td>538.5</td>
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<tr>
<td>1993</td>
<td>129.8</td>
<td>206.4</td>
<td>336.2</td>
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<tr>
<td>1994</td>
<td>146.7</td>
<td>120.3</td>
<td>267.0</td>
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<tr>
<td>1995</td>
<td>107.9</td>
<td>75.7</td>
<td>183.6</td>
</tr>
<tr>
<td>1996</td>
<td>40.0</td>
<td>100.0</td>
<td>140.0</td>
</tr>
</tbody>
</table>

Total $1,757.1 $1,020.8 $2,777.9

Navy Reserve NGREA Funds. For the FY 1996 reporting period that included FYs 1989 through 1996, the Assistant Secretary of the Navy (Financial Management and Comptroller) allocated Navy Reserve NGREA funds to the following seven Navy organizations to procure aircraft and miscellaneous equipment for the Navy Reserves:

- Naval Air Systems Command;
- Naval Sea Systems Command;
- Space and Naval Warfare Systems Command;
- Office of the Chief, Naval Operations;
- Naval Facilities Command;
- Naval Supply Systems Command; and
- Naval Supply Management Activity.
The seven Navy organizations provide status of funds information for the NGREA into the DFAS Cleveland Center Standard Accounting and Reporting System. The status of fund information from the Navy organizations is then accumulated into the summary report on budget execution.

**Marine Corps Reserve NGREA Funds.** For the same FY 1996 reporting period, the Assistant Secretary of the Navy (Financial Management and Comptroller) allocated NGREA funds for the purchase of miscellaneous equipment to the Marine Corps Systems Command. The Assistant Secretary of the Navy (Financial Management and Comptroller) also allocated NGREA funds to NAVAIR for the purchase of miscellaneous equipment and aircraft. For the period for which records are available (FYs 1992 through 1996), NAVAIR received about 83 percent of the Marine Corps Reserve NGREA funds as shown in Table B-2.

**Table B-2. Allocation of Marine Corps Reserve NGREA (Dollars in millions)**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total Marine Corps</th>
<th>MAC SYSCOM¹</th>
<th>NAVAIR²</th>
<th>Percentage to NAVAIR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>$158.0</td>
<td>$22.3</td>
<td>$135.7</td>
<td>86</td>
</tr>
<tr>
<td>1993</td>
<td>206.4</td>
<td>8.2</td>
<td>198.2</td>
<td>96</td>
</tr>
<tr>
<td>1994</td>
<td>120.3</td>
<td>31.6</td>
<td>88.7</td>
<td>74</td>
</tr>
<tr>
<td>1995</td>
<td>75.7</td>
<td>11.8</td>
<td>63.9</td>
<td>84</td>
</tr>
<tr>
<td>1996</td>
<td>100.0</td>
<td>36.9</td>
<td>63.1</td>
<td>63</td>
</tr>
<tr>
<td>Total</td>
<td>$660.4</td>
<td>$110.8</td>
<td>$549.6</td>
<td>83</td>
</tr>
</tbody>
</table>

¹Marine Corps Systems Command.
²Naval Air Systems Command.

Most of the Marine Corps Reserve NGREA funds were allocated to NAVAIR. However, there is no report on budget execution reflecting the status of funds for the Marine Corps NGREA funds.
Appendix C. Key Accounting No. 8, "Audit Trails"

DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, May 1993, requires audit trails. The following is the complete text of KAR No. 8, "Audit Trails."

Audit trails permit tracing transactions through a system. Audit trails allow auditors or evaluators to ensure transactions are properly accumulated and correctly classified, coded, and recorded in all affected accounts. Audit trails should allow a transaction to be traced from initiation through processing to final reports. In addition, good audit trails allow for the detection and tracing of rejected or suspended transactions, such as unmatched disbursements, for ultimate systemic correction in a reasonable time frame.

A fundamental requirement for any compliant accounting system is that the financial transactions for which the system must account be adequately supported with pertinent documents and source records. All transactions, including those which are computer-generated and computer-processed, must be traceable to individual source records. Audit trails enable the tracing or replicating of a transaction form its source to the resulting record or report, and from the resulting record or report to the source. Items in source records necessary for audit-trail purposes include transactions type, record or account involved, amount, processing references, and identification of the preparer and approver of the transaction. A key test of the adequacy of an audit trail is whether tracing the transaction from the source or back from the result will permit verification of the amount recorded or reported.
Appendix D. Report Distribution

Office of the Secretary of Defense
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Assistant Secretary of Defense (Reserve 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
Director of Naval Reserve
Naval Air Systems Command

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

U.S. Marine Corps
Deputy Chief of Staff for Programs and Resources
Assistant Deputy Chief of Staff for Manpower and Reserve Affairs
Marine Corps Systems Command
Appendix F. Report Distribution

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
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 Governmental 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
MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Navy and Marine Corps Reserve
Financial Reports on the National Guard and Reserve
Equipment Appropriation (Project No. 7RE-2002.01)

We have reviewed the subject report and are providing the attached management comments.

My point of contact for this matter is Mr. Charles McIntosh on (703) 607-5105.

Edward A. Harris
Deputy Director for Accounting

Attachment:
As stated
SUBJECT: Audit Report on the Navy and Marine Corps Reserve
Financial Reports on the National Guard and Reserve
Equipment Appropriation (Project No. 7RE-2002.01)

Recommendation 1.a. The Director, Defense Finance and Accounting
Service Cleveland Center document the audit trail process for the
preparation of the Navy Reserve report on budget execution, as
required by Key Accounting Requirement No. 8, "Audit Trails."

Management Comments to 1.a. Concur. In April 1997, DFAS
initiated new procedures to ensure that preparation of budgetary
reports for the Navy Reserve appropriation is properly
documented. For example, the procedures now include the use of
newly created spreadsheets that provide clear audit trails for
all calculations. Additionally, DFAS intends to develop a
standard operating procedure for use in preparing budgetary
reports for the Navy Reserve appropriation. A draft of these
procedures should be completed by September 30, 1997.

Recommendation 1.b. The Director, Defense Finance and Accounting
Service Cleveland Center reconcile discrepancies between the
source documents and Marine Corps Reserve transactions for FY
1996 at the Naval Air Systems Command.

Management Comments to 1.b. Concur. DFAS performed a detailed
reconciliation of all discrepancies reported in Table 1 on page 9
of the subject report. We agree that the amount of Marine Corps
Reserve NRERA at NAVAIR differs based on the Navy Reserve and
Marine Corps Reserve Reports on budget execution.

To correct this condition, footnotes disclosing discrepancies
affecting balances brought forward will be added to the budget
execution reports beginning with the May 1997 reporting month and
continue until the fiscal year end. Adjustments will be made to
the September 1997 reports as required. These adjustments will
reflect the correct beginning balances for FY 1998. All
discrepancies not affecting beginning balances for FY 97 will be
corrected immediately. Estimated completion date is

Recommendation 1.c. The Director, Defense Finance and Accounting
Service Cleveland Center establish a date for providing the
Defense Finance and Accounting Service Kansas City Center access
to the Defense Finance and Accounting Service Cleveland Center
Standard Accounting and Reporting System.
Management Comments to 1.c. Concur. DFAS agrees that the DFAS-KC Center should have access to the Standard Accounting and Reporting System (STARS)-Headquarters Claimant Module (HCM). DFAS will obtain access and training in STARS-HCM through the STARS Project Office. Once access is obtained, DFAS will review its existing procedures for reporting Marine Corps NGREA and make the appropriate adjustments as necessary. Estimated completion date is August 30, 1997.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Kansas City Center, provide complete financial reporting for the Marine Corps Reserve National Guard and Reserve Equipment Appropriation after obtaining access to Marine Corps Reserve transactions within the Defense Finance and Accounting Service Cleveland Center Standard Accounting and Reporting System.

Management Comments to 2. Partially concur. DFAS agree that the DFAS-KC Center should "provide complete financial reporting for the Marine Corps Reserve National Guard and Reserve Appropriation." However, DFAS does not agree that DFAS-KC Center should obtain access to the Marine Corps Reserve Transactions within the DFAS-CL Standard Accounting and Reporting System to obtain complete financial reporting. The reason is that on October 1, 1997, the NGREA will be supported by the Standard Accounting Budgeting and Reporting System (SABRS). At that time, we are recommending that Marine Corps Air Stations use the SABRS accounting system for NGREA transactions. Data entered into SABRS after implementation would provide complete financial reporting, supporting detail transactions, and the audit trail required by this finding. Estimated completion date is October 31, 1997.
Audit Team Members

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

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INTERNET DOCUMENT INFORMATION FORM

A. Report Title: Navy and Marine Corps Reserve Financial Reports on the National Guard and Reserve Equipment Appropriation

B. DATE Report Downloaded From the Internet: 10/13/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions) Inspector General, Department of Defense 400 Army Navy Drive (Room 801) Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by: DTIC-OCA, Initials: _VM_ Preparation Date 10/13/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.

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