ACCOUNTING SUPPORT FOR PREPARATION OF BALLISTIC MISSILE DEFENSE ORGANIZATION FINANCIAL STATEMENTS

Report No. 96-068

February 9, 1996

Department of Defense

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Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>BMDO</td>
<td>Ballistic Missile Defense Organization</td>
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<tr>
<td>DAO/WHS</td>
<td>Defense Accounting Office, Washington Headquarters Services</td>
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<td>DFAS</td>
<td>Defense Finance and Accounting Service</td>
</tr>
<tr>
<td>RDT&amp;E</td>
<td>Research, Development, Test and Evaluation</td>
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<td>WAAS</td>
<td>Washington Headquarters Services Allotment Accounting System</td>
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MEMORANDUM FOR DIRECTOR, BALLISTIC MISSILE DEFENSE
ORGANIZATION
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit of Accounting Support for Preparation of Ballistic Missile Defense
Organization Financial Statements (Project No. 5RF-6010.10)

Introduction

We are providing this audit report for information and use. The audit was
performed as part of the Research for Audits of Defense Agencies' Financial
Statements (Project No. 5RF-6010). The Chief Financial Officers Act of 1990
(Public Law 101-576) 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 statements for
the Ballistic Missile Defense Organization (BMDO).

"Financial Management Regulation," volume 1, chapter 3, May 1993, requires
full financial disclosure and that adequate financial information be in financial
reports required by DoD managers and other Government officials. DoD
Directive 7000.14-R, volume 1, chapter 2, May 1993, states that general ledger
accounts shall be the source of required budget execution reports and annual
financial statements submitted to the Department of Treasury.

In a memorandum dated June 6, 1995, the DoD Deputy Chief Financial Officer
advised DoD Components of the FY 1996 financial statement reporting
requirements. The June 6, 1995, memorandum identified the BMDO as a
Defense agency aligned under the Under Secretary of Defense for Acquisition
and Technology. The memorandum also made the BMDO responsible for the
reliability of its annual financial statements. The Deputy Director for
Accounting Operations, Defense Finance and Accounting Service (DFAS), also
stipulated in a June 25, 1995, memorandum a requirement for all DoD
Components to prepare and submit monthly trial balances to the DFAS
Indianapolis Center.

Preparation of BMDO Financial Statements. The DFAS Denver Center,
Defense Accounting Office, Washington Headquarters Services (DAO/WHS), is
responsible for supporting BMDO accounting and disbursing activities, and the
BMDO relies on the DFAS for preparation of its financial statements. The FY 1996 BMDO financial statements will be prepared by the DFAS Indianapolis Center.

Audit Results

The FY 1994 BMDO financial statements prepared by the DAO/WHS were inaccurate and incomplete. The DAO/WHS reported BMDO Research, Development, Test and Evaluation (RDT&E) funds to the DFAS Indianapolis Center on two separate financial statements, resulting in overstated financial statements. In addition, the DAO/WHS used budgetary information from budget execution reports instead of using propriety general ledger account information to prepare BMDO FY 1994 financial statements for the BMDO. Budget execution reports did not contain adequate information to prepare complete and accurate FY 1994 financial statements. We identified errors and omissions, totaling about $1.9 billion, in 12 financial statement accounts. We did not attempt to determine whether the errors in the 12 accounts affected the status of BMDO FY 1994 budget execution reports. Enclosure 1 contains a description of the errors in the 12 accounts.


Audit Objective

The audit objective was to evaluate the FY 1995 DAO/WHS and BMDO management control programs pertaining to the preparation of general-purpose financial statements.

Scope and Methodology

Scope and Methodology. We reviewed financial information produced by the Washington Headquarters Services Allotment Accounting System (WAAAS) as of September 30, 1994. We were unable to review any portion of the FY 1995 BMDO trial balance because the WAAAS operational manager could not generate a trial balance for only part of the year. We reviewed BMDO management controls pertaining to the financial statements prepared by the DAO/WHS. We also reviewed:
funds control exception reports pertaining to FY 1994 transactions as they related to the FY 1994 general ledger accounts as reflected in the BMDO trial balance;

- the extent of the documentation supporting 80 transaction documents for 4 general ledger accounts; and


**Audit Period, Standards and Locations.** This financial-related audit was performed from June 1 through December 12, 1995, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. We reviewed computer-processed accounting information in the WAAS and tested the adequacy and reliability of supporting documentation for four accounts. The audit was performed at the DAO/WHS and at the BMDO. We did not use statistical sampling procedures for this audit. Enclosure 4 lists the organizations visited or contacted.

**Management Control Program**

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

**Scope of Review of the Management Control Program.** We evaluated the management controls applicable to the preparation of BMDO financial statements and determined that the BMDO has a system for monitoring commitments, obligations, and disbursements, but had no management controls over the maintenance of general ledger accounts or the preparation of financial statements. During the audit, we discussed the need for management controls with the BMDO Deputy Director of the Financial Management Directorate, who agreed to initiate a system of monthly reviews of the financial information that will comprise the BMDO annual financial statements prepared by the DFAS Indianapolis Center.

**Adequacy of Management Controls.** The BMDO had a system of reviews of budgetary information in its revised management control program. As a result of our audit, the BMDO initiated management controls to ensure review and feedback on the proprietary information used as the basis for future financial statements.

The DAO/WHS had management control deficiencies cited in the two prior Inspector General, DoD, reports. The DAO/WHS and the DFAS Denver Center were acting to correct the deficiencies, and the corrective actions planned or taken should remedy the problems found in the FY 1994 BMDO financial statements.
A copy of this report will be provided to the senior official responsible for management controls in the BMDO and in the DAO/WHS.

Adequacy of Management Self-Evaluation. The BMDO self-evaluation of management controls did not include an evaluation of financial statements. The BMDO had not included an evaluation of financial statements because the Office of the Under Secretary of Defense (Comptroller) had not delineated BMDO requirements or responsibilities for financial statements until June 1995.

Prior Audits

Management controls related to the DAO/WHS are discussed in the following Inspector General, DoD, audit reports.


Inspector General, DoD, Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995. The report discusses the adequacy of the DAO/WHS procedures for preventing duplicate and erroneous payments and for detecting and correcting any such payments. The report concludes that the DAO/WHS procedures were inadequate and that the propriety of payments was compromised. The DAO/WHS made incorrect or improper payments, improperly certified vouchers, did not update the accounting system in a timely manner, and did not maintain proper supporting documents for obligations, accruals, and disbursements. In addition, the DAO/WHS did not use exception reports that identified accounting errors, did not consistently perform certifying fund availability, and did not implement the internal management control program.

The Deputy Director for Finance, DFAS, agreed to improve accounting procedures, recoup duplicative payments, and maintain proper documentation for accounting transactions. The Deputy Director also agreed to implement the
internal management control program and to include the operations of the DAO/WHS in the FY 1995 Annual Statement of Assurance for the Defense Accounting Office, Air Force District of Washington.

Audit Background

BMDO Organization, Mission, and Funding. The mission of the BMDO is to manage, direct, and execute the Ballistic Missile Defense Program to enable the deployment of effective and rapidly relocatable advanced theater missile defenses, to develop options for an antiballistic missile system that is capable of providing effective defense of the United States, to demonstrate advanced technologies, and to continue programs of basic and applied research to develop follow-on technologies to sustain a highly effective missile defense capability. The BMDO has 346 personnel (216 civilian and 130 military) to manage, direct, and execute the Ballistic Missile Defense Program. In FY 1994, the BMDO received $2.7 billion to support 13 congressionally mandated programs. About 95 percent of the funds was for RDT&E. The BMDO relies on the DFAS for accounting support to include the preparation of financial statements.

BMDO Financial Management. The BMDO Financial Management Directorate has 12 personnel who are primarily responsible for the planning, programing, budgeting, and management of BMDO RDT&E funds. Two of the twelve people monitor and compare budget-related information received from the DAO/WHS each month. Those individuals review the commitment, obligation, and disbursement information for reliability and review a summary report of discrepancies between the DAO/WHS information and the BMDO database. The personnel reconcile any discrepancies with the DAO/WHS.

Establishment of the Defense Accounting Office, Washington Headquarters Services. On March 7, 1993, the DFAS Denver Center capitalized part of the Washington Headquarters Services Directorate for Budget and Finance as the DAO/WHS. The DFAS decided to continue to use the WAAS to provide accounting and reporting support. Responsibility for the DAO/WHS was assigned to the Defense Accounting Office, Air Force District of Washington, Bolling Air Force Base. On May 1, 1995, the operational command and control of the Defense Accounting Office, Air Force District of Washington, Finance Washington, transferred to the DFAS Denver Center. The DAO/WHS continued to use the WAAS to provide the accounting support of the Defense agencies that the DAO/WHS supported. The DAO/WHS provides the BMDO quarterly reports to track the actual accrued expenditures for each program and identifies the basis for the formal financial execution reports and the applications of the funds for each program. For FY 1995, the DFAS billed the BMDO $1.8 million for accounting services.

Management of the Washington Headquarters Services Allotment Accounting System. The WAAS is managed and supported by the Washington Headquarters Services. The primary purpose of the WAAS is to provide a means of building, storing, and maintaining historical transaction files for DoD
Components. The Washington Headquarters Services has trained DAO/WHS personnel on the operation and use of the WAAS with the expectation that the DAO/WHS could operate the system independently.

Discussion

Reporting of BMDO RDT&E Appropriated Funds. The DAO/WHS prepared FY 1994 financial statements for the BMDO that overstated BMDO assets and equity as a result of reporting amounts for RDT&E on two financial statements when the assets did not equal liabilities plus equity. The DAO/WHS double reported RDT&E funds for the BMDO by reporting RDT&E on two financial statements, one for RDT&E and one for Other Appropriations, which includes Operation and Maintenance, Procurement, and Military Construction. In addition, equity amounts were unsupported because in order to balance the financial statements, the DAO/WHS inserted unsupported figures in equity accounts when the assets did not equal liabilities plus equity.

The DAO/WHS and the DFAS had not properly implemented a management control program for the preparation and review of financial statements to preclude double reporting of RDT&E funds and inserting unsupported figures to make the BMDO financial statements balance.

Double Reporting of BMDO Asset and Equity Accounts. The DAO/WHS reported $653 million for the Fund Balance with Treasury (asset) account and $643 million for the Unexpended Appropriations (equity) on two separate financial statements, the RDT&E and the Other Appropriations. The double reporting resulted in an overstatement of $653 million for the BMDO Fund Balance with Treasury (asset) account and $643 million for the Unexpended Appropriations (equity) account.

BMDO Equity Section Used to Balance Financial Statements. The DAO/WHS used the Unexpended Appropriations line item in the equity section of the RDT&E financial statement as a balancing tool. DAO/WHS personnel could not explain the calculation of that line item. For example, the assets in the initial submission of the BMDO RDT&E financial statements were understated by $554 million because of an addition error. The DFAS Indianapolis Center detected the error, and the DAO/WHS increased the Unexpended Appropriations account control by inserting an unsupported $554 million. The DAO/WHS used the Unexpended Appropriations account in the equity section of the financial statement as an account to insert whatever number was needed to balance the financial statement. If the DAO/WHS had calculated the equity account balances in accordance with the guidance in DoD Directive 7220.9-M, "DoD Accounting Manual," chapter 94, October 1983, the FY 1994 financial statement would not have balanced because of the addition error in the assets section.

Budget Execution Reports as Source Data for RDT&E Statements. The DAO/WHS inappropriately used budget execution reports as source data for preparing the RDT&E financial statement. The budgetary accounts did not contain all the needed information to prepare complete and accurate financial
statements. Because the DAO/WHS used budget execution data to prepare the RDT&E portion of the financial statement, the FY 1994 financial statement understated BMDO assets by $15.2 million, liabilities by $5.4 million, and equity by $7.8 million. The understated amounts are discussed below and in Enclosure 1.

**Effects on BMDO Asset Accounts.** As a result of using budget execution data to prepare the FY 1994 financial statements, the DAO/WHS understated BMDO assets on the RDT&E financial statement. The BMDO general ledger contained account balances for five asset accounts that were not included in the RDT&E financial statement. The BMDO general ledger showed an Accounts Receivable balance of $1.4 million, Military Equipment balance of $7.1 million, Refunds Receivable of $1.2 million, Allowance for Loss on Accounts Receivable of $1.2 million and Automatic Data Processing Software of $0.7 million. The RDT&E financial statement did not include balances for the five accounts because budgetary source data have no details on Accounts Receivables and Military Equipment. In addition, a balance for the Advances and Prepayments account was understated by at least $3.6 million. The account was understated because the financial statement preparer used budget statement preparation procedures instead of following instructions for preparing financial statements; consequently, the preparer incorrectly subtracted $1.8 million from the asset account instead of adding that amount.

**Effects on BMDO Liability Accounts.** The DAO/WHS also understated BMDO liabilities on the RDT&E financial statement. As a result of preparing the financial statements from budgetary account data and of not using proprietary information, the FY 1994 financial statements were incomplete. The BMDO general ledger proprietary accounts showed account balances of $4.5 million for Accounts Payable-Federal, $0.5 million for Accrued Payroll and Benefits, and $0.4 million for Accrued Unfunded Annual Leave. These proprietary general ledger accounts did not appear on the 1994 RDT&E financial statement.

**Effects on BMDO Equity Account.** The DAO/WHS also understated BMDO equity on the RDT&E financial statements. BMDO total equity was understated because the DAO/WHS financial statement preparer did not include in the Invested Capital Account the $7.8 million that was in the general ledger.

**Documentation Supporting Financial Account Transactions**

The DAO/WHS did not have the supporting documentation needed for the transactions involving financial statement accounts. Entire document files and individual documents were missing from supporting documentation account files. As a result of the lack of an adequate audit trail, incorrect or improper payments and potential violations of fiscal statutes could go undetected. Detailed descriptions of missing documents are in Enclosure 2. The same condition was also reported in Inspector General, DoD, Report No. 95-231.
Management Comments

Although written comments were not required, the BMDO provided information to show that the Office of the Under Secretary of Defense (Comptroller) had not delineated BMDO requirements or responsibilities for financial statements until June 1995. The BMDO emphasized that it had concentrated management on the accuracy of budgetary (commitments, obligations, and disbursements) information. The BMDO comments show its willingness to fully support the DoD need for accurate financial statements. A complete text of the comments is in Enclosure 3. As a result of the BMDO comments, we revised portions of the report to reflect the intent of the suggested changes.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Harlan M. Geyer, Audit Program Director, at (703) 604-9594 (DSN 664-9594) or Mr. Charles J. Richardson, Audit Project Manager, at (703) 604-9582 (DSN 664-9582). The distribution of this report is listed in Enclosure 5. Audit team members are listed inside the back cover.

David K. Steensma
Deputy Assistant Inspector General for Auditing

Enclosures
# Information on the BMDO FY 1994 Financial Statements

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount of Error</th>
<th>Footnote Number Describing Error</th>
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<td>Automatic Data Processing Software</td>
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<td><strong>Total</strong></td>
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1 RDT&E funds were double reported, once on the "Other Appropriations Financial Statement" and again on the "RDT&E Financial Statement."

2 The operating accountant at DAO/WHS improperly used budgetary information to prepare financial statements and did not use the trial balance as a source to prepare the RDT&E Financial Statement. Therefore, the accounts were understated. Amounts listed are estimates based on 95 percent of the amount listed on the trial balance, because RDT&E funds make up 95 percent of BMDO funding.

3 The subtotal in Advances and Prepayment section on the RDT&E Financial Statement was subtracted instead of added to total assets. The operating accountant improperly used budget statement preparation procedures instead of following instructions for preparing financial statements.

4 The operating accountant inserted amounts into the account to balance the RDT&E Financial Statement. The operating accountant was unable to properly explain calculation of the amounts.
# Documentation and Accounting Transactions

<table>
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<tr>
<th>General Ledger Account</th>
<th>Posting Number</th>
<th>Missing Commitment Documents</th>
<th>Missing Obligation Documents</th>
<th>Disbursement Documents</th>
<th>Disbursement Greater Than Obligations</th>
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Total: $31,365,013 $6,363,187 $142,267,894 $1,721,914

1762 - Military Equipment
4710 - Outstanding Commitments-Direct Program
4811 - Undelivered Orders Without Advance Direct Program
6120 - Other Services

1 Amount in this column is the value of the missing commitment documents.
2 Amount in this column is the value of the missing obligation documents.
3 Amount in this column is the value of the missing disbursement documents.
4 In addition to not having supporting documentation for $24.4 million, the clerk entered $19,818 instead of $19,818,000 and then deducted the $19,818 as an erroneous entry; improperly added $1.4 million to the commitment column after the funds were deobligated; and did not record a $25,000 obligation because there was a shortage of funds recorded under the document number.
MEMORANDUM FOR INSPECTOR GENERAL, DOD
ATTENTION: MR. C.J. RICHARDSON

SUBJECT: Accounting Support for Preparation of Ballistic Missile Defense Organization Financial Statements (Project No. 5RF-6010.10)

In response to your request for BMDO's comments on the subject audit report, the following comments are provided:

a. Page 1, Introduction - Last sentence in the third paragraph states in part that, "...all DoD Components to prepare and submit monthly trial balances...." Review of the June 6, 1995 memorandum refers only to preparation and reporting requirements of the defense agencies and does not address the specifics of preparing and submitting monthly trial balances.

b. Page 2, Audit Results - After the next to the last sentence in the first paragraph, add the following sentence:

"We do not believe, however, that these errors materially affected the status of BMDO's FY 1994 budget execution (commitments, obligations, and expenditures) as recorded in the monthly 1002 reports. Rather, the audit has identified errors in the year-end financial statement (SF 220) prepared by DFAS that were attributable to incorrectly extracting the data from the budget execution reports combined with a failure by DFAS to accurately calculate entries and/or compile the SF 220 in its specified format."

c. Page 2, Audit Objectives - After the first sentence, add the following sentences:

"POF contacted the OUSD(C) (Mr. Oscar Covell) on June 26, 1995 regarding clarification of the June 6, 1995 memorandum requiring submission of financial statements by sub-entities. OUSD(C) informed POF that this was an information memorandum, DFAS would prepare the necessary documents on behalf of the BMDO, and that no further action was required. On June 25, 1995, a memorandum from DFAS-IN, subject: General Ledger Reporting for the Department 97 Appropriations, did indicate that Defense Agencies and other submitters of Department 97 reports would transition to full trial balance reporting using the DoD Standard General Ledger chart of accounts during FY 1996. The BMDO understands that under the CFO Act of 1990, the agency is responsible for reviewing and verifying all financial statements and other pertinent documents prepared in the future by DFAS."
d. **Page 3, Management Control Program:**

(1) After the first sentence, add the following sentence:

"Again, it should be noted that the requirement for DoD components to exert management control over maintenance of general ledger accounts and preparation of financial statements by DFAS is not effective until FY 1996."

(2) Revise the next to the last sentence to read as follows:

"During the audit, we discussed the need for management controls with the BMDO Deputy Director of the Financial Management Directorate, who agreed to initiate a system of monthly reviews of the financial information that will be compiled to formulate the BMDO financial statements prepared by DFAS, Indianapolis Center, commencing with FY 1996."

e. **Page 5, Audit Background - Paragraph 2, BMDO Financial Management:**

(1) Delete first 3 sentences and replace them with the following:

"The BMDO has 12 people within the Financial Management Directorate, primarily responsible for the planning, programming, budgeting, and financial execution activities. Only two people monitor and compare accounting data received from the DAO/WHS each month, in addition to other execution duties. These individuals review the commitment, obligation, and disbursement information for reliability. A report of any discrepancies between the DAO/WHS accounting system and the BMDO financial execution database is prepared automatically at the end of each month by the BMDO. This reconciliation report was developed by the BMDO in 1992 in an effort to confirm adequate management controls were in place to ensure accurate accounting data was being entered. The two Financial Management Directorate personnel assigned to this task reconcile any discrepancies between the databases, determine the causes, and provide the required documentation and/or accounting adjustments to DAO/WHS to correct the discrepancies."

(2) Delete the next to the last sentence. It does not appear to be germane to this audit.

If you have further questions regarding our comments, please feel free to contact Ms. Marilyn Warrington or Ms. Linda Stewart at 693-1641.

[Signature]

ROBERT SNYDER
Deputy for Program Operations

c: DMO
Organizations Visited or Contacted

Defense Agencies

Ballistic Missile Defense Organization, the Pentagon, Washington, DC
Defense Finance and Accounting Service Denver Center, Denver, CO
Defense Accounting Office, Washington Headquarters Services, Arlington, VA
Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
Washington Headquarters Services, Arlington, VA
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- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
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Audit Team Members

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

Thomas F. Gimble
Harlan M. Geyer
Charles J. Richardson
Sharon D. Nguyen
Kimberly Slater
Kenneth B. VanHove
Nancy C. Cipolla
Celeste R. Broadstreet
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A. Report Title: Accounting Support for Preparation of Ballistic Missile Defense Organization Financial Statements

B. DATE Report Downloaded From the Internet: 12/08/99

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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

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