Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE AIR FORCE FY 1992 FINANCIAL STATEMENTS

Report No. 94-073 March 31, 1994

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Acronyms

AFAA	Air Force Audit Agency
CAM	Contractor-Acquired Material
CFO	Chief Financial Officer
DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
GFM	Government-Furnished Material
GLA	General Ledger Account
GLSA	General Ledger Subsidiary Account
IG	Inspector General
MAFR	Merged Accounting and Fund Reporting
MAJCOM	Major Command
OMB	Office of Management and Budget
SOMPO	Summary of Military Pay Obligations

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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March 31, 1994

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements (Report No. 94-073)

We are providing this final report for your review and comment. This report addresses matters concerning the Defense Finance and Accounting Service-Denver Center's work on the Air Force FY 1992 financial statements. The audit was made as part of the audits required by the Chief Financial Officers Act of 1990. We considered your comments on the draft report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that you provide comments on the unresolved recommendations by May 31, 1994. See the chart at the end of each finding for the specific requirements for your comments. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. We also ask that your comments indicate concurrence or nonconcurrence with the internal control weaknesses highlighted in Part I.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. David C. Funk, Program Director, at (303) 676-7445 (DSN 926-7445) or Mr. Thomas J. Winter, Project Manager, at (303) 676-7445 (DSN 926-7445). Copies of the report will be distributed to the activities listed in Appendix D. The audit team members are listed inside the back cover.

Robert J. Lieberman

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Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Audit Report No. 94-073 **March 31, 1994**
Project No. 2FD-2006

DEFENSE FINANCE AND ACCOUNTING SERVICE WORK ON THE AIR FORCE FY 1992 FINANCIAL STATEMENTS

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires the Inspector General (IG), DoD, or an independent auditor appointed by the IG, DoD, to audit financial statements of DoD activities. The IG, DoD, delegated the Air Force FY 1992 financial statement audit to the Air Force Audit Agency. The IG, DoD, provided assistance to the Air Force Audit Agency through audit work at the Defense Finance and Accounting Service (DFAS)-Denver Center (the Denver Center). The Denver Center maintains Air Force departmental accounting records and prepares the Air Force financial statements. The Air Force Audit Agency rendered a disclaimer of opinion on the overall financial statements.

Objective. The overall objective was to determine whether the Denver Center prepared complete, accurate, and reliable FY 1992 financial statements for the Air Force. As part of the audit, we examined associated internal controls and compliance with existing laws and regulations.

Audit Results. The Denver Center did not prepare complete, accurate, and reliable FY 1992 Air Force financial statements.

o The Denver Center did not comply with DoD 7720.9-M, "DoD Accounting Manual" (the DoD Accounting Manual), or maintain effective procedures and internal controls over its systems. The source of most of the information was derived from non-integrated management systems that were not designed as accounting systems. As a result, financial statement data presented was unreliable (Finding A).

o Internal controls over the budgetary process were not effective. Standard DoD accounts were not used, unsupported accounting adjustments were made, and Treasury reconciliations were not performed. As a result, budgetary data used on the financial statements was unreliable (Finding B).

o The Statement of Operations did not include all activity affecting Air Force operations. Revenues were overstated by $424.5 million; support for operating expenses was unavailable for leases of $8.3 billion, asset damage of $568.7 million, and bad debts of $24.7 million; extraordinary losses of $1.2 billion were excluded; and prior period adjustments of $13.0 billion were incorrect or omitted. As a result, the Air Force Statement of Operations was inaccurate (Finding C).

o The Denver Center did not validate the accuracy of Construction in Progress data and did not adhere to Air Force guidance on Government-Furnished Material and Contractor-Acquired Material when preparing the financial statements. As a result, we have no assurance that the $24.0 billion for Construction in Progress on the financial statements is accurate (Finding D).

Internal Controls. The audit identified material internal control weaknesses. Internal controls over the general ledger and supplemental journal voucher system, accounts

receivable, and military pay (Finding A); the budget execution process (Finding B); adjustments to the Statement of Operations (Finding C), and Construction in Progress (Finding D) were not adequate to ensure accuracy of the financial statements. Internal controls assessed are discussed in Part I, "Internal Controls." To comply with OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, we evaluated the Denver Center's process for implementing an Internal Management Control program. The process was in place, but weaknesses existed that had not been formally reported.

Potential Benefits of Audit. All recommendations in this report, if implemented, will result in compliance with regulations and improved financial statement disclosure. Fiscal responsibilities should improve when the Denver Center implements a transaction-driven general ledger that complies with the DoD Accounting Manual and establishes adequate internal controls over the current non-integrated systems. We identified no potential monetary benefits associated with the audit. For other benefits, see Appendix B, "Summary of Potential Benefits Resulting From Audit."

Summary of Recommendations. We recommended that the Director, Defense Finance and Accounting Service, establish accounting systems, issue additional regulatory guidance, ensure compliance with existing regulations, enhance internal controls, and implement formal internal control procedures.

Management Comments. Management either concurred or concurred with the intent of the recommendations on all the system issues related to the preparation of the financial statements. On the use of budgetary data in the financial statements, management nonconcurred concerning reconciliations with Department of the Treasury records and use of the general ledger. For the Statement of Operations, the Denver Center cannot provide detailed information for expenses. The Denver Center also included a revenue amount to offset an equal amount in bad debts to increase the allowance account for accounts receivable claims. On Construction in Progress, the DFAS will improve the quality of data received, but contended it used the correct accounts for Government-Furnished Material and Contractor-Acquired Material. The DFAS is requested to respond to the unresolved recommendations by May 31, 1994. For a full discussion of management's responses see Part II, and for the full text of management's comments see Part IV.

Audit Response. The issues yet to be resolved are voucher processing, use of the general ledger, reconciliation of Fund Balance, bad debt revenue sources, inability to provide accounting data from budgetary systems, and incorrect accounts for Construction in Progress. Until these issues are resolved, the financial statements prepared by the Denver Center will have questionable value.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

Public Law 101-576, The Chief Financial Officers Act of 1990 (CFO Act), requires the annual preparation and audit of Government financial statements. Those statements are for trust funds, revolving funds, and substantial commercial activities of 23 executive departments and agencies, as well as Government corporations. The CFO Act also requires preparation of organization-wide financial statements. It mandated pilot audits for certain designated organizations, including the Air Force, for FY 1992. The Inspectors General, or appointed external auditors, are required to perform the financial statement audits in accordance with generally accepted government auditing standards and standards established by the Office of Management and Budget (OMB). The Inspector General (IG), DoD, delegated the audit of the Air Force's FY 1992 financial statements, including rendering the opinion, to the Air Force Audit Agency (AFAA). The IG, DoD, provided assistance to the AFAA through audit work at the Defense Finance and Accounting Service (DFAS)-Denver Center (the Denver Center).

To fulfill its mission, the Air Force has resources valued at about $324.1 billion located at over 120 bases and received about $83.1 billion in appropriations in FY 1992. In addition, the Air Force manages $114.1 billion of weapon systems (aircraft and missiles) and approximately $25.0 billion of inventories and spare parts. The Air Force has about one million civilian and military employees.

In January 1991, the finance and accounting centers of the Military Departments and Defense agencies were combined into the DFAS. The DFAS established finance and accounting centers at Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; Kansas City, Missouri; and Washington, D.C. A goal of that reorganization was to standardize, consolidate, and improve finance and accounting systems and operations throughout the DoD. The DFAS is responsible for providing timely, accurate, and meaningful financial information.

A primary mission of the Denver Center is to provide finance and accounting support for the Air Force. The Denver Center is the focal point for all Air Force CFO matters. The Denver Center maintains Air Force departmental-level records and prepares financial statements from data submitted by Air Force field locations. In FY 1992, the Denver Center also paid all active duty and Reserve Air Force personnel ($21.3 billion) and maintained billing and collection functions for the Air Force Departmental Debt Management System. As the DFAS achieves its objective to standardize and consolidate, Air Force functions may be redistributed among the other DFAS Centers.

Objective

The overall objective of this IG, DoD, audit was to determine if the Denver Center prepared complete, accurate, and reliable FY 1992 financial statements for the Air Force. We reviewed and tested the internal controls and methods the Denver Center used to consolidate and prepare the Air Force financial statements. We determined whether the Denver Center complied with existing laws and regulations and met accounting standards.

Scope and Methodology

We performed this financial related audit at the Denver Center during the period December 1991 through May 1993. Our audit was done to assist the AFAA in rendering its opinion on the Air Force FY 1992 financial statements. To assess compliance with DoD accounting policies, General Accounting Office (GAO) standards, and OMB guidance, we reviewed documents supporting the FY 1992 financial statements. Those documents included the consolidated Air Force trial balance, the Report on Budget Execution, and the various adjustments to the statements made by the Denver Center. The data used to support those documents was computer processed, and based on our evaluation, we determined that the data were unreliable due to the lack of reconciliations required for a non-integrated system. We also evaluated selected line item amounts and related adjustments contained on both the Statement of Financial Position and the Statement of Operations, including associated footnotes. While our review was primarily performed at the Denver Center, we did meet with or contact other organizations affecting the financial statements. Those organizations are listed in Appendix C.

Limitations. The Air Force FY 1991 financial statements submitted to the Department of the Treasury (the Treasury) were not audited; therefore, audited beginning FY 1992 balances were not available. Our review focused on the FY 1992 yearend balances. Also, we evaluated the Denver Center's procedures for preparing the Statement of Financial Position and the Statement of Operations, but did not review the Statement of Cash Flows or the Statement of Budget and Actual Expenses. In addition, we did not evaluate the accuracy of the data provided by outside sources.

The thrust of our audit was to evaluate the Denver Center's role in preparing the financial statements. Accordingly, we did not, and are not, rendering an opinion on the financial statements. That was accomplished by the AFAA in its report on Project No. 92053011, "Opinion on the Fiscal Year (FY) 1992 Air Force Consolidated Financial Statements," June 29, 1993.

Auditing Standards. We performed the audit in accordance with auditing standards established by the Comptroller General, as implemented by the

IG, DoD, and in accordance with OMB guidance. Accordingly, we included such tests of internal controls and management's compliance with laws and regulations as we considered necessary.

Internal Controls

The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. To comply with OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, we evaluated the Denver Center's process for implementing a DoD Internal Management Control program. We found that the program was in place, but internal control weaknesses existed that had not been reported. We did not evaluate the reasons for the failure of the Internal Management Control Program to prevent the weaknesses we discovered.

Internal controls were either not established or were ineffective for use in preparing accurate Air Force financial statements. We reviewed internal controls to determine whether revenues and expenses were properly reported on the financial statements, whether management complied with laws and regulations having a direct and material effect on the financial statements, and whether presentation was consistent in the financial statements and footnotes. Our work disclosed weaknesses in internal controls that resulted in a high level of risk, instances of noncompliance, and misstatements that affected the principal statements. We found instances where internal controls were not present to detect errors or irregularities in a timely manner.

Internal control weaknesses such as lack of reconciliations and unsupported adjustments existed in the non-integrated systems used to prepare the financial statements (Finding A). All recommendations associated with Finding A, if implemented, will correct those weaknesses. Complete reconciliations were needed for Fund Balance with the Treasury (Finding B). Recommendation B.2., if implemented, will correct the weakness. Improved support was needed to enhance the accuracy of the Statement of Operations (Finding C). Recommendation C, if implemented, will correct the weakness. Use of the correct accounts was needed to properly present Construction in Progress in the financial statements (Finding D). Recommendation D.1., if corrected, will correct the weakness. We identified no monetary benefits related to the audit. Other benefits resulting from this audit are detailed in Appendix B, "Summary of Potential Benefits Resulting From Audit." See Part II of this report for further information concerning internal controls reviewed and specific internal control weaknesses. A copy of the report will be provided to the senior official responsible for internal controls within the Defense Finance and Accounting Service.

Prior Audits and Other Reviews

The GAO performed two recent financial audits of the Air Force. Also, the AFAA performed 28 audits of the Air Force FY 1992 financial statements.

GAO Audits. GAO Report No. AFMD-90-23 (OSD Case No. 8193-A), "Air Force Does Not Effectively Account for Billions of Dollars of Resources," was issued in February 1990. The principal report findings were that financial systems did not provide reliable financial data, basic internal control weaknesses existed, full costs of weapon systems were not identified, and inventory systems did not provide accurate data. The report included 26 recommendations, and the Comptroller of the Department of Defense concurred with all 26. The recommendations involved utilizing existing financial information, developing more accurate financial information, performing reconciliations and documenting adjustments, accounting for costs of weapon systems, achieving financial management of inventories, and developing a new accounting system. To date, the Air Force has made limited progress in correcting deficiencies in its financial management systems. That situation exists because the DoD's emphasis has been on long-term efforts to improve and standardize its financial management operations; however, the benefits derived from those efforts will not be realized for years. The Denver Center has expended resources to improve the finance and accounting reporting during FY 1992. As examples, the Denver Center trained more than 400 Air Force personnel on the CFO Act and its requirements and developed a Self-Paced General Ledger Training pamphlet. Many of the GAO findings are repeat findings in this IG, DoD, report, including the lack of an integrated general ledger system, weak internal controls, and unsupported adjustments totaling billions of dollars.

GAO Report No. AFMD-92-12 (OSD Case No. 8376-L), "Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act," was issued in February 1992. The principal report findings were that financial systems were not integrated and generated unreliable information, reported costs of weapon systems were unreliable, accounting and controls over Air Logistics Command inventories were inadequate, internal accounting controls were inadequate, and short-term actions were needed to improve the quality of financial data and to ensure completion of a financial statement audit. In Report No. AFMD-92-12, the GAO reaffirmed all 26 recommendations included in its February 1990 report and made additional recommendations to improve management's accountability, strengthen internal controls, improve the quality of financial information, and assist the Air Force in meeting the objectives of the CFO Act.

AFAA Audits. The AFAA performed 1 audit on the Consolidated Air Force financial statement, 16 audits on general funds, 1 audit on a trust fund, 5 audits on stock funds, 3 audits on industrial funds, and 2 audits on logistics systems concerning the FY 1992 Air Force financial statements. Those audits were performed concurrently with our audit. See Appendix A for a list of those AFAA audit report titles.

In its report on Project No. 92053011, "Opinion on the Fiscal Year (FY) 1992 Air Force Consolidated Financial Statements," June 29, 1993, the AFAA

disclaimed an opinion on the consolidated Air Force FY 1992 financial statements because of the inadequacy of the systems used to obtain information for the financial statements and the lack of management and legal representation letters. The AFAA found that over $260.0 billion reported on the financial statements was assembled from a variety of separate information systems of uncertain reliability and that for most items it was unable to verify the account balances. Lack of management and legal representation letters was in itself sufficient grounds on which to base a disclaimer of opinion on the financial statements.

Part II - Findings and Recommendations

Finding A. Systems Used to Prepare Financial Statements

In preparing the FY 1992 Air Force financial statements, the Defense Finance and Accounting Service-Denver Center did not comply with DoD Manual 7220.9-M, "DoD Accounting Manual," (DoD Accounting Manual) or maintain effective procedures and internal controls over its systems. Those conditions existed because the Denver Center did not have a transaction-driven general ledger; did not verify and reconcile amounts reported in the Merged Accounting and Fund Reporting (MAFR) System to field-level data; did not have a reliable system to determine the amount of accounts receivable; and did not have an effective system to determine cut-off data for military pay. As a result, the data used to prepare the Air Force FY 1992 financial statements did not present a reliable picture of the financial condition of the Air Force.

Background

The Denver Center used a variety of accounting and non-accounting systems to prepare the Air Force FY 1992 financial statements. The general ledger system and supplemental journal voucher system provided data for certain asset and liability accounts. The MAFR system provided data on cash transactions. Internal reports were used to provide data on accounts receivable. The military payroll system provided data on military pay.

General Ledger System

Transaction-Driven General Ledger. The Denver Center did not have a double-entry, transaction-driven general ledger, and its supplemental journal voucher system did not contain adequate internal controls to ensure the validity of the data used to prepare the financial statements. The DoD Accounting Manual requires that a double-entry, transaction-driven general ledger be maintained and used as the basis for preparation of financial statements. The Annual Statements of Assurance for 1991 and 1992 prepared by the Denver Center identified the lack of a transaction-driven general ledger as an Air Force base material internal control weakness, but the Denver Center did not consider it to be a departmental material weakness and did not propose corrective action in its 1991 and 1992 reports. Without such a general ledger, the Denver Center could not prepare meaningful financial statements in accordance with the DoD Accounting Manual. Although personnel at the Denver Center stated that the solution was being worked on, at the time of the audit we found no significant results of efforts to improve the weakness.

The Air Force and the Denver Center attempted to meet the need for an integrated general ledger by adapting portions of the General Finance and Accounting System and developing the Base-Level Accounting and Reporting System. The adaptation of the General Finance and Accounting System did not fully satisfy the general ledger requirements, and the Base Level Accounting and Reporting System development effort was discontinued before it reached the implementation stage.

Journal Vouchers. In lieu of a transaction-driven general ledger, the Denver Center developed a supplemental journal voucher system that complemented the Air Force general ledger. Denver Center personnel made $51.4 billion in absolute adjustments to the Air Force general ledger accounts before preparing the FY 1992 financial statements. Certain journal voucher adjustments were made by the Denver Center at the request of the Air Force major commands (MAJCOMs) because the MAJCOMs did not have access to the system to make adjustments during fiscal yearend processing. The Denver Center prepared a journal voucher and entered the data on a personal computer spreadsheet that was then used to update the financial statements. However, the spreadsheet only included asset and liability accounts that were going to be used in the financial statements. If the journal voucher included accounts that were not on the spreadsheet, the Denver Center did not make the entire adjustment. Furthermore, the spreadsheet entries for FY 1992 were not entered into the Air Force general ledger. Therefore, the FY 1993 financial statements will contain inaccurate data because the FY 1992 financial records have not been appropriately updated.

For example, the Air Combat Command requested an adjustment of $94.8 million to debit General Ledger Account (GLA) 311, "General Expenses." The Denver Center prepared a journal voucher based on that request; however, the journal voucher did not include an adjustment to GLA 311 or to any of the related General Ledger Subsidiary Accounts (GLSAs). Instead, Denver Center made the adjustment to the equity account (GLA 731, Net Investment) rather than going through the expense account as requested by the Air Combat Command. In addition, debits and credits on that journal voucher were not equal. The journal voucher was out of balance by $576,824. The condition occurred because Denver Center personnel had to manually update both GLAs and GLSAs on the vouchers, increasing the likelihood of error. The Denver Center ultimately made a debit entry in the amount of $96.5 million to GLA 731, "Net Investment," and the subsidiary account GLSA 73104, "Operating and Investment Changes," but could not adequately explain how that amount was derived.

Internal Controls. The supplemental journal voucher system did not contain adequate internal controls to safeguard data used to prepare the financial statements, as required by the DoD Accounting Manual, chapter 14, "Internal Control." The Denver Center system allowed for duplications or omissions of data used to prepare the financial statements. Internal controls over the preparation of the financial statements relate to support for transactions, reconciliations, transaction processing/production, error handling, financial reporting, and accuracy. Financial reporting and accuracy are discussed throughout this report and will not be specifically addressed here.

Support for Transactions. Denver Center personnel did not obtain source documents prior to making adjustments to the spreadsheet used to prepare the financial statements. Source documents were not obtained because Denver Center wanted to ensure that the adjustments would be included in the financial statements and were concerned that waiting for the source documents would delay financial statement preparation. Not verifying adjustments to source documents circumvented the internal controls that require adequate supporting documentation, proper supervisory approval, and easily traceable data.

Reconciliations. Denver Center personnel were not reconciling Air Force general ledger control and subsidiary accounts. For example, Denver Center personnel prepared a voucher to the records for donated computer equipment valued at $1.9 million. The debit should have been posted to both GLA 161, "Equipment in Use," and GLSA 16104, "Automated Data Processing Equipment." However, the amount was only posted to GLSA 16104. Since only the control account is used to prepare the financial statements, the statements would have been understated by $1.9 million had the auditors not disclosed the problem to Denver Center personnel. Had reconciliations been performed, the error would have been detected.

Transaction Processing/Production. The Denver Center did not have adequate transaction processing/production controls in place. The vouchers prepared to adjust financial data prior to inclusion of that data on the financial statements had no evidence of supervisory approval. The Denver Center eventually provided vouchers with supervisory signatures; however, the supervisory approvals were dated a month after the preparation of the audited version of the financial statements. In addition, the vouchers were not assigned control numbers during financial statement preparation. Denver Center personnel explained that they did not assign control numbers to the vouchers until after the voucher adjustments had been entered on the spreadsheet. The lack of control numbers could lead to a lost voucher or double entry of a voucher and also could hinder the ability to track individual vouchers, increasing the risk of an error being undetected.

Error Handling. Several errors existed in the Air Force general ledger and supplemental journal voucher system that were not detected by Denver Center personnel and corrected in a timely manner as required by the DoD Accounting Manual, chapter 14. For example, a $20.0 million credit error for Construction in Progress was made to the spreadsheet used to prepare the financial statements. That error was not corrected prior to the issuance of the financial statements. The Denver Center also did not properly account for $4.4 billion in Government-Furnished Material and Contractor-Acquired Material as reported by the Defense Logistics Agency. Finding D, Construction in Progress, discusses that error in greater detail.

Merged Accounting and Fund Reporting System

The Denver Center did not reconcile out-of-balance cash disbursements and receipts in the MAFR system. The MAFR system accounts for all cash transactions affecting the Air Force and provides consolidated cash accountability and reporting. The primary objectives of the system are to control, purify, and consolidate all disbursement and collection data from disbursing stations. Denver Center personnel did not detect illogical errors entered into the MAFR system. Those situations occurred because entries were made into the system without supervisory reviews or edit checks for reasonableness. During FY 1992, the MAFR system processed $142.0 billion in disbursements and $32.0 billion in reimbursements, with input from 122 Air Force Accounting and Disbursing Stations; the Departments of the Army, Navy, and State; and other Government agencies.

MAFR Reconciliations. The Denver Center did not perform monthly reconciliations on MAFR data submitted by two of the five Air Force disbursing stations we reviewed. The Denver Center was required by Air Force Regulation 177-101, "General Finance and Accounting Systems at Base Level," February 15, 1991, to reconcile the cumulative dollar amounts to the monthly MAFR Package, "Report of Disbursements and Collections" (7113 Report) submitted by each Air Force disbursing station. The Denver Center could determine what disbursing station caused an out-of-balance condition by examining the code used by the entity making the entry. If the Denver Center caused a MAFR system out-of-balance condition, it was responsible for reconciling the data and correcting the out-of-balance condition. Conversely, if the disbursing station caused the out-of-balance condition, then the disbursing station was required to reconcile the condition and submit the correct information to the Denver Center for entry into the MAFR system. An out-of-balance condition existed, and a reconciliation was required, if a cumulative dollar amount reported by a disbursing station did not agree with the Denver Center data.

No evidence existed that Denver Center personnel had reconciled all 120 of the 7113 Reports that were submitted by 2 Air Force disbursing stations over the past 5 years. At the end of FY 1992, the Denver Center reported that Los Angeles Air Force Base disbursing station had 651 line items valued at $90.2 million in need of reconciliation. By the end of February 1993, the numbers had grown to 749 items valued at $557.2 million. The second disbursing station, Hanscom Air Force Base, had 482 items valued at $207.5 million in need of reconciliation at the end of FY 1992. By February 1993, that had changed to 496 items valued at $184.6 million.

Illogical Entries. An internal management report (Recon Counts by ADSN [Accounting and Disbursing Station Number] Within Command), which ultimately provided data to the financial statements, was out of balance by $59.0 billion as of September 30, 1992. One error, out of 13,775 as of September 30, 1992, was a manual entry for $61,432,527,362.50 instead of the correct amount of $61,433.52. The error was corrected in October 1992, after management reports were issued showing the incorrect amount. Balances for

other months also appeared to be overstated. The following out-of-balance conditions illustrate the problem: October 1992, $68.0 billion; November 1992, $5.0 billion; December 1992, $93.0 billion; January 1993, $393.0 billion; and February 1993, $5.0 billion. (Note: FY 1993 data is used as an example of the condition because FY 1992 data was not available.) Such wide monthly variations indicate that internal controls over manual inputs were deficient.

Accounts Receivable

The Denver Center did not have a reliable system to determine Accounts Receivable. The DoD Accounting Manual, Chapter 33, "Receivables," establishes accounting controls to ensure that receivables are recorded when earned and collected when due. Recordings must be accurate and prompt in order to provide reliable financial status on all debts owed to the DoD.

We compared transactions from the reporting activities on an internal Air Force 8108 Report, "Accounts and Loans Receivable Due From the Public" (8108 Report), to the consolidated report on the Standard Form 220-9, "Accounts and Loans Receivable Due From the Public" (220-9 Report), that was prepared by the Denver Center and submitted to the Treasury. We also reviewed the "Reconciliation of Accounts Receivable" prepared by the Denver Center as received from the MAJCOMs. Such comparisons were made to verify the validity and accuracy of the data.

Internal Reporting. Denver Center personnel consolidated data received from the MAJCOMs and Center directorates without verifying the data as valid, accurate, and reliable. Further, the consolidated 8108 Report did not agree with the spreadsheet used to prepare it, and Denver Center personnel could not explain the differences. For example, one line item (i.e., MAJCOM Receivables Within a Given Appropriation) had been overstated by $1.0 million dollars and erroneously included in the financial statements. In addition, the Denver Center gave MAJCOMs a one-time authority to change their Accounts Receivable beginning-of-fiscal-year balances. Because of such a change, the June 30, 1992, report showed a beginning balance difference of $183,874 from the March 31, 1992, report. The Denver Center could not ensure that it accounted for all bases and, ultimately, made an adjustment of $452,401 for the reclassification. A total verification of the consolidated 8108 Report could not be performed by the Denver Center because some of the data received from the MAJCOMs was illegible and because the Denver Center substituted interest, penalty, and other data rather than using data submitted by the MAJCOMs. According to Denver Center personnel, the consolidated 8108 Report should not be used as support for Accounts Receivable, Net Non-Federal, of $253.5 million on the Statement of Financial Position because the data was often inaccurate. It was used, however, because the Denver Center had no other data available.

External Reporting. The Denver Center reported erroneous amounts on the 220-9 Report sent to the Treasury. We identified an error of $353,863 on the 220-9 Report that was attributed to an incorrect formula computation and caused the report to be understated by that amount. The Denver Center subsequently made the correction. The Denver Center recognized that data in the 220-9 Report were unreliable, but used the data because no other data were available.

Reconciliation of Accounts Receivable. The Denver Center did not reconcile its contractor debt records to the MAJCOM contractor debt records. Air Force Regulation 177-102, chapter 40, "Reconciliation of Accounts Receivable," requires the Denver Center to send a listing of accounts receivable back to the MAJCOMs for reconciliation. The MAJCOMs should report any discrepancies found between the records. Although Denver Center personnel sent the reports to the MAJCOMS and received responses, the Denver Center did not take action when discrepancies were reported. Therefore, we could not verify contractor debt as accurate. For FY 1993, this function has been transferred to the DFAS-Columbus Center.

Military Pay

The Summary of Military Pay Obligations (SOMPO) did not provide timely and reliable cut-off data for use in the financial statements. Specifically, cut-off differences caused omissions of data in the FY 1992 financial statements, and manual entries were not controlled or reviewed for reasonableness. The Denver Center did not maintain a payroll accounting system as prescribed by the DoD Accounting Manual, chapter 15, "Military Pay System Standards." Instead, it used a payroll system that was not designed to support financial statements.

Cut-Off Differences. Our audit of military pay disclosed that expenses were reported in the wrong fiscal year, causing cut-off differences. Separation pay can be determined through reconciliations that the Denver Center is currently performing. Differences caused by using a payroll system, rather than an accounting system, will require additional action by the Denver Center since the information is not currently available.

Separation Pay. The FY 1992 financial statements were not adjusted to reflect timing differences for separation pay. For example, $37.0 million in separation pay was reported in February 1993 instead of in January when earned. As discussed with Denver Center personnel, the FY 1992 financial statements did not include an adjustment at yearend for separation pay earned in September, but was reported in October. (At the time we attempted to compare the SOMPO to the Master Military Pay Account reconciliation, for separation pay, FY 1992 records were not available. Therefore, we used the Military Pay Directorate's attempted reconciliation for February 1993 to determine the accuracy of the method used to compute pay for the financial statements.) The financial statements were not accurate because the Denver Center did not adjust for separation pay.

Payroll versus Accounting Data. The FY 1992 financial statements did not include all military pay activity because the SOMPO was prepared before the end of the fiscal year. The SOMPO represented the total payroll for the entire month, but the Denver Center prepared the SOMPO on about the 22nd of each month. Activity occurring between September 22 and September 30 was reported in the following fiscal year and was not reflected on the financial statements. The SOMPO had to be prepared prior to the end of the month to meet deadlines for preparation and mailing of leave and earnings statements to the military members. The Denver Center did not make adjustments to include all activity occurring between September 22 and September 30 on the FY 1992 financial statements.

Manual Entries. The SOMPO could be manually adjusted without affecting the Master Military Pay Account. When that happened, it changed data that were used to prepare the financial statements. The payroll system allowed summary data to be modified without automatically updating the detail records. As an example, the Denver Center made a manual entry to correct the records for a Special Separation Benefit payment for an officer. A $9.2 million entry was made in the February 1993 SOMPO, but the actual amount should have been $94,586. That error created an imbalance between the Net (Interim) and the actual net pay. The Net (Interim) was defined as the gross pay minus all the deductions on the SOMPO. The actual net pay from the Master Military Pay Account was the amount received by Air Force personnel. No system edits or supervisory reviews for reasonableness were in place to reject or question that manual entry.

Conclusion

The lack of a double-entry, transaction-driven general ledger and effective internal controls, along with the failure to correct known deficiencies, perpetuates the inability to produce accurate financial statements. Associated with this deficiency is the failure to verify and reconcile data in accordance with DoD regulations. Further, using inadequate systems for manual vouchers and spreadsheets to process adjustments to the general ledger data led to unsupportable entries in the financial statements. Because the Denver Center did not adhere to existing DoD regulations and maintain effective internal controls, we have no assurance that the financial statements prepared by the Denver Center are an accurate representation of the financial condition of the Air Force.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, develop and implement an integrated, double-entry, transaction-driven general ledger system for use in preparing the Air Force financial statements.

Management Comments. The Deputy Director for Business Funds, responding for the DFAS, concurred that the Denver Center does not have a transaction-driven general ledger fulfilling the DoD Accounting Manual requirements. However, the DFAS disagreed that no significant effort had been made to improve the areas where weaknesses existed. The Denver Center has proposed a number of plans for developing an interim transaction-driven general ledger system. The most recent effort is the Implementation/Modernization Plan 2000 (IMP 2000), which will provide a comprehensive management information system modifying and expanding existing systems. The IMP 2000 effort will start in FY 1995 to incrementally improve the accounting process by October 1999.

Audit Response. The comments were responsive to the recommendation. However, DFAS comments indicate that we reported that no significant efforts were made to improve accounting deficiencies. In the finding and in the section entitled "Prior Audits and Other Reviews," we discussed Denver Center efforts to meet the need for an integrated general ledger, but said we saw no "significant results" of those efforts. The Denver Center has made efforts to correct deficiencies in the past, but useful results have not been achieved. As an example, the Denver Center expended $11.0 million over an 8-year period to improve its MAFR system. The project was ultimately canceled because it was not providing the intended results. Also, the IMP 2000 is a major effort and with good planning can result in improvements to the accounting systems. Implementation of a transaction-driven general ledger, should help to avoid many of the problems we identified. However, the IMP 2000 project is in its preliminary stages, and considerable planning must be done before any action can be taken to improve the accounting systems. The action proposed by management addresses the lack of a transaction-driven general ledger. Therefore, no further comments on this recommendation are required from the DFAS.

2. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, require Denver Center personnel to make all adjustments requested by Major Commands or justify deviations with properly supported documentation supplying reasons for the noncompliance.

Management Comments. Management concurred with the intent of the recommendation. The DFAS contended that it had sufficient internal controls over its general ledger to maintain integrity. Command-reported information must be put into a Denver Center personal computer spreadsheet used to prepare the financial statements. Whether to make all entries of information reported by

Commands is based on an analysis by the Denver Center. Information that would be duplicated is not entered. The DFAS disagreed with the IG, DoD, conclusion that adjustments excluded in FY 1992 will affect balances in FY 1993.

The DFAS responded that total debits and credits on the Denver Center vouchers may not be equal. However, when comparing control accounts only, the amounts do agree. The difference in debits and credits at departmental level exists because the departmental system does not update based on subsidiary accounts.

Audit Response. The DFAS comments were partially responsive to the recommendation. Although the DFAS response provided information about the systems, it did not address the specific recommendation that adequate supporting documentation be made available for adjustments that deviated from MAJCOM requests. A properly integrated accounting system is dependent on information flowing from one period to another. Without adequate flow, weaknesses exist that can affect the accuracy of the data used to prepare the financial statements. We request that DFAS provide comments to the final report on whether it will maintain adequate supporting documentation for all adjustments that deviate from Major Command requests.

3. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, develop internal controls to ensure proper control over the preparation, approval, tracking, and data entry of journal vouchers to provide complete, accurate, and reliable data as required by DoD Manual 7220.9M, "DoD Accounting Manual."

Management Comments. Management concurred with the recommendation to develop internal controls. The DFAS recognized that problems existed for FY 1992 since supervisory reviews were untimely, and vouchers did not have control numbers. The Denver Center considered the 20 vouchers to be few in number with minimal risk of loss. Due to strict time limits, the Denver Center did make adjustments without having documentation available. Support was received after the financial statements were issued. An IG, DoD, auditor identified a $20.0 million error on the financial statement spreadsheet that was found too late to revise the financial statements. The DFAS disagreed that there were several errors. The DFAS also disagreed that posting to the subsidiary account would misstate the control account and cited the roll-up methodology used at the Denver Center as rationale.

Audit Response. The DFAS comments were partially responsive. The Denver Center has improved internal controls for FY 1993 financial statements. It now has current supervisory reviews and has initiated a numbering system for its vouchers. The Denver Center still needs to adequately document input sources for the vouchers, and controls need improvement to ensure data are entered only once. The DFAS statement disagreeing about "several errors" is correct because we did not identify the specific number. In the audit we identified errors of $20.0 million, $1.9 million, and $576,824. We consider those 3 errors to be significant since only 20 vouchers were processed. The DFAS conclusion that posting to the subsidiary account would not misstate the control

account is misleading because existing internal controls allowed the $576,824 error to be processed without detection. We ask the Denver Center to provide comments to the final report on how it will improve internal controls over voucher input sources and data entry.

4. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, require Denver Center personnel to perform Merged Accounting and Fund Reporting System reconciliations and make appropriate corrections.

Management Comments. Management concurred with the intent of the recommendation. The DFAS comments agreed that reconciliation differences caused by erroneous base-level entries existed. To correct the reconciliation deficiency, the Denver Center has enhanced internal controls by requiring supervisory reviews and requesting a system change to automate reconciliations.

Audit Response. We consider management's comments to be responsive to the recommendation. No further comments on this recommendation are required.

5. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, develop and implement additional internal control procedures and operating instructions for the Denver Center personnel to use that specifically outline, in detail, procedures to verify that accounts receivable data reported are valid, accurate, and reconciled prior to consolidation and reporting.

Management Comments. Management concurred with the intent of the finding and described the process for obtaining data from the field activities. The Denver Center uses this data in a spreadsheet containing edits to ensure accuracy of amounts entered. In addition, all formulas in the 220-9 Report spreadsheet were verified and corrected during the audit. The DFAS considers the $1.0 million error identified negligible when compared to total accounts receivable. A reconciliation cannot be performed due to the lack of detailed records. The Denver Center has instituted procedures to ensure all supporting data are legible. Denver Center personnel contended that a reconciliation of contractor debt was performed for FY 1992 financial statements. To address our recommendation, the Denver Center has prepared a draft Operating Instruction for its personnel.

Audit Response. Management's comments addressed only a portion of the recommendation. The Denver Center implementation of an Operating Instruction should fulfill the need to accurately reconcile accounts receivable. Requiring legible data from field activities fully addresses our concern over this issue. The DFAS indicated that the $1.0 million dollar example we used is negligible; however, that was only one example we presented. Our presentation of the example was to demonstrate that edit checks existed, but were ineffective due to internal controls not identifying the error. The DFAS statement about formulas being corrected for the 220-9 Report is correct, but additional edit checks for the 8108 Report are needed. We request comments to the final report on the edits that require modification in the use of the 8108 Report.

6. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, establish procedures to adjust for yearend separation pay and other timing differences.

Management Comments. Management concurred with the recommendation and stated it will establish procedures to allow for cut-off differences.

Audit Response. The comments are responsive to the recommendation. No further comments on this recommendation are required.

7. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, establish military pay system edits to reject transactions that exceed reasonable limits and require supervisory review of all manual inputs.

Management Comments. Management concurred with the recommendation and will establish system edits and supervisory reviews to evaluate transactions exceeding tolerance limits.

Audit Response. The comments are responsive to the recommendation. No further comments on this recommendation are required.

See Part IV for the complete text of management comments to the draft report. Comments to the final report must be received by May 31, 1994. The chart below details specific requirements for those comments.

Response Requirements for Each Recommendation

Responses to the final report are required from the Denver Center for the items indicated with an "X" in the chart below.

	Response Should Cover:			
Number	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
2.	X	X	X	IC
3.		X	X	IC
5.	X	X	X	IC

* IC = material internal control weakness.

Finding B. Budgetary Data Used in the Financial Statements

Internal controls over budgetary data used to prepare the financial statements were not effective. The DoD Uniform Chart of Accounts was not used, unsupported accounting adjustments were made, data from the Status of Funds were used in lieu of data from the general ledger, and reconciliations were not made to Treasury account balances. The internal control weaknesses existed because both the Denver Center and the Air Force had not converted to the DoD Uniform Chart of Accounts, accountants assumed they knew the correct entry without confirmation from the field, Denver Center personnel considered the general ledger less reliable than the budgetary system, and Denver Center personnel made adjustments to force their records to agree with Treasury balances. As a result, Air Force budget execution documentation used to prepare the Air Force financial statements was unreliable.

Background

Uniform Chart of Accounts. The DoD needs reliable and timely accounting data for formulating budgets, controlling funds, executing budgets, supporting management with financial information, and meeting legal and reporting requirements that require a basic accounting structure. The DoD Accounting Manual established the DoD Uniform Chart of Accounts as the DoD basic accounting structure. Within the DoD account structure, uniform accounting for assets, liabilities, revenues, expenses, budget execution, investments, and gains and losses can be maintained. The DoD uses those accounts as the minimum source necessary to develop its financial statements. The Statement of Financial Position provides the end-of-year position for assets and liabilities available to accomplish the mission. The Statement of Operations provides a summary of revenues and expenses attributed to the organization during the year.

Report on Budget Execution. The OMB Circular No. A-34, "Instructions on Budget Execution," August 1985, provides guidance on the preparation of the Report on Budget Execution. The Denver Center prepares that report for Congress. Congress evaluates the details on how funds were spent and provides the basis for evaluating the budgetary process. That circular states that agencies are responsible for maintaining accounting, internal control, and administrative control systems to facilitate effective management of Federal programs. Those systems should provide reliable accounting for the activities of the agency, to include information on actual obligations, outlays, and budgetary resources. Chapter 93, "Appropriation and Fund Status Reports," of the DoD Accounting Manual implements the requirements of OMB Circular No. A-34 and provides detailed instructions for each line item on the Report on Budget Execution.

Status of Funds System. The Status of Funds system summarizes all the information required to be in the Air Force Report on Budget Execution. That system receives input from the Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller), the Air Force MAJCOMS, the MAFR system, and activities of the Army, the Navy, and the Department of Transportation. The Status of Funds system maintains and summarizes data to show the status of budgetary resources and related financial data.

Uniform Chart of Accounts

The Air Force and the Denver Center did not maintain the DoD general ledger Uniform Chart of Accounts. Instead, the general ledger used by the Denver Center incorporates a unique Air Force Chart of Accounts that does not correspond to the DoD Uniform Chart of Accounts. For example, the Air Force Chart of Accounts has one account for Fund Balance with Treasury, while the DoD Accounting Manual specifies five; Air Force Accounts Receivable has four accounts and DoD has six; and the Air Force Chart of Accounts has no Accounts Payable, while the DoD has five. Even when accounts in the two systems have the same or similar data, the accounts do not have the same name. Throughout the audit, we contacted Denver Center personnel to request a crosswalk between the Air Force Chart of Accounts and the DoD Uniform Chart of Accounts, but Denver Center personnel indicated that one did not exist and they could not devise one.

Data used to prepare the Report on Budget Execution is extracted from the Status of Funds system maintained by the Denver Center rather than from a system using the DoD Uniform Chart of Accounts as required by the DoD Accounting Manual. In addition, the Denver Center has not reconciled budgetary data to proprietary accounting data as required, which would substantiate the reliability of Air Force data. That reconciliation could be done if the Denver Center used the DoD Uniform Chart of Accounts. The Air Force has reported the issue in its Annual Statement of Assurance. The Denver Center has been aware of the weakness since February 1990 when the GAO reported the condition; however, the DoD Uniform Chart of Accounts has not been implemented.

Accounting Adjustments

The Denver Center routinely made adjustments to financial data without having supporting documentation or contacting the activity originating the information. Discussions with accountants at the Denver Center responsible for $52.8 billion (67.9 percent) of the $77.8 billion in Air Force net accrued expenditures for FY 1992 indicated that those were routinely changed without contacting the originating activity to ensure that the change was proper. For example, the Denver Center changed a Budget Program Activity Code on a

$408,153 accounts payable (Accrued Expenditures Unpaid) to a paid status without confirmation from the originating activity of the correct code. As a result, financial data provided cannot be relied upon.

Budgetary versus General Ledger Data

Accounts Payable on the Statement of Financial Position could not be verified because the Denver Center used questionable budgetary data rather than general ledger data. The Denver Center used the Report on Budget Execution, which incorporated data from the Accrued Expenditures Report submitted by the Defense Contract Management Command. Budget data were used because that data were perceived to be more accurate than data on the accounting reports received from the field activities.

One problem area we found was the possible duplication of data through the Data Base Transfer between the field activities and the Denver Center. Denver Center personnel did not know if the data from the Accrued Expenditures Reports overwrote the data from the field activities that were already entered into the Status of Funds through the Data Base Transfer or were in addition to data reported by the field activities. Accordingly, the potential existed for double counting the data.

Analysis of the Accrued Expenditures Report uncovered several discrepancies. The accountant posting the data from the source documents to an internal worksheet did not post all amounts accurately. For example, comparison of the worksheet to the data submitted by the Defense Contract Management Command indicated $89.2 million that was not on the worksheet. Additionally, although the Defense Contract Management Command data included negative entries totaling $823.4 million, the Denver Center did not include those entries in the Status of Funds system. Discussions with Defense Contract Management Command personnel, however, revealed that they did not know why the negative figures were occurring or whether they were valid. In addition, $8.1 million was posted to the Air Force Missile Procurement appropriation, when that amount should have been included in the Air Force Other Procurement appropriation.

Because of those factors discussed, we could place no reliance on data provided by the Defense Contract Management Command. Accordingly, we could not verify Undelivered Orders Outstanding or Accrued Expenditures Unpaid on the Report on Budget Execution. Also, we have no assurance that accounts payable on the Statement of Financial Position was accurate because it was based on the Report on Budget Execution data.

Fund Balance with Treasury

The Denver Center did not reconcile Treasury data with Air Force records, as required by OMB and DoD regulations. It also made unsupported adjustments to the Air Force Status of Funds to make it agree with the Treasury amounts. Denver Center personnel explained that the differences were due to "timing." They were, however, unable to produce reconciliations of Treasury totals to Air Force records so the timing differences could be identified.

OMB Circular No. A-34 requires that Fund Balance with Treasury on the Statement of Financial Position be supported by the entity's accounting records and be reconciled to the corresponding accounts reported on the Treasury's end-of-period balances. The DoD Accounting Manual, chapter 93, requires that amounts reported by the Treasury be verified against data in the agency records.

We selected four appropriations with a total post-closing trial balance of $29.96 billion and performed a limited review of adjustments to the fund balance. In order to balance Air Force records with Treasury totals, Denver Center personnel made unsupported adjustments to the Report on Budget Execution to force agreement with the Treasury. Those adjustments totaled $1.55 billion. Because of those unsupported adjustments and the lack of reconciliations, we have no assurance that the total $72.1 billion in Fund Balance with Treasury on the Statement of Financial Position is accurate.

Conclusion

The Denver Center used the Air Force Chart of Accounts instead of the DoD Uniform Chart of Accounts as required by the DoD Accounting Manual. Unsupported accounting adjustments were made without contacting the originating activity as required by the Denver Center operating instruction. Due to problems with the Denver Center general ledger, budgetary data were used as the Accounts Payable amount on the financial statements, but no evidence was available to demonstrate that the budgetary system data were more accurate than general ledger data. In addition, the Denver Center did not reconcile Treasury data with Air Force records, as required by the OMB and the DoD. We have no assurance that budgetary data provided to Congress, as well as budgetary data used to prepare the Air Force financial statements, contained accurate information.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, implement the DoD Uniform Chart of Accounts as required by DoD 7220.9-M, "DoD Accounting Manual," October 1983.

Management Comments. Management concurred with the finding and plans to meet the DoD requirement by October 1999. The Denver Center will incorporate the requirement in its IMP 2000 effort to incrementally improve its accounting systems.

Audit Response. The comments were partially responsive due to the extended completion date proposed by DFAS. We request that DFAS accelerate the proposed completion date and develop an interim crosswalk between the Air Force Chart of Accounts and the DoD Uniform Chart of Accounts. The interim crosswalk will assist in the development of a successful IMP 2000 since the definition of accounts to be used is critical. We ask the DFAS to comment on the final report on instituting an accelerated timetable for implementation of the DoD Uniform Chart of Accounts. We also ask for a date when an interim crosswalk between Air Force and DoD accounts will be available.

2. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, limit changes to field-reported accounting data to situations where adequate supporting documentation exists to justify the change.

Management Comments. Management concurred with the intent of the finding and stated that the Denver Center does not make unsupported adjustments. The Denver Center changed its policy in April 1993 to require written documentation for adjustments.

Audit Response. The comments were responsive to the recommendation. Having written documentation will aid in the evaluation of financial statement adjustments. No further comments on this recommendation are required.

3. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, use general ledger data instead of budgetary data to prepare the financial statements.

Management Comments. Management nonconcurred, contending that the General Fund General Ledger is less accurate than the budgetary data currently being used for portions of the financial statements. Management agreed that the General Fund General Ledger should be the single source for data, but said it contains significant errors. The DFAS contended the Denver Center makes the financial statements more accurate by adjusting monthly data from the Defense Contract Management Command. That data were not available to base/command-level offices. The DFAS said the Denver Center also chooses not to use some Defense Contract Management Command data because the Denver Center considers the negative balances to be illogical and the data to be

unreliable. The DFAS also stated it did not know to what the two examples totaling $97.3 million related.

Audit Response. The DFAS comments were nonresponsive. The DoD Accounting Manual directs that the source for financial statement data will be an integrated, double-entry general ledger. The DFAS contended that the Denver Center 's budgetary system is more accurate than its general ledger, but has not provided support for that contention. If budgetary data are more accurate, the Denver Center should reconcile the systems and modify the general ledger accordingly. Relying on the budgetary system and failing to make improvements to the DoD-prescribed source will result in the Denver Center receiving disclaimers of opinion on financial statements in the future.

The Denver Center made adjustments to the financial statements by eliminating data it considered illogical or unnecessary. However, the Denver Center did not provide support for those adjustments. During the audit, we informed Denver Center personnel of the source of the $97.3 million. The report identifies the source as Defense Contract Management Command and the Air Force Missile Procurement appropriation. We ask that the DFAS provide comments to the final report. The comments should address how the DFAS can support the financial statement data using the general ledger and provide documentation supporting the reconciliation of the general ledger to the budgetary system.

4. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, reconcile the Air Force accounting records to Fund Balance with Treasury and limit adjustments to valid changes supported by documentation.

Management Comments. Management nonconcurred, stating it does not make unsupported adjustments and that it balances with Treasury.

Audit Response. The DFAS comments were nonresponsive. OMB Bulletin No. 93-02 specifically states that Fund Balance with Treasury will be reconciled, not balanced. Balancing identifies that a difference exists, where a reconciliation explains the causes for the differences. At the time of the audit, the Denver Center personnel were unable to provide us a complete reconciliation. We ask the DFAS to provide comments to the final report. The comments should address when a complete reconciliation will be completed to comply with OMB guidance.

See Part IV for the complete text of management comments. Comments to the final report must be received by May 31, 1994. The chart below details specific requirements for those comments.

Response Requirements for Each Recommendation

Responses to the final report are required from the Denver Center for the items indicated with an "X" in the chart below.

	Response Should Cover:			
Number	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
1.	X	X	X	C
3.	X	X	X	C
4.	X	X	X	IC

* IC = Material internal control weakness. C = Compliance.

Finding C. Statement of Operations

Revenues on the Statement of Operations were overstated by $424.5 million and operating expenses were misstated. The misstatements included $8.3 billion for leases that was not properly disclosed; $568.7 million due to storm damage and aircraft losses that was understated; $24.7 million for bad debts that was improperly expensed; $1.2 billion for extraordinary losses that was intentionally not included; and $13.0 billion (absolute value of $45.4 billion) for net prior period adjustments that were either made incorrectly or omitted on the Statement of Operations. Those overstatements and misstatements occurred because Denver Center personnel did not properly classify and record revenues, expenses, and losses. As a result, the Statement of Operations submitted with the Air Force FY 1992 financial statements is not accurate.

Background

OMB Bulletin No. 93-02, "Form and Content for Agency Financial Statements," October 22, 1992, specifies that revenues and financing sources, expenses, extraordinary items, prior period adjustments, and other items as specified in applicable agency guidance should be included in the Statement of Operations. OMB Bulletin No. 93-02 allows for variation from the prescribed form and content, but only "to allow the financial statements accurately to reflect financial operations and conditions." The GAO Title 2, "Accounting," of the GAO's, "Policy and Procedures Manual for Guidance of Federal Agencies," and the DoD Accounting Manual provide specific guidance on what should be included on the Statement of Operations.

Revenues and Financing Sources

Revenues were overstated by $424.5 million. To offset a bad debt writeoff resulting from contractor debt, the Denver Center recognized that amount as a revenue at the time the bad debt expense was recorded. However, the $424.5 million was also properly recorded as an asset on the Statement of Financial Position. Therefore, the financial statements included the amount twice.

Operating Expenses

Operating expenses were misstated by a total of $8.9 billion on the Statement of Operations because Denver Center accounting and budgetary systems were not designed to distinguish between capital expenses and operating expenses. OMB Bulletin No. 93-02 states that expenses include operating expenses, cost of goods sold both to the public and intragovernmental, depreciation and amortization, bad debts and writeoffs, interest, and other items not otherwise stated. The DoD Accounting Manual, chapter 63, "Expenses and Miscellaneous Items," states:

> Expenses shall be identified to the programs to which they relate. Accordingly, accounting systems shall have the ability, at a minimum, to report expenses by budget program line, the Five-Year Defense Plan, the force structure, and organizational unit.

Expenses listed in the DoD Accounting Manual include payroll; travel and transportation of persons and things; rents, communications, and utilities; printing and reproduction; leases; repair and alterations; storage of vehicles and household goods; custom automated data processing software contracts; supplies and materials; equipment (not capitalized); and losses from the sale or destruction of assets.

Leases. Lease costs of $8.3 billion were not included as a separate line item in the financial statements, as required by OMB Bulletin No. 93-02. The $8.3 billion was supported by the Air Force general ledger and records at the Air Force Real Estate Agency. The Statement of Operations used the budgetary system to show total expenses and lease costs, but those costs were not reconciled between the two systems. Without separate identification, we could not determine that the Statement of Operations included operating lease expenses, which would result in understated expenses.

Destruction of Assets. The Denver Center did not include all losses from the destruction of assets as Other Operating Expenses. A total of $568.7 million was omitted. During FY 1992, the Air Force sustained losses of aircraft valued at $565.8 million. According to the financial statement footnotes, those aircraft losses were deducted directly from the equity accounts without first being recognized as expenses on the Statement of Operations. In addition, heavy rains caused $2.9 million in damage at two Air Force facilities and there is no indication that the Statement of Operations included that damage amount. Denver Center personnel claimed that costs for the losses and the rain damage were expensed, but they were unable to provide any supporting documentation.

Bad Debt Expense. The Denver Center improperly calculated Bad Debt Expense. The DoD Accounting Manual allows the use of the general reserve method for calculating the amount of uncollectible accounts receivable. The general reserve method is based on bad debt expenses and changes in outstanding accounts receivable balances. Denver Center personnel included $478.2 million of Bad Debt Expense on the FY 1992 Statement of Operations. The Denver Center expensed both the adjustment to the allowance account of $453.5 million and the actual writeoffs for the year of $24.7 million, for the

total of $478.2 million. Under the accrual basis of accounting, only the adjustment based on prior bad debt experience should have been expensed, so the actual writeoff was in error.

Extraordinary Items

Extraordinary losses of $1.2 billion were not included on the Statement of Operations because Denver Center personnel did not consider the events causing the losses to be extraordinary. Extraordinary items are costs or income so unusual in type as to be accorded special treatment in the accounts or separate disclosure on the financial statements. The Air Force has incurred losses from both natural disasters and the decommissioning of weapon systems that should be accorded special treatment on the financial statements.

Natural Disasters. During FY 1992, the Air Force suffered two extensive losses that should have been classified as extraordinary and included on the Statement of Operations. The first was the destruction of Homestead Air Force Base by Hurricane Andrew. The Air Force Safety Agency estimated costs associated with that loss at $450.0 million. The second item was severe damage to Andersen Air Force Base facilities caused by Typhoon Omar. The Air Force Safety Agency estimated damages of $50.9 million at Andersen. An additional extraordinary loss occurred in FY 1991 at Clark Air Force Base when Mount Pinatubo erupted. The base was subsequently abandoned due to the damage. The Air Force Safety Agency estimates that total losses incurred due to Mount Pinatubo erupting were $526.4 million during FY 1991 and FY 1992. (Note: The adjustment should have been made in FY 1992, when the first accurate estimate of the loss was determined.) The losses from the three natural disasters totaled more than $1.0 billion.

Decommissioning Weapon Systems. Also part of the $1.2 billion not included on the Statement of Operations were costs the Denver Center did not include for decommissioning weapon systems. Those costs should receive special treatment in the financial statements because such decommissioning qualifies as an unusual and infrequent event. During FY 1992, the Air Force decommissioned 80 Minuteman II missiles. The estimated related costs of $143.3 million to decommission those assets were not included on the Statement of Operations. Therefore, expenses were understated by $143.3 million.

Prior Period Adjustments

Prior period adjustments were not always properly made on the Statement of Operations. Prior period adjustments of $13.0 billion (absolute value of $45.4 billion) were made incorrectly or omitted. Denver Center personnel believed that since they had not prepared financial statements in accordance with the CFO Act in prior periods, prior period adjustments were not always

required. The Denver Center, however, has submitted the Report on Operations (Standard Form 221) to the Treasury for several years. That report was the equivalent of the Statement of Operations prepared under the CFO Act, and the same data source were used to prepare both reports. GAO Title 2 defines prior period adjustments as:

> . . . mathematical errors in statement preparation or information supporting the statements, errors in the application of accounting principles, or errors using or interpreting information that existed at the time the prior-period statements were developed.

Prior period adjustments may not be made for changes in accounting estimates. For example, changing the estimate for Bad Debt Expense for receivables recorded in a previous year is not a prior period adjustment. It is recognized in the current and future years when more accurate information becomes available.

Table 1 shows net and absolute prior period adjustments needed to correct the Statement of Operations:

Table 1. Net and Absolute Prior Period Adjustments

Adjustment	Amount (billions)
Change in Estimate	$ .2
Correction of Ammunition Inventory	(26.0)
Revaluation of Weapon Systems	8.8
Duplication of Vehicles	(3.2)
Construction in Progress	7.2
Total (Net)	($13.0)
Total (Absolute)	$45.4

Change in Estimate. The Denver Center included a prior period adjustment of $226.5 million for a correction to the allowance for doubtful accounts. Since that was a change in an estimate, it should not have been a prior period adjustment. Instead, it should be recorded as part of the current year's Bad Debt Expense.

Correction of Ammunition Inventory. The Denver Center did not record a prior period adjustment of $26.0 billion for the ammunition inventory. That adjustment was necessary because of a programming error in the Combat Ammunition System at base level. Although the reporting activities were unable to provide the actual value of the overstatement, AFAA auditors were able to confirm the $26.0 billion estimate developed by the Denver Center.

Revaluation of Weapon Systems. During FY 1992, the Air Force revalued weapon systems upward by $8.8 billion; therefore, a prior period adjustment for that amount was needed. The DoD Accounting Manual, Chapter 36, "Fixed

Assets," defines acquisition cost as ". . . the amount, net of authorized discounts, paid or payable for the assets plus the transportation, installation, and other related costs of obtaining the assets in the form and place to be put into use." In FY 1992, the Air Force started revaluing weapon systems to account for modification costs, research costs, and Government-Furnished Material.

Duplication of Vehicles. The Denver Center needed to make a prior period adjustment to correct a $3.2 billion duplication of vehicles on the FY 1991 financial statements. The duplication was identified in FY 1991, but had not been corrected in the FY 1992 financial statements. The AFAA discussed the issue in its audit report. The duplication of vehicles occurred in FY 1992 because the Denver Center issued a guidance letter incorrectly instructing the field activities to report vehicles in two separate general ledger accounts.

Construction in Progress. The Denver Center did not report Construction in Progress on the financial statements submitted to Treasury before FY 1992. The Denver Center received data from the U.S. Army Corps of Engineers (Corps of Engineers) showing $7.2 billion of Construction in Progress at the end of FY 1991. Therefore, the Denver Center must make a prior period adjustment to correct the beginning Net Investment balance. This problem is discussed in detail in Finding D, Construction in Progress.

Conclusion

Denver Center personnel misstated revenues and expenses and omitted information on extraordinary losses and prior period adjustments on the Air Force Statement of Operations. Revenues were overstated by $424.5 million. Expenses were understated by at least $8.3 billion for lease costs and $568.7 million for aircraft losses and storm damage. Also, $24.7 million was improperly expensed for bad debts. Extraordinary losses of $1.2 billion were intentionally not included at all. Net negative prior period adjustments of $13.0 billion (absolute value of $45.4 billion) were not properly made. The Statement of Operations did not accurately reflect the financial condition of the Air Force because of those errors and omissions.

Recommendation, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service-Denver Center, adjust the Statement of Operations to correct revenues, expenses, extraordinary items, and prior period adjustments applicable to Air Force operations.

Management Comments. Management segregated its response into four areas consisting of Revenues and Financing Sources, Expenses, Extraordinary Items, and Prior Period Adjustments. It concurred and nonconcurred on an area-by-area basis.

Revenue and Financing Sources. Management concurred as to the amount, but nonconcurred as to the treatment. The DFAS stated that its Selected Balances for Accrual Reporting report, RCS:HAF-ACF(M)7184, shows that claims increased by $198.0 million for FY 1992 and that its restated FY 1992 financial statements reflect that. The comments indicate that the $198.0 million is offset by an equal amount in bad debt expense. The DFAS contended it presented equal amounts for revenue and bad debt expense so its unexpended appropriation balance would prevent misstatement of the net effect. The DFAS comments stated that the Director of the Denver Center wanted the claims to be "on the books" and "in the financial statements" since the Denver Center contended the accounts receivable were not in the beginning balance for FY 1992.

Expenses. Management nonconcurred with the lease expense issue and concurred with the destruction of assets and the bad debt expense of $249.4 million. The DFAS stated that lease expenses do not have to be a separate line item on the Statement of Operations according to DoD and CFO guidance. The DFAS contended that lease expense and destruction of assets is included in Program of Operating Expenses, line 10, of the Statement of Operations. The DFAS questioned the $2.9 million for destruction of assets because it did not know if the dollar value was for the asset or an operating expense. The DFAS stated that operating expenses were not overstated as indicated in our report. The Denver Center uses its budgetary Status of Funds System to account for expenses; however, the DFAS cannot provide specific details.

Extraordinary Items. Management concurred with the intent of the recommendation, but disagreed that the natural disaster losses due to hurricanes and typhoons were extraordinary items. The DFAS believes that due to the large size of the Air Force and its various geographical locations, the Air Force should expect natural disasters, and resulting losses would be an operating expense. The DFAS contended the amount is in the Statement of Operations, but cannot show specific details. For salvage value at Clark Air Force Base, it "can only assume that some of the assets were transferred."

Prior Period Adjustments. Management concurred with the intent of the recommendation and adjusted its restated FY 1992 financial statements for all of the proposed adjustments, except the one for $.2 billion. The Denver Center made adjustments of (net) $12.8 billion and (absolute) $45.2 billion. The $.2 billion is being questioned by management because it considers it a prior period adjustment and not a change in estimate. Management takes strong exception to our comment that the DFAS does not always require prior period adjustments. The DFAS also says it did not make prior period adjustments because it did not have the audit finding to support them. Management was not aware of the $26.0 billion that Air Force Audit Agency recommended.

Audit Response. Our response to the DFAS comments on each area follows.

Revenue and Financing Sources. Management comments were partially responsive to the recommendation. The IG, DoD, position is that including an equal amount as revenue and bad debt expense in the current year duplicates the accounts receivable recognized in an earlier year, and that, therefore, a misstatement occurs in the Statement of Operations. The DFAS has artificially created revenues through its treatment of the bad debt expense. Writing off a bad debt does not create revenue. The DFAS contended that the beginning accounts receivable balance for claims included $226.5 million, and the Denver Center had to increase the account by $198.0 million during FY 1992 to total the $424.5 million identified. Our research shows that the full $424.5 million had been reported on the books prior to FY 1992 on the Denver Center Reconciliation of Accounts Receivable RCS:HAF-ACF(A)7194 report.

Expenses. Management comments were partially responsive to the recommendation. The Denver Center uses a budgetary system that cannot provide accounting data to account for expenses. As described in Finding B, budgetary data are not suited for all accounting applications. The DFAS comments that lease costs do not need to be a separate line on the Statement of Operations is correct. However, OMB Bulletin No. 93-02 requires significant detail on the Statement of Financial Position for capital and operating leases, and the Denver Center system could not provide that detail. The Denver Center cannot show specifically where the $8.3 billion for leases is included in the expense line item of $55.4 billion. Without being able to specifically identify the $8.3 billion, the system does not provide sufficient data for accounting purposes. The DFAS uses a similar argument for the destruction of assets, which totaled $2.9 million, stating that the amount was included in the $55.4 billion, but cannot provide detail. The DFAS said it did not know whether the $2.9 million was for destroyed assets or operating expenses, but we had explained to managers at the time of the audit that it was wind, water, and mud damage to the assets. The DFAS concurred with the recommendation on $524.6 million for aircraft crashes and restated the FY 1992 financial statements to reflect that amount.

Extraordinary Items. Management comments were partially responsive to the recommendation. We consider the hurricane and typhoon damage to be unusual and infrequent and it should be classified as an extraordinary item. Usual damage would not completely destroy an Air Force Base to the point where the premises are totally vacated. Even though we have a difference of opinion on classification, an inherent weakness exists in the budgetary system that does not allow for the separate identification of those costs. The Denver Center cannot "assume" that assets were transferred, but instead is charged with the responsibility to have accounting data to support accounting transactions. For the $143.3 million of decommissioning costs, we identified to the Denver Center that the costs were for missile procurement only. Those missiles will not be used in the future and are currently being disassembled and the silos made inoperative.

Prior Period Adjustments. Management comments were responsive except for the Change in Estimate adjustment for $.2 billion. The Change in

Estimate issue is related to the Revenue and Financing Sources issue in this finding and both need to be addressed at the same time. Management's comment about our statement that DFAS did not always require prior period adjustments is correct. Since the Change in Estimate was proposed as a prior period adjustment, we will concede to the DFAS objection. The DFAS indicates that it will not make prior period adjustments until it receives auditor findings. It is DFAS's responsibility to prepare accurate financial statements, and it should know before the auditors what prior period adjustments need to be made. The $26.0 billion was discussed in detail with Denver Center personnel during our audit, and they were provided documentation during April 1993. The AFAA report referencing the $26.0 billion was titled, "Review of Inventories Not Held for Sale, Fiscal Year (FY) 1992 Air Force Consolidated Financial Statements," January 10, 1994 (Project No. 93053021).

We ask that the DFAS respond to the final report. The DFAS response should address the treatment of the $424.5 million on the Statement of Operations and explain why its Reconciliation of Accounts Receivable did not place the claims on the books. In addition, the $.2 billion proposed as a prior period adjustment should be addressed since it relates to the $424.5 million. Management should address how it will provide detailed support for accounting requirements for the $55.4 billion on the Statement of Operations. The other management action for bad debts addresses our recommendation; therefore, no further comments are required on that issue.

See Part IV for the complete text of management comments. Comments to the final report must be received by May 31, 1994. The chart below details specific requirements for those comments.

Response Requirements for Each Recommendation

Responses to the final report are required from the Denver Center for the recommendations as indicated with an "X" in the chart below.

Response Should Cover			
Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
X	X	X	IC

* IC = material internal control weakness.

Finding D. Construction in Progress

The Denver Center did not validate the accuracy of Construction in Progress data provided for inclusion on the Air Force financial statements and did not adhere to Air Force guidance on Government-Furnished Material (GFM) and Contractor-Acquired Material (CAM) when preparing those statements. Those conditions occurred because the Denver Center had no procedures to verify the validity, propriety, or accuracy of the amounts reported as Construction in Progress from DoD Components. Also, the Denver Center developed internal guidance that was inconsistent with DoD and Air Force regulations on the reporting of GFM and CAM. As a result, we were unable to verify that Construction in Progress of $24.0 billion on the Statement of Financial Position was accurate.

Background

Elements of Construction in Progress. The Denver Center combined four major cost elements to arrive at the $24.0 billion for Construction in Progress for FY 1992:

o progress payments paid for work at contractor facilities, valued at $12.6 billion;

o construction in progress being administered by the Corps of Engineers and by the Naval Facilities Engineering Command, valued at $6.4 billion;

o base-level construction, valued at $1.1 billion; and

o material held by contractors (GFM and CAM), valued at $3.9 billion.

Criteria. The DoD Accounting Manual, chapter 31, "Financial Control of Assets," outlines the requirement for reporting and accounting for financial control of assets.

> Assets shall be under continuous accounting control from acquisition to disposition. This helps ensure proper and authorized use as well as adequate care and preservation, since no asset can be acquired, put into use, transferred, written down, written off, or disposed of without the proper authorization necessary to document and record the transaction. All tangible assets provided to the Department of Defense shall be accounted for, including assets in transit and assets in the hands of contractors, private parties and other Government Agencies.

The DoD Accounting Manual, chapter 14, states that transactions shall be properly accumulated and correctly classified, coded, and recorded in all affected accounts. Further, transactions shall be recorded in the accounts promptly and accurately, and in the proper amounts. Such practices permit the

preparation of financial reports in accordance with internal needs and external requirements, as well as prompt analysis of the information by management. The OMB Bulletin No. 93-02 and the DoD Accounting Manual, chapter 31, both required the inclusion of Construction in Progress as an asset on the Statement of Financial Position.

Scope. We reviewed procedures the Denver Center used to examine reported Construction in Progress from data submitted by the Corps of Engineers, the Naval Facilities Engineering Command, and Air Force bases. We reviewed the Denver Center's process for verifying and recording data reported on the financial statements and determined whether Denver Center personnel performed any type of reconciliation to assess the reliability of data. We also tested the internal controls and compliance with laws and regulations that pertain to Construction in Progress. In addition, we examined the procedures Denver Center personnel used to record GFM and CAM, reported by the Defense Logistics Agency, in the general ledger and on the financial statements. We did not, however, review any data related to progress payments, which accounted for $12.6 billion.

Construction in Progress Reporting Requirement

The Denver Center did not validate the accuracy of Construction in Progress. The Denver Center accepted amounts reported by various Defense activities as accurate and valid without verifying the data or obtaining supporting documentation.

The Air Force began reporting construction performed by the Corps of Engineers and the Naval Facilities Engineering Command in the general ledger and on the financial statements during FY 1992. The total reported for Construction in Progress was $6.4 billion. The Corps of Engineers had reported $5.859 billion and the Naval Facilities Engineering Command had reported $583.4 million to the Air Force. Since Construction in Progress data from preceding years were not reflected in the Air Force general ledger, a prior period adjustment should have been made to include that data in the financial statements. The Corps of Engineers informed the Denver Center that Construction in Progress was $7.2 billion at the end of FY 1991. The Naval Facilities Engineering Command did not provide any information for FY 1991. The prior period adjustment is discussed in Finding C, Statement of Operations. Because the Denver Center personnel did not validate amounts reported, we could not verify that Construction in Progress was properly reported.

Corps of Engineers Data. The Corps of Engineers provided Construction in Progress data to the Denver Center that was derived from a system that the GAO had previously found to contain deficiencies. The GAO found that the reported cost of completed military construction projects did not include design and engineering costs, contained completed project costs, and did not consistently capitalize personal property. Because of the deficiencies in the

Army systems, the Denver Center needed to establish a method to verify Corps of Engineers data.

Base-Level Data. Amounts reported for Construction in Progress from Air Force base-level activities, $1.1 billion, were not verified as to their validity or accuracy. Several problems within the base civil engineering community made it difficult for bases to trace Construction in Progress transactions. For example, if an erroneous cost account code was assigned to a project, property accounts might be understated. Therefore, those costs might not be included in the Construction in Progress data reported in the general ledger accounts.

Departmental-Level Adjustments. Denver Center personnel made a departmental-level adjustment, decreasing Construction in Progress by $20.0 million, without having supporting documentation. Weak internal controls over journal vouchers permitted such an entry to occur. Denver Center personnel stated the entry was erroneous; nevertheless, the entered amount had been included on the Statement of Financial Position.

GFM and CAM

The Denver Center did not properly account for GFM and CAM in the Air Force general ledger. The DoD Accounting Manual defines GFM as property acquired directly by the Government and made available to a contractor. On the other hand, CAM is property procured or otherwise provided by a contractor for the performance of a contract. The contractor acquires CAM at Government expense, but title to the material is vested with the Government.

The Air Force Chart of Accounts includes separate accounts for GFM and CAM. The Air Force Chart of Accounts defines GLA 146, "Material in Stores," as the accounting standard for Air Force-owned inventories on hand or in storage. That account applies to base stocks, medical inventories, contractor-held or Government-held GFM provided from inventories tracked by the Standard Base Supply Systems, and other Air Force-owned property. The GLA 164, "Procurement Source - Government Provided Material Held by Contractor," accounts for the standard price of CAM, acquired directly by contractors from vendors, the Defense Supply Agency (now the Defense Logistics Agency), or other sources except for supply system inventories. The CAM is paid for by Air Force appropriations and is generally incorporated in a manufactured end item.

The Defense Logistics Agency reported the value of GFM on all Air Force contracts at $4.353 billion, which included $2.275 billion for material on Air Force production contracts as detailed in the following table.

Table 2. Value of Government Material on Air Force Contracts
(billions)

	GFM	CAM	Total
Other Than Production	$1.548	$ .530	$2.078
Production	1.503	.772	2.275
Total	$3.051	$1.302	$4.353

The Denver Center reported only a portion ($1.503 billion) of the $4.353 billion reported by the Defense Logistics Agency for Government Material on Air Force Contracts and did not use the correct GLAs for accounting. The $1.503 billion was part of $3.9 billion reported in the financial statements as material held by contractors. The $1.503 billion was included in GLA 164 as GFM for production contracts; however, the Air Force Chart of Accounts specifically designated GLA 164 for CAM, not GFM. According to Denver Center personnel, the annual report provided by the Defense Logistics Agency did not adequately distinguish between GFM and CAM. Further, the Denver Center had developed guidance to record only GFM issued for Air Force production contracts in GLA 164, regardless of instructions provided in Air Force Regulation 700-20, volume I, part V, "Unclassified, Data Elements, Chains, and Codes," February 1, 1990. Denver Center personnel were under the impression that CAM was captured via progress payments billed by the contractors and entered into GLA 166, "Work in Process Under Progress Payments." Denver Center personnel did not make a separate entry for CAM.

Conclusion

The FY 1992 Air Force financial statements were the first to include Construction in Progress performed by the Corps of Engineers and the Naval Facilities Engineering Command; however, the Denver Center did not evaluate the reported data for validity. Because no requirement existed for Denver Center personnel to verify Construction in Progress, they did not identify the cost elements included in the amounts reported and had no records available to do so. The Denver Center made departmental-level adjustments to the general ledger without having adequate supporting documentation. In addition, the Denver Center did not properly account for GFM and CAM in the Air Force general ledger. Because of those factors, we have no assurance that Construction in Progress of $24.0 billion reported on the Statement of Financial Position is accurate.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service, negotiate a Memorandum of Agreement for the Defense Finance and Accounting Service-Denver Center between the U.S. Army Corps of Engineers and the Naval Facilities Engineering Command to ensure accurate and timely amounts are reported for major military Construction in Progress.

Management Comments. Management concurred with the recommendation. The Denver Center explained how they had received data in the past; however, it agreed that a Memorandum of Agreement between the Denver Center and the U.S. Army Corps of Engineers, and the Naval Facilities Engineering Command is required and will be developed.

Audit Response. The comments were responsive to the recommendation. No further comments are required.

2. We recommend that the Director, Defense Finance and Accounting Service-Denver Center, develop and implement changes in internal guidance to conform to DoD and Air Force regulations on the reporting of Government-Furnished Material and Contractor-Acquired Material in Air Force records.

Management Comments. Management nonconcurred with the recommendation. The Denver Center responded that in 1987 the former Air Force Accounting and Finance Center developed and implemented, as an interim solution, the current procedures for recording GFM and CAM. Denver Center personnel believe that the current Air Force General Fund General Ledger accounts used are correct and relate to the GFM and CAM accounts in the DoD Uniform Chart of Accounts. They state that the source for reported GFM is the Contractor Property Management System maintained by the Defense Logistics Agency.

Audit Response. Management comments were partially responsive. Both GFM and CAM were recorded to the wrong accounts. Air Force Regulation 700-20, volume I, part V, February 1, 1990, states GFM held by contractors should be accounted for in GLA 146. However, the Denver Center reports GFM in GLA 164, inconsistent with the Air Force Regulation. (Note: DFAS is currently using the Air Force Chart of Accounts to present the Air Force financial statements as discussed in Finding B. The Air Force regulation also states that GLA 164 should be used for CAM and that GLA 166 should be used for progress payments. The Denver Center was using GLA 166 to record CAM instead of GLA 164. In order for the Denver Center to have specific support for CAM and GFM, it needs to use the accounts provided by the Air Force. We ask that the DFAS respond to the final report. The DFAS comments should address how it will use GLAs 146, 164, and 166 to specifically identify GFM and CAM.

See Part IV for the complete text of management comments. Comments to the final report must be received by May 31, 1994. The chart below details specific requirements for those comments.

Response Requirements for Each Recommendation

Responses to the final report are required from the Denver Center for the item indicated with an "X" in the chart below.

Number	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
2.	X	X	X	IC

* IC = material internal control weakness.

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Part III - Additional Information

Appendix A. Air Force Audit Agency Audits of FY 1992 Financial Statements

Consolidated Air Force Financial Statements

92053011 - Review of FY 1992 Air Force Consolidated Financial Statements

General Funds

92053003 - Review of Military Payroll Process
92053004 - Review of the Civilian Payroll Process
92053007 - Review of Cash Operations
92053008 - Review of the Military Equipment Inventory Process - Aircraft
92053009 - Review of the Military Equipment Inventory Process - Satellites
92053010 - Review of the Liabilities Process
92053012 - Review of the Military Equipment Inventory Process - Guided and Ballistic Missiles
92053013 - Review of the Budget Allocation and Fund Control Process
92053014 - Review of the Operating Consumable Inventory Process
92053015 - Review of the Accounts Receivable Process
92053016 - Review of the Real Property Inventory Process
92053017 - Review of the General Fund Revenue Process
92053018 - Review of the Equipment and Vehicle Inventory Process
92053019 - Review of the General Fund Operating Expenditure Process
92053020 - Air Force Implementation of Section 4 (Accounting Systems) of the Federal Managers' Financial Integrity Act.
92053023 - Review of the Military Equipment Inventory Process - Uninstalled Engines

Trust Fund

92053022 - Review of the Trust Fund Financial Statement

Air Force Stock Fund

92068004 - Air Force Stock Fund Cost of Operations Division FY 1992 Financial Statement
92068010 - Audit of Air Force Supply Operations, General Support Division FY 1992 Financial Statements
92068012 - Audit of Air Force Supply Operations, Repairable Support Division FY 1992 Financial Statements
92068013 - Air Force Stock Fund Fuels Support Division FY 1992 Financial Statements
92068040 - Audit of Air Force Supply Operations, Systems Support Division FY 1992 Financial Statements

Air Force Industrial Fund

92068002 - Review of Depot Maintenance Industrial Fund FY 1992 Financial Statements
92068003 - Review of Laundry and Dry Cleaning Air Force Industrial Fund FY 1992 Financial Statements
92071002 - Air Force Airlift Services Industrial Fund FY 1992 Financial Statements

Logistical Financial Statements

92066002 - Review of the General and Application Controls Within the Equipment Inventory Accounting System
92066010 - Review of the General and Application Controls Within the Contract Depot Maintenance Production and Cost System

Appendix B. Summary Of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
A.1., A.2., A.3., A.5., A.6., A.7.	Internal Controls. Implementing proposed policies and procedures will improve reliability of Air Force financial data.	Nonmonetary
A.4.	Internal Controls. Performing reconciliations will improve fiscal accountability and management of Air Force appropriations.	Nonmonetary
B.1.	Compliance. Following current policies and procedures by implementing the DoD Uniform Chart of Accounts for the budget execution process will improve fiscal accountability and management of Air Force appropriations.	Nonmonetary
B.2.	Internal Controls. Proposed policies and procedures will improve fiscal accountability and management of Air Force appropriations.	Nonmonetary
B.3.	Compliance. Implementing proposed policy will improve financial statement data.	Nonmonetary
B.4.	Internal Controls. Performing reconciliations will improve fiscal accountability and management of Air Force appropriations.	Nonmonetary
C.	Internal Controls. Implementing proposed adjustments will improve the accuracy of future Statements of Operation.	Nonmonetary

Appendix B. Summary Of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
D.1.	Internal Controls. Negotiating a Memorandum of Agreement with other Services will provide more accurate and timely Construction in Progress data.	Nonmonetary
D.2.	Internal Controls and Compliance. Following current policies and procedures will improve the reliability of financial data related to GFM and CAM and accountability over progress payments.	Nonmonetary

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Comptroller of the Department of Defense
  Director of Financial Management Policy, Washington, DC

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Director of Budget Management and Execution, Washington, DC
Headquarters Air Force Materiel Command, Wright-Patterson Air Force Base, OH
  Aeronautical Systems Center
  Materiel Command Law Center
Air Mobility Command, Scott Air Force Base, IL
  Contract Airlift Management Division
  Office of the Staff Judge Advocate
Air Force Safety Agency, Norton Air Force Base, CA
Air Force Audit Agency
  Financial and Support Audits Directorate, March Air Force Base, CA
  Acquisition and Logistics Support Directorate, Wright-Patterson
    Air Force Base, OH

Defense Agencies

Headquarters Defense Finance and Accounting Service, Arlington, VA
  Defense Finance and Accounting Service Center, Denver, CO
Defense Logistics Agency, Alexandria, VA

Non-Defense Organizations

Federal Accounting Standards Advisory Board, Washington, DC
General Accounting Office, Washington, DC
  General Accounting Office, Dallas, TX

Appendix D. Report Distribution

Office of the Secretary of Defense

Assistant Secretary of Defense (Public Affairs)
Comptroller of the Department of Defense

Department of the Air Force

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

Defense Agencies

Director, Defense Finance and Accounting Service
  Director, Customer Service and Performance Assessment Deputate
Director, Defense Finance and Accounting Service, Denver Center

Non-Defense Organizations

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

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 Defense, Committee on Appropriations
- House Committee on Armed Services
- House Committee on Governmental Operations
- House Subcommittee on Legislation and National Security, Committee on Government Operations

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Part IV - Management Comments

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

WASHINGTON DC 20376 5001

JAN 13 1994

(Business Funds)

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE
INSPECTOR GENERAL, DOD

SUBJECT: DoD(IG) Draft Report, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," (Project No. 2FD-2006)

We have reviewed the subject report and attached are responses to the recommendations related to the Defense Finance and Accounting Service.

My point of contact is Mr. Bill deBardelaben. He may be reached at (703) 607-1581/1579 or DSN 327-1581/1579.

Daniel Turner
Deputy Director for Business Funds

Attachment

DoD(IG) Draft Report, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," (Project No. 2FD-2006)

Finding A. Systems Used to Prepare Financial Statements.

- **Recommendation 1, Page 15:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center, to develop and implement an integrated, double-entry, transaction-driven general ledger system for use in preparing the Air Force financial statements.

  DFAS Position: Concur. However, DFAS-DE does not agree with assertions that there have been no significant efforts to improve this weakness.

  The Denver Center has proposed a number of plans for developing an interim transaction-driven general ledger system. Essentially, these plans would modify or otherwise adapt existing systems to process general ledger transactions at the detail level as opposed to the summary posting technique currently in use.

  DFAS-DE recently developed the DFAS-DE Implementation/Modernization Plan 2000 (IMP 2000). The General Accounting and Finance System (GAFS) IMP 2000 blends Air Force information management and Defense Finance and Accounting Service financial systems into a comprehensive management information system. The goals of GAFS and IMP 2000 are to incrementally improve the accounting process and to:

  a. Meet General Accounting Office (GAO), Treasury, Office of Management and Budget (OMB) requirements for systems.

  b. Comply with the Chief Financial Officers (CFO) Act and Federal Managers Financial Integrity Act (FMFIA) requirements.

  c. Reduce the total number of financial systems.

  GAFS IMP 2000 is an evolutionary process that will start with FY 1995 and continue for 5 years. Estimated completion date: October 1999.

1 Attachment

- **Recommendation 2, Page 15:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to require Denver Center personnel to make all adjustments requested by Major Commands or justify deviations with properly supporting documentation supplying reasons for the noncompliance.

DFAS Position: Concur with intent. The Departmental General Funds General Ledger (GFGL) system has sufficient internal controls to maintain the integrity of the accounting data as reported by commands. Additionally, a spreadsheet was used to accumulate account balances from the GFGL which were reported on the CFO financial statements. Adjustments to these accounts from commands and from various departmental sources were included in this spreadsheet to compute adjusted finalized account balances. The spreadsheet included only those accounts which were used in the preparation of CFO statements. The GFGL is a report which is not provided to an outside source.

The Departmental GFGL consists of command account balances reported on a 100 percent cumulative basis versus a net change basis. At departmental level, no yearend close out of nominal accounts is accomplished. Instead, close out of nominal accounts is done at base level. This means beginning of period account balances are established at base level. The statement that "since the spreadsheet adjustments for FY 1992 were not included in the GFGL, the FY 1993 Financial Statements will be inaccurate" is not correct. The FY 1992 adjustments pertaining to FY 1993 were input to the FY 1993 GFGL by the appropriate accounting office.

When commands requested GFGL adjustments, the adjustments were entered on the spreadsheet to the extent that they impacted the CFO statements. Entries were not made on the spreadsheet for adjustments to income and equity accounts since income and equity were derived from the status of funds database rather than the GFGL.

Journal vouchers were prepared listing control and subsidiary accounts and in some cases, total debits and total credits may not equal. If only total control account debits and credits are added, the journal voucher will balance. The reason control and subsidiary shreds are listed on the journal vouchers is that the departmental GFGL system does not update the control accounts on the basis of subsidiary accounts. The Departmental GFGL system does balance control and subsidiary accounts once they are both input to the system.

The reason the command requested adjustments were not recorded exactly as they requested is that DFAS-DE had departmentally computed some adjustments the commands were also reporting. If the command requested adjustments were input with the departmental adjustments, a duplication of accounting data would have occurred. Estimated completion date: Closed.

Recommendation 3, Page 16: We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to develop internal controls to ensure proper control over the preparation, approval, tracking, and data entry of journal vouchers to provide complete, accurate, and reliable data as required by the DoD Manual 7220.9M, "DoD Accounting Manual."

DFAS Position: Concur. A change of branch supervisory personnel took place around the time the audited financial statements were being prepared and this resulted in a delay of supervisory approval. As vouchers were prepared, they were entered on the spreadsheet with a reference character, but the reference characters were not put on the journal vouchers. Since there were only 20 departmental journal vouchers, control of the journal vouchers was easily maintained and the risk of losing data was minimal.

A $20.0 million error discovered by the DoDIG auditors was an input error on the spreadsheet used to accumulate departmental adjustments. The error was discovered and corrected, but it was too late to revise the FY 1992 audited financial statements. The reference to several errors is incorrect. DFAS-DE is aware of only this one error.

Working within strict time constraints, several departmental adjustments were made to the GFGL before documentation was received and recorded. After the CFO statements were prepared and issued, documentation for those entries made without support was received. All GFGL adjustments eventually had supporting vouchers with source documentation.

Inputs to the spreadsheet used to accumulate GFGL account balances reported on the CFO financial statements were made at general ledger subsidiary account level and then rolled into the general ledger control account programmatically. The audit statement that the posting to the subsidiary account would misstate the control account is incorrect. Estimated completion date: None. Action Complete.

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17 **Recommendation 4, Page 16:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to require Denver Center personnel to perform Merged Accounting and Fund Reporting System reconciliations and make appropriate corrections.

DFAS Position: Concur with intent. However, the majority of the reconciliation differences are caused by erroneous base-level entries and their making entries to another appropriation without making the proper adjustments. Reconciliations are cleared at DFAS-DE where possible, but the majority require field adjustments. Additional supervisory control has been implemented departmentally to ensure bases are notified of the reconciliation differences. The reconciliations mailed to the bases will get first priority so the bases will have more time to get the corrections in the current report and the internal entries will be made last and entered into the DFAS-DE system. Additionally, a system change request has been prepared to automate reconciliations of the Monthly Package Report of Disbursements and Collection Transactions, RCS:HAF-ACF(M) 7113 and DFAS-DE data. Estimated completion date: October 1995.

17 **Recommendation 5, Page 16:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to develop and implement additional internal control procedures and operating instructions for the Denver Center personnel to use that specifically outline, in detail, procedures to verify that accounts receivable data reported is valid, accurate, and reconciled prior to consolidation and reporting.

DFAS Position: Concur with intent. For internal reporting, Air Force field activities prepare the 8108 public accounts receivable reports from field level source documents and forward them to their commands. Each command consolidates the 8108 information for their reporting entities and forwards it to DFAS-DE by operating agency code (OAC) and basic symbol. DFAS-DE personnel enter the 8108 information into a spreadsheet containing edits to ensure accuracy of amounts entered. All formulas in the spreadsheet were verified and corrected during the audit. The $1.0 million alleged overstatement identified in the audit is negligible, only 0.1 percent ($1/$806.8 = .0012) of the $806.6 million total gross public accounts receivable.

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DFAS-DE does not have all of the details necessary to accurately reconcile the public accounts receivable amounts. Field level activities must prepare and reconcile the 8108 reports based on source documents located at their locations. Currently, all 8108 reports received by the Denver Center must be legible and balance. If any 8108 reports are illegible or contain errors, the correct amounts are obtained over the phone and the applicable command must forward a legible and corrected report.

Regarding the finding "The Denver Center did not reconcile its contractor debt records to the MAJCOM contractor records." The Denver Center does not maintain detailed contractor debt records. It appears that the 7194 report reconciliation was accomplished during March or April 1993 for FY 1992. Monitoring and collection of delinquent contractor debt was transferred to DFAS-CO commencing with FY 1993.

Updated operating instructions (OI) are being developed. A more detailed outline currently exists. The new OI is still in draft because the requirements to comply with Treasury are changing and the new requirements will be considered before the document is completed. Estimated completion date: March 31, 1994.

Recommendation 6, Page 16: We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to establish procedures to adjust for yearend separation pay and other timing differences. 18

DFAS Position: Concur. We will establish procedures to adjust for yearend separation pay and other timing differences. Estimated completion date: December 30, 1994.

Recommendation 7, Page 16: We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to establish military pay system edits to reject transactions that exceed reasonable limits and require supervisory review of all manual inputs. 18

DFAS Position: Concur. System edits will be established to reject transactions that exceed tolerance limits and require supervisory review of unique transaction input. Estimated completion date: December 30, 1994.

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Finding B. Budgetary Data Used in Financial Statements.

23 **Recommendation 1, Page 21:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center to implement the DoD Uniform Chart of Accounts as required by the DoD 7220.9-M "DoD Accounting Manual," October 1983.

DFAS Position: Concur. Conversion to the DoD Uniform Chart of Accounts is included in IMP 2000 previously described. However, total conversion will span the 5-year time frame of IMP 2000. Estimated completion date: October 1999.

23 **Recommendation 2, Page 21:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center, to limit changes to field-reported accounting data to situations where adequate supporting documentation exists to justify the change.

DFAS Position: Concur with intent. Although DFAS-DE does not make unsupported adjustments to financial data presently, DFAS-DE has made adjustments based on verbal requests from commands (except for yearend processing). The policy changed in April 1993; all adjustments are now supported by messages, FAX, etc., from commands requesting adjustments to their reports. Additionally, DFAS-DE reconciles budgetary data (AF budget extract) to command reported accounting data. The process generates management notices which are reviewed, etc., by appropriation accountants. Estimated completion date: Closed.

23 **Recommendation 3, Page 21:** We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center, to use the general ledger data instead of budgetary data to prepare the financial statements.

DFAS Position: Nonconcur. The GFGL should be a single and accurate source of accounting and finance data. However, at this time, base-level GFGL reports contain significant errors due to inaccurate or incomplete compilation by base-level accountants. Therefore, DFAS-DE does not agree with the analysis that GFGL data are more accurate than budgetary data. Status of Funds (SOF) information is used because it is the most accurate information available. Additionally, Defense Contract Management Command provides contract status information monthly which is not available at base/command level at the time the Data Base Transfer (DBT) data are extracted. These data are input as a temporary adjustment to command DBT reports to improve overall accuracy of our SOF reports. There is no duplication; the negative values

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sent by DCMD are illogical and therefore not used. However, DFAS-DE does agree that DCMD numbers are not very reliable. DFAS-DE does not know what the $89.2 million or $8.1 million examples relate to.

Recommendation 4, Page 21: We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center, to reconcile the Air Force Accounting records to Fund Balance with Treasury and limit adjustments to valid changes supported by documentation. 24

DFAS Position: Nonconcur. DFAS-DE balances with Treasury every month. DFAS-DE does not make unsupported adjustments to balance with Treasury. If differences exist, they become undistributed lines on second level reports.

Finding C. Statement of Operations.

Recommendation, Page 27: We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center, to adjust the Statement of Operations to correct revenues, expenses, extraordinary items, and prior period adjustments applicable to Air Force operations. 30

DFAS Position:
REVENUES AND FINANCING SOURCES: Concur as to the amount, nonconcur as to the treatment that amount represents. Revenues were overstated by $424.5 million. The corrected amount for Revenues and Other Financing Sources, as included in the restated Consolidated Statement of Operations and Changes in Financial Position, is $200,802,033. The major part of the restated consolidated amount represents the change, or increase, in General Funds 7184 claims from September 30, 1991, to September 30, 1992, of $198,045,293. This amount of "revenue or financing source" is offset by an equal amount included in Bad Debts to record the increase in the contra evaluation or "allowance" account for General Funds 7184 claims. A contra evaluation or "allowance" account is used to offset the General Funds 7184 claims added to the Statement of Financial Position. This treatment on the Statement of Financial Position of an offsetting contra account prevents misstatement of the unexpended appropriations portion, or other portions , of net position. The treatment of offsetting amounts for current year changes in other revenues and financing sources and bad debts prevents misstatement of the net effect of current year changes in unexpended appropriations, or in other portions, of net position.

The treatment of including General Funds 7184 claims in the financial statements allows the Air Force to state that these claims are still "on the books" and "in the financial statements". This treatment answered the concerns of the DFAS-DE Director that these claims for refunds be included in the receivables reported in the FY 1992 statements. Estimated completion date: Closed.

EXPENSES: Nonconcur with the finding regarding lease expenses. DoD CFO Guidance does not require lease expenses to be reflected on a separate line on the Statement of Operations . Lease expenses are included in Program or Operating Expenses, Line 10, of the Statement of Operations. DFAS-DE was also advised by the Secretary of the Air Force, Real Property Management Office that Air Force property leases are always considered operating leases. Since Line 10 of the Statement of Operations included these expenses, operating expenses were not understated for FY 1992 by the $8.3 billion identified in the audit report.

Concur with the finding regarding accounting for destruction of assets. We restated FY 1992 financial statements to reflect "Decreases from Aircraft Crashes" of $524.6 million on the Statement of Operations. Neither our Status of Funds system or the general ledger specifically identify expenses related to rain damage. The audit identifies $2.9 million as rain damage expense, but does not indicate if the amount is destroyed assets or operating expenses associated with repairs. In any event, rain damage expenses are currently reflected in Line 10, Program or Operating Expenses, of the Statement of Operations and destroyed property are reflected on Line 24B, Net Decrease in Invested Capital. Estimated completion date: Closed.

Concur with the finding regarding bad debt expense. The restated amount of bad debt expense was $249.4 million for FY 1992. This is the amount that was used for the FY 1992 and FY 1993 comparative statements. Estimated completion date: Closed.

EXTRAORDINARY ITEMS: Concur with intent. Regarding natural disasters, we do not believe that nominal losses associated with a hurricane, rains or typhoons are extraordinary expenses for an area where such activity is a regular occurrence because of the location, and for an organization such as the Air Force with world wide operations. At the time FY 1992 statements were first prepared, estimates were not available as to the amount of losses at Homestead Air Force Base resulting from Hurricane Andrew. The restated FY 1992 Statement of Operations includes as a component the net change in invested capital line for, "Decrease from Natural Disasters" of ($592.9 million) which represent

losses at Homestead Air Force Base. Losses at Anderson Air Force Base due to Typhoon Omar are included in Line 10, Program or Operating Expenses and/or on Line 24B, Net Decrease in Invested Capital. Property Losses relative to Clark AFB occurred in FY 1991. As no invested capital was reported for Clark AFB at September 30, 1991, the effect of a total loss in FY 1991 was reflected in the September 30, 1991 balance of invested capital. Subsequent events indicate that some invested capital was salvaged and transferred to other military installations. The amount of such salvage has not been sufficiently determined to warrant reporting. We can only assume that some of the assets were transferred to other Air Force bases, and are included in their property and inventory accounts. All expenses associated with Clark's FY 1992 cleanup expenses are included in Line 10, Program or Operating Expenses. Estimated completion date: Closed.

Regarding decommissioning weapon systems, the audit report states that the estimated related costs of $143.3 million to decommission 80 Minuteman II missiles were not included on the Statement of Operations. Accrued expenditures are reflected on the Statement of Operations, Line 10, Program or Operating Expenses, from Line 16 (Accrued Expenditures) of the Report on Budget Execution. This report reflects all expenses incurred during the fiscal year. We cannot isolate the dollar value applicable to the cost of decommissioning weapon systems. We did not reflect the cost to decommission 80 Minuteman II missiles on a separate line, however, all current year expenses are reflected in budgetary records used to report accrued expenses. Also, the audit report does not identify if the $143.3 million are costs to turn off missiles, remove and relocate them, disassemble or inactivate them, or if it is a decrease in value relating to decommissioning. Estimated completion date: Closed.

PRIOR PERIOD ADJUSTMENTS: Concur with intent. Regarding change in estimate, the adjustment of $.2 billion is proper. The auditors are calling this prior period adjustment a change in estimate. The adjustment is not a change in estimate, but rather an adjustment to properly restate the FY 1991 unexpended balance. In FY 1991, all receivables reported on the 7184 Report (Selected Balances for Accrual Accounting) were entered into the departmental database. The receivables in this report except for travel debts were not considered proper for inclusion in the Status of Funds database during FY 1992. The departmental action of including them in the database, improperly increased unexpended appropriations. In FY 1992 the practice was corrected, and 7184 receivables entered into the departmental database only included travel debts. DFAS-DE's

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prior period adjustment was necessary to properly restate the unexpended appropriations portion of net position for FY 1991. In retrospect, DFAS-DE should have called the adjustment a Correction of Position (General) in lieu of Allowance. Estimated completion date: Closed.

The remaining prior period adjustments addressed in the audit report are reflected in the restated FY 1992 balances on the FY 1993 financial statements. The Construction-in-Progress (CIP) amount was increased from $7.2 billion to $7.8 billion to include CIP from Navy. Estimated completion date: Closed.

Other comments: The auditors stated, "Denver Center personnel believed that since they had not prepared financial statements in accordance with the CFO Act in prior periods, prior period adjustments were not always required." DFAS-DE strongly disagrees with this statement. The fact that DFAS-DE made prior period adjustments is prima fascia evidence that the auditor's statement is not based on fact. The reason these prior period adjustments were not made is that DFAS-DE did not have the audit findings to support the adjustments when the CFO statements were finalized on February 19, 1993. Also, the report states, "AFAA auditors were able to confirm the $26 billion estimate developed by the Denver Center" for correction of ammunition inventory. DFAS-DE was not aware of the confirmation until reading it in this draft DODIG audit report, and DFAS-DE is not in receipt of the confirmation by AFAA. However, DFAS-DE restated the FY 1992 ending property, plant, and equipment balance to reflect the $26 billion based on the DoDIG recommendation.

Finding D. Construction in Progress.

38 Recommendation 1, Page 32: We recommend that the Director, Defense Finance and Accounting Service negotiate a Memorandum of Agreement for the Defense Finance and Accounting Service - Denver Center between the U.S. Army Corps of Engineers and the Naval Facilities Engineering Command to ensure accurate and timely amounts are reported for major military Construction in Progress.

DFAS Position: Concur. To date, written and telephonic request to the U.S. Army Corps of Engineers and the Naval Facilities Engineering Command has enabled the acquisition of needed construction in progress information. However, a Memorandum of Agreement between DFAS-DE and the U.S. Army Corps of Engineers, and the Naval Facilities Engineering Command is required and will be developed. Estimated completion date: May 30, 1994.

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Recommendation 2, Page 32: We recommend that the Director, Defense Finance and Accounting Service direct the Director, Defense Finance and Accounting Service - Denver Center, to develop and implement changes in internal guidance to conform to DoD and Air Force regulations on the reporting of Government Furnished Material and Contractor Acquired Material in Air Force records. 38

DFAS Position: Nonconcur. In 1987, the former Air Force Accounting and Finance Center implemented the current procedures for recording the dollar value of GFM in the Air Force GFGL. The system was developed as an interim solution to the GFM accounting problem and will be replaced upon development and implementation of a DoD-wide property accounting system. DFAS-DE believes the current AF GFGL accounts it uses are correct and relate to the GFM and CAM accounts in the DoD chart of accounts. DFAS-DE obtains the AF GFM dollar value for recording in the GFGL from the Contractor Property Management System database maintained by the Defense Logistics Agency. Financial accounting for CAM is based on the policy contained in paragraph 31E14b(c), DoD 7220.9-M, DoD Accounting Manual. Current DoD Comptroller policy is that the basis for recording amounts for contractor acquired property shall be approved progress payment requests submitted by contractors. DFAS-DE accounting for CAM uses AF GFGL account 166, Work in Process Under Progress Payments. The CPMS database CAM amount which DoDIG recommends that DFAS-DE record in the AF GFGL is contractor acquired material which the contractor is required to maintain property control records for (exclusive of advances, progress payments, and partial payments) in accordance with the Federal Acquisition Regulation. DFAS-DE will not include the value of this category of CAM in accounting records unless DoD Comptroller changes its existing CAM accounting policy to include accounting for CAM that the contractor will request reimbursement for later in accordance with contract provisions.

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