Audit Report

OFFICE OF THE INSPECTOR GENERAL

CONSOLIDATING FINANCIAL STATEMENTS OF THE DEFENSE FINANCE AND ACCOUNTING SERVICE REVOLVING FUND OF THE DEFENSE BUSINESS OPERATIONS FUND - FY 1992

Report No. 93-110 June 11, 1993

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Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
FMFIA	Federal Managers' Financial Integrity Act
OMB	Office of Management and Budget

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

June 11, 1993

MEMORANDUM FOR SECRETARY OF DEFENSE
COMPTROLLER AND CHIEF FINANCIAL OFFICER OF
THE DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Consolidating Financial Statements of the Defense Finance and Accounting Service Revolving Fund of the Defense Business Operations Fund - FY 1992 (Report No. 93-110)

We are providing this audit report for your information and use, and for use by Congress. Financial statement audits are required by the Chief Financial Officers Act of 1990 (the CFO Act). Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General to render an opinion on the fairness of financial statements. Also, we are required to report on the adequacy of internal controls and compliance with laws and regulations.

Although we were able to evaluate the internal controls and compliance with laws and regulations, we were unable to express an opinion on the financial statements. We are disclaiming an opinion on the consolidating financial statements because of a scope limitation for which we were unable to apply other auditing procedures. Specifically, we could not ascertain the net value of property, plant, and equipment, which represented $111.7 million. Without establishing the value of property, plant, and equipment, we could not satisfy ourselves that either depreciation stated at $13.8 million or the transfer in of property, plant, and equipment shown at $75.6 million was reasonably accurate. In addition, the Defense Finance and Accounting Service did not provide us the required management and legal representation letters. The failure of management to provide the letters also constitutes a limitation of scope sufficient to compel us to disclaim an opinion.

We concluded that there were internal control weaknesses in reconciling the Fund Balances with Treasury and developing depreciation schedules. Also, we noted that the Defense Finance and Accounting Service was not in compliance with DoD Manual 7220.9-M, "DoD Accounting Manual," to reconcile the Fund Balances with Treasury, match property records with financial records for capital assets, record depreciation, and record the transfer of capital assets in financial records. The Defense Finance and Accounting Service also failed to disclose related party transactions required in Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies." Details of the weaknesses are discussed in Parts II and III of the report. This report contains no recommendations that are subject to resolution in accordance with DoD 7650.3, and accordingly, comments are not required.

The courtesies extended to the audit staff during the audit are appreciated. If you have any questions about this audit, please contact Mr. F. Jay Lane, Program Director, at (703) 693-0430 (DSN 223-0430) or Mr. Carl F. Zielke, Project Manager, at (703) 693-0453 (DSN 223-0453). The distribution of this report is listed in Part IV, Appendix C.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 93-110 June 11, 1993
(Project No. 2FG-2004)

AUDIT REPORT ON THE CONSOLIDATING FINANCIAL STATEMENTS OF THE DEFENSE FINANCE AND ACCOUNTING SERVICE REVOLVING FUND OF THE DEFENSE BUSINESS OPERATIONS FUND - FY 1992

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act requires an annual audit of funds such as the Defense Finance and Accounting Service (DFAS) Revolving Fund of the Defense Business Operations Fund (the Fund). The revolving Fund was created to provide finance and accounting services to DoD customers, charging them the full cost of those services. The DFAS was established in January 1991, consolidating the six finance and accounting centers of the Military Departments and the Defense Logistics Agency. The DFAS Centers are located in Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri. Another, the Washington Center, was closed at the end of FY 1992. At the end of FY 1992, the DFAS had a staff of about 11,000 people. The Fund reported revenues of $651.3 million and an operating surplus of $114.5 million for FY 1992.

Objectives. The primary objective of the audit was to determine whether the DFAS Consolidating Financial Statements for FY 1992 were presented fairly in accordance with generally accepted accounting principles for Federal entities. We evaluated the internal control structure established for the Fund and assessed compliance with laws and regulations that could have a material effect on the financial statements. We also determined the reliability and usefulness of financial information reported to the Office of Management and Budget (OMB), the Department of the Treasury of the United States (Treasury), the DoD, and Fund management.

Independent Auditor's Opinion. We are issuing a Disclaimer of Opinion on the financial statements. The DFAS had not completed a physical inventory of property, plant, and equipment in FY 1991 or FY 1992 to support the September 30, 1992, closing balance of $111.7 million. Further, reliable evidence supporting the cost of property, plant, and equipment acquired prior to January 1991 was no longer available. Those data also affected depreciation reported at $13.8 million and asset transfers reported at $75.6 million. Since we were not able to apply other auditing procedures to satisfy ourselves as to the cost of property, plant, and equipment, the scope of our audit was not sufficient to enable us to express, and we do not express, an opinion on those financial statements. In addition, we are disclaiming an opinion on the financial statements because we were not provided the necessary management and legal representation letters.

Internal Controls. Material internal control weaknesses existed. There were no procedures for reconciling the Fund Balances with Treasury, which caused an unreconciled difference of $15.8 million between the Cash Book of the Treasury and General Ledger of the DFAS. Also, depreciation schedules were not properly developed for capital assets of $153.0 million. Part II contains our report on material internal control weaknesses identified in our audit.

Compliance with Laws and Regulations. Material instances of noncompliance with regulations were disclosed. The DFAS did not comply with requirements to reconcile its Fund Balances with Treasury, match financial records to accounting records for capital assets, develop depreciation schedules for capital assets, record the transfer of assets, or make required financial disclosures. Part III discusses the material instances of noncompliance with DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983; Title 2 of the General Accounting Office, "Policy and Procedures Manual for Guidance of Federal Agencies," August 1987; OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993; and Comptroller of the Department of Defense memorandum, "Capital Asset Accounting Guidance for the Defense Business Operations Fund," July 21, 1992. Appendix A of Part IV lists all laws and regulations tested.

Usefulness of Financial Statements. The reliability and usefulness of the consolidating financial statements are questionable. Although we could not ascertain the overall accuracy of the statements, we did note control problems which affected the reported numbers and suspect that the statements do not fairly present an accurate picture of the DFAS financial position. Accordingly, the usefulness of the statements is in doubt. In any event, the audit will significantly improve the accuracy of future financial information and financial statements. Also, managers will have more accurate data for possible use in their decisionmaking processes. We have initiated Audit Project 3FG-2008, "Audit of Management Data Used to Manage the Defense Finance and Accounting Service Revolving Fund," to review this aspect in depth.

Management Comments. No recommendations were made because actions taken by management during the audit should resolve the weaknesses in internal controls and compliance with laws and regulations. We provided draft reports of Parts II and III to management on May 14, 1993, and asked for comments by May 28, 1993. None were received.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, (703) 614-6303 (DSN 224-6303).

Part I - Independent Auditor's Opinion on the Financial Statements

Introduction

The Defense Finance and Accounting Service (DFAS) Revolving Fund was created to provide finance and accounting services to DoD customers, charging them the full cost of providing those services. The DFAS was established in January 1991, consolidating the six finance and accounting centers that served the Army, the Navy, the Air Force, the Marine Corps, and the Defense Logistics Agency. The DFAS Centers are located in Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri. A sixth, the Washington Center, was closed at the end of FY 1992. At the end of FY 1992, DFAS had a staff of about 11,000 people. The Fund reported revenues of $651.3 million and an operating surplus of $114.5 million for FY 1992.

The Chief Financial Officers Act requires an annual audit of funds such as the DFAS Revolving Fund. As part of the Defense Business Operations Fund, the DFAS is required to produce Consolidating Financial Statements for FY 1992. Those statements are the responsibility of the DFAS. Our responsibility is to express an opinion on those Statements based on our audit.

Scope

We attempted to audit the Consolidating Financial Statements of the Defense Finance and Accounting Service (DFAS) Revolving Fund of the Defense Business Operations Fund as of and for the year ending September 30, 1992. The Consolidating Financial Statements include the Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. Also included are the Footnotes, Overview, and Supplemental information.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements, including accompanying notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Statement presentation. We developed client profiles for each DFAS Center and developed cycle memorandums that assessed the internal control structure for the fund balances with Treasury, procurement, revenue, expenditure, capital assets, accounts receivable, and payroll. This financial statement audit was made during the period November 1991 through April 1993. See Appendix B of Part IV for the activities visited or contacted. Also, we performed substantive testing of each financial statement account. We believe that our audit efforts provide a reasonable basis for our results.

Limitations on scope impeded our attempts to audit the statements. The DFAS did not complete an inventory of property, plant, and equipment in FY 1991 or

FY 1992, shown in the financial statements at $111.7 million as of September 30, 1992. Further, reliable evidence supporting the cost of property, plant, and equipment acquired prior to January 1, 1991, is no longer available. Those data also affect depreciation reported at $13.8 million and asset transfers reported at $75.6 million. The DFAS records do not permit the application of other auditing procedures to satisfactorily test the property, plant, and equipment account. Also, we requested management and legal representation letters from the DFAS. Because management failed to provide the letters, there was a further limitation on scope.

Auditing Standards

We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Consolidating Statements are free of material misstatements.

Accounting Principles

Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal entities are to be promulgated by the Joint Financial Management Improvement principals, based on advice from the Board. In the interim, Federal agencies are to use a comprehensive basis of accounting as defined in OMB Bulletin No. 93-06. The summary of significant policies included in the Notes to the Consolidating Statements describes the accounting principles and methods of applying those principles that management has concluded are the most appropriate for presenting the DFAS Revolving Fund's significant assets, liabilities, net position, results of operations, cash flows, and reconciliation to the budget.

Disclaimer of Opinion

Since the DFAS did not complete a physical inventory of property, plant, and equipment and we were not able to apply other auditing procedures to satisfy ourselves as to the cost of property, plant, and equipment, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements. We also requested management and legal

representation letters from the Defense Finance and Accounting Service on March 17, 1993. The representation letters are part of the evidential matter necessary to afford a reasonable basis for our opinion on the financial statements. We have not received the representation letters: specifically, the Fund manager and legal counsel have not responded. The failure of management to provide the letters constitutes another scope limitation and further basis for disclaiming an opinion on the financial statements.

Additional Information

During the course of our audit we reported several deficiencies to DFAS management in the form of a Management Advisory Memorandum (Part VI), issued on October 14, 1992. The deficiencies included inaccurate inventory records, noncompliance with capital assets policy, failure to disclose the value of services and use of facilities provided at no cost to the DFAS, overstatement of accounts payable, and lack of written support agreements. The DFAS provided written comments on September 2, 1992. Management concurred with all recommendations and initiated action on these problems; however, several resulting changes were still being completed at the conclusion of our field work. We also reviewed the financial information presented in management's "Defense Finance and Accounting Service-Financial Operations Defense Business Operations Fund Overview" for FY 1992. Such information has not been audited by us; accordingly, we do not express an opinion on this information.

Part II - Internal Controls

Introduction

We audited the internal controls structure of the Defense Finance and Accounting Service (DFAS) Revolving Fund (the Fund) of the Defense Business Operations Fund for the year ended September 30, 1992. Such audits are a requirement of the Chief Financial Officers Act of 1990.

Management of the DFAS is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that the following are met.

o Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets.

o Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

o Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the consolidating statements, and any other laws and regulations that the Office of Management and Budget (OMB), entity management, or the Inspector General, Department of Defense, have identified as being significant for which compliance can be objectively measured and evaluated.

o Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Objectives and Scope

The objective of the audit was to determine whether material internal control weaknesses existed.

In planning and performing our audit of the Fund for the year ending September 30, 1992, we evaluated the Fund's internal control structure. The purposes of this evaluation were to determine our auditing procedures for expressing our opinion on the Consolidating Statements and to determine whether the internal control structure was established to ensure that the statements were free of material misstatements. We obtained an understanding of the internal control policies and procedures and assessed the level of control

risk relevant to all significant cycles, classes of transactions, and account balances. For those significant control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed.

For the purpose of this report, we have classified the significant internal controls, policies, and procedures into the following categories: cash, procurement, expenditures, capital assets, revenue, payroll, and reporting. Our consideration of the internal control structure included all of the categories. Our consideration of the internal control structure would not necessarily disclose all matters that might be reportable and, accordingly, would not necessarily disclose all conditions that are also considered to be material weaknesses. Conditions discussed will have a material effect on the FY 1992 DFAS Consolidating Statements. The conditions were reported by the DFAS to the DoD in its Federal Managers' Financial Integrity Act Annual Statement for FY 1992, dated November 19, 1992.

We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Consolidating Statements are free of material misstatements.

Prior Audit Coverage

There have been no prior audits of the internal controls of the DFAS Fund.

Results of Audit

Internal control weaknesses existed that we consider to be material and reportable conditions under standards established by OMB Bulletin 93-06. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information to manage and evaluate operational performance. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors would be in amounts that would be material in relation to the statements being audited, or

material to a performance measure or aggregation of related performance measures, and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We found that procedures were not in place for reconciling the Fund Balances with Treasury and that depreciation schedules were not properly developed for capital assets of $153.0 million.

Reconciliation of Fund Balances with Treasury. Internal controls did not ensure that the $121.0 million Fund Balance with Treasury shown on the Statement of Financial Position was reasonably stated. The General Ledger showed $136.8 million, an unreconciled difference of $15.8 million. The DoD Manual 7220.9-M, "DoD Accounting Manual," Chapters 14 and 31, require that these accounts be reconciled. No reconciliations had been performed in FY 1992, and DFAS personnel could not recall when the last reconciliation had been performed.

Depreciation Schedules. Internal control procedures did not exist for developing depreciation schedules. The Comptroller of the Department of Defense memorandum, "Capital Asset Accounting Guidance for the Defense Business Operations Fund," July 21, 1992, requires that depreciation schedules be developed for capital assets. During our audit, depreciation schedules for capital assets of $153.0 million were being developed, but they had not been completed at the end of our field work on April 20, 1993. Accordingly, depreciation, shown as $13.8 million, was understated. Because the physical inventory reconciliation and matching to the financial records had not been completed by the DFAS, we could not determine the amount of the understatement.

Part III - Compliance with Laws and Regulations

Introduction

We tested the Defense Finance and Accounting Service (DFAS) Revolving Fund (the Fund) of the Defense Business Operations Fund for material instances of noncompliance with laws and regulations for the year ended September 30, 1992. Such tests are required by the Chief Financial Officers Act of 1990.

Objectives and Scope

The objective of the audit was to determine whether material instances of noncompliance with laws and regulations existed. Material instances of noncompliance are failures to follow requirements of, or violations of prohibitions contained in, laws and regulations. Such failures or violations are those that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Consolidating Statements, or those whose sensitive nature would cause them to be perceived as significant by others.

Compliance with laws and regulations applicable to the DFAS is the responsibility of DFAS management. As part of obtaining reasonable assurance about whether the DFAS Consolidating Statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements and certain other laws and regulations designated by the Office of Management and Budget (OMB) and the DoD (see Appendix A of Part IV). As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA). We compared the audited entity's most recent FMFIA reports with the evaluation we conducted on the entity's policies, procedures, and systems for documenting and supporting financial, statistical, and other information as presented to us in the Overview and Supplemental sections of the financial statements. Our objective, however, was not to provide an opinion on overall compliance with such provisions.

We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance that the DFAS Consolidating Statements are free of material misstatements.

Prior Audit Coverage

There have been no prior audits of compliance with laws and regulations related to the DFAS Fund.

Results of Audit

The results of our tests of compliance disclosed the following instances of noncompliance that materially affected the reliability of the DFAS Consolidating Statements.

Reconciliations of Fund Balances with Treasury. Chapters 14 and 31 of DoD Manual 7220.9-M, "DoD Accounting Manual," require that the Fund Balances with Treasury be reconciled between the agency's records and records of the Department of the Treasury (the Treasury). The DFAS had not reconciled the Fund Balances with Treasury in FY 1992. DFAS personnel could not recall when the last reconciliation had been made. Accordingly, there was an unreconciled difference of $15.8 million between the Treasury's Cash Book (which showed $121.0 million) and the agency's General Ledger (which showed $136.8 million).

Matching Property Records to Financial Records. Chapters 31 and 36 of DoD Manual 7220.9-M require that physical inventories be performed and matched to the accounting records at least annually. Differences are to be researched and adjustments documented. The DFAS had not completed a physical inventory in FY 1991 or FY 1992; however, it was in the process of completing a physical inventory at the completion of our field work on April 20, 1993. We identified at least $13.3 million more in property, plant, and equipment than the $153.0 million reported on the Fund's financial statements at September 30, 1992. Inventory records showed assets valued at $166.3 million for the period ending September 30, 1992. That amount did not include inventory corrections from three of the five DFAS Centers.

Recording Depreciation. Guidance from the Comptroller of the Department of Defense, "Capital Asset Accounting Guidance for the Defense Business Operations Fund," July 21, 1992, requires that depreciation schedules be developed for capital assets based on established useful life criteria as set forth in the guidance memorandum. Depreciation could not be accurately determined until inventory records were corrected and values compared to supporting documentation. The DFAS reported only $263,881 in depreciation expense for the $77.4 million of capital assets purchased in FY 1992, while reporting $13.5 million in depreciation expense on assets transferred in having an original acquisition value of $75.6 million. The DFAS arbitrarily used 4 months depreciation and a useful life of 10 years to calculate depreciation expense of $263,881 on $7.9 million of equipment shown as purchased and in use in

FY 1992 (General Ledger Account Code 150.120). Based on the financial records, the DFAS determined that $69.5 million of assets purchased in FY 1992 were not in use. Accordingly, the amounts reported on the financial statements for property, plant, and equipment, net ($111.7 million), and depreciation ($13.8 million), were understated.

Transfer of Assets. The DoD Manual 7220.9-M, Chapter 52, and memorandum guidance from the Comptroller of the Department of Defense, "Capital Asset Accounting Guidance for the Defense Business Operations Fund," July 21, 1992, require that assets be transferred to the Fund at the original acquisition cost. The DFAS had not transferred in assets assigned to the central design activities and information processing centers capitalized to the DFAS on January 15, 1991, nor did the DFAS transfer the assets out to the Defense Information Technology Services Organization (DITSO) established on May 18, 1992. All assets assigned to the central design activities and information processing centers were to be capitalized to the DITSO when it was established on May 18, 1992. We identified $126.5 million in assets that should have been transferred into the Fund on October 1, 1991, and transferred out to the DITSO on May 18, 1992. This caused depreciation expense for the DFAS to be understated on these assets for about 7.5 months use (by $15.8 million) in FY 1992. Excluding the $126.5 million in DITSO assets, at least $13.3 million more of assets was shown on the various DFAS Centers' inventory records than was shown on the Fund's financial statements. Accordingly, the net value of property, plant, and equipment shown at $111.7 million will require adjustment in FY 1993, when the physical inventory has been completed and the inventory records are matched to supporting documentation and financial records.

Disclosure of Related Party Transactions. The General Accounting Office, Title 2, "Policy and Procedures Manual for Guidance of Federal Agencies," August 1987, requires disclosure in the financial statements or footnotes of significant transactions between Federal entities that materially impact the information presented in the financial statements. The disclosure enables users of the financial statements to assess the impact of the transactions on agency operations and compare results to what would have resulted if the transactions had been conducted at fair value. The DFAS did not disclose the value of the use of the facilities at three of the five DFAS Centers provided at no cost in FY 1992. The estimated value of the free use of these facilities was about $27.0 million, based on the average rate for those areas provided by the General Services Administration. This estimate takes into consideration that the DFAS paid maintenance and other fees, such as lights, heat, etc. The General Services Administration determined that those fees are equal to about 25 percent of the total value ($36 million) of the facilities. In addition, $9.5 million in "free" services provided to the DFAS-Columbus Center and its field offices in FY 1992 was not disclosed.

The results of our tests of compliance indicated that, with respect to the items tested, the DFAS did not comply with the provisions of the DoD Accounting

Manual. Therefore, the resulting conditions could have a material effect on the FY 1992 financial statements and affected our opinion on the Fund's financial statements. With respect to items not tested, nothing came to our attention to cause us to believe that the DFAS had not complied, in all material respects, with those provisions.

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Part IV - Additional Information

Appendix A. Laws and Regulations

Federal Managers' Financial Integrity Act of 1982, Public Law (P.L.) 97-255

Prompt Payment Act of 1988, P.L. 100-496

Chief Financial Officers Act of 1990, P.L. 101-576

Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies," August 1987

Office of Management and Budget (OMB) Bulletin 93-02, "Form and Content of Agency Financial Statements," October 22, 1992

OMB Circular A-123, "Internal Control Systems," August 4, 1986

OMB Circular A-125, "Prompt Payment," December 12, 1989

OMB Circular A-127, "Financial Management Systems," December 19, 1984

DoD Directive 5010.38, "Internal Management Control Problem," April 14, 1987

DoD Manual 7110.1, "DoD Budget Guidance," October 30, 1980

DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983

Appendix B. Activities Visited or Contacted

Office of the Secretary of Defense

Deputy Comptroller of the Department of Defense (Management Systems), Washington, DC

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Washington, DC
- Defense Finance and Accounting Service Center, Cleveland, OH
- Defense Finance and Accounting Service Center, Columbus, OH
- Defense Finance and Accounting Service Center, Denver, CO
- Defense Finance and Accounting Service Center, Indianapolis, IN
- Defense Finance and Accounting Service Center, Kansas City, MO
- Defense Finance and Accounting Service Center, Washington, DC

Non-DoD Federal Organizations

Office of Management and Budget, Washington, DC
Department of the Treasury, Washington, DC
General Accounting Office, Washington, DC

Appendix C. Report Distribution

Office of the Secretary of Defense

Assistant Secretary of Defense (Public Affairs)
Comptroller and Chief Financial Officer of the Department of Defense
Deputy Chief Financial Officer of the Department of Defense

Department of the Army

Secretary of the Army
Inspector General, Department of Army
Auditor General, U.S. Army Audit Agency

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Auditor General, Naval Audit Service

Department of the Air Force

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

Defense Agencies

Director, Defense Finance and Accounting Service

Non-DoD Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
  NSIAD Technical Information Center

Non-DoD Federal Organizations, (cont'd)

Chairman and Ranking Minority Member of each of the following Congressional Committees:

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 Service
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

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Part V - Consolidating Financial Statements of the Defense Finance and Accounting Service Revolving Fund of the Defense Business Operations Fund - FY 1992

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON DC 20301 1100

APR 8 1993

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Transmittal of Printed Financial Statements on FY 1992 Financial Activity

Attached are printed financial statements on FY 1992 financial activity for the Department of Defense reporting entities listed below. The printed copies are bound, have a common typeset and have been edited by the Defense Finance and Accounting Service - Indianapolis Center. The attached statements encompass the following reporting entities:

- Department of the Army (all funds and accounts)
- Department of the Navy (revolving and trust funds)
- Department of the Air Force (all funds and accounts)
- Defense Logistics Agency Revolving Funds
- Pentagon Reservation Maintenance Revolving Fund
- Defense Revolving Funds (Army as Executive Agent)
- DoD Military Retirement Trust Fund
- DoD Education Benefits Fund
- National Security Education Trust Fund
- Defense Commissary Surcharge Collections Account
- Defense Security Assistance Agency

My staff is available to provide additional assistance and information, if needed. Additionally, the Department will continue to work with your staff to make such adjustments or improvements as may be identified, and appropriate, to enhance, explain, or more fairly present the assets, liabilities, and net financial position shown in the attached unaudited financial statements.

Alvin Tucker
Acting Chief Financial Officer

Attachments

DEFENSE FINANCE AND ACCOUNTING SERVICE-FINANCIAL OPERATIONS DEFENSE BUSINESS OPERATIONS FUND

OVERVIEW

MESSAGE FROM THE ACTING DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

Enclosed are the Defense Finance and Accounting Service (DFAS) Financial Statements for fiscal year 1992--the first full fiscal year of operations for this new organization. The DFAS operates under the Defense Business Operations Fund whereby financing is provided by users Emphasis within DFAS is increasingly on service to our customers.

During FY 1992, DFAS consisted of several Centers and a Headquarters staff performing centralized finance and accounting services for all DoD components. FY 1992 was also a year of organizational change for DFAS. We reduced the number of Centers from six to five. Also, most DFAS information management functions were transferred to a new Defense Business Operations Fund business area, the Defense Information Technology Service Organization.

In spite of rapid changes in the environment, the DFAS mission was successfully accomplished during FY 1992. During FY 1992, DFAS played a key role in the DoD-wide implementation of various new laws including the Chief Financial Officers Act of 1990 and legislation which abolished merged accounts.

In FY 1992 DFAS started standardization and consolidation of finance and accounting systems, procedures and operations which will produce large savings in future years. These actions included recommendation of interim migratory systems and, after DoD Comptroller selection, preparation for their implementation. Major progress was also made toward developing Corporate Information Management functional requirements for the finance and accounting systems for the longer term. Another major accomplishment in FY 1992 was the initiation of a competitive process to select locations where the finance and accounting Centers of the future will be located.

Plans were finalized in FY 1992 for capitalizing field finance and accounting functions under DFAS to implement Defense Management Report Decision 910. This will more than double the size of DFAS during FY 1993. The actual capitalization of field finance and accounting functions has already started and will continue through FY 1993 into FY 1994.

The DFAS has met all challenges to date. I am confident that we will meet the challenges ahead and achieve our goal of providing better finance and accounting support to our customers at substantially lower cost.

John P. Springett
Acting Director

DEFENSE FINANCE AND ACCOUNTING SERVICE - FINANCIAL OPERATIONS DEFENSE BUSINESS OPERATIONS FUND OVERVIEW

Description of the Reporting Entity

These Financial Statements report on the operations of the Defense Finance and Accounting Service (DFAS) - Financial Operations business area of the Defense Business Operations Fund for fiscal year 1992.

The Financial Statements include all aspects of DFAS commercial function operations. The Financial Statements do not include any other appropriated, trust or revolving funds.

Mission and goals

DFAS was activated in January 1991 to improve finance and accounting service and reduce costs by adopting standard policies, procedures, forms, data and systems; streamlining and consolidation operations; and eliminating redundancies. DFAS was composed originally of six finance and accounting centers situated across the country as well as a small headquarters located in the Washington, DC area. It encompasses former Army, Navy, Air Force, Marine Corps, Defense Logistics Agency (DLA), and Washington Headquarters Services finance and accounting headquarters. Prior to the establishment of DFAS, each military Service operated its own finance and accounting headquarters, focused on its own requirements, and used its own unique systems. Initially, the focus of the individual Centers did not change. Centers which were created to provide pay and financial management support to a single military department or agency have continued to provide that dedicated support. But, as DFAS standardization and consolidation initiatives are implemented, Center missions are expanding and changing to support functions throughout DoD.

Based on the success experienced by DFAS in its first year of operations, the Department of Defense decided in December 1991 that DFAS would assume management responsibility for the finance and accounting functions of DoD components. Additionally, DFAS will finish the job of consolidating DoD finance and accounting by consolidating finance and accounting functions into a limited number of locations. Through consolidation, DoD will realize significant savings.

Over 13,000 finance and accounting employees, at more than 300 locations, will become an integral part of DFAS during FY 1993. Additional personnel will be subsumed from other agencies as DFAS continues to consolidate and standardize DoD finance and accounting operations. These functions and employees will be centralized and relocated to a limited number of finance centers throughout the country over the next several years.

I-6-6 Overview

In addition to consolidating operations, DFAS is also consolidating and standardizing policy and procedures. Over 70,000 pages of regulations in 360 publications are being streamlined into a single set of 15 volumes of DoD financial manuals. This will result in a 72 percent reduction in the number of pages of regulations. At least 10 of the 15 volumes will be completed in FY 1993; several are already done. Significant progress has also been made toward adoption of a DoD-wide standard budget and accounting code structure.

DFAS has made significant strides in the area of system standardization. For example, DFAS will pay all military retirees and annuitants with a single system. A single civilian payroll system, a single travel payment system, a single transportation system, a single debt management system, and a single accounting system for the Defense Business Operations Fund have been selected as well. Through similar initiatives, DFAS expects DoD finance and accounting to be increasingly standardized over the next five years, resulting in substantial savings for the taxpayer. DFAS is well on its way to achieving the goal of $150 million annual savings by 1996.

DFAS Corporate Information Management efforts are also under way to document improved functional requirements in the form of data and process anodes for future enhancements to finance and accounting systems.

Types and numbers of people benefiting from DFAS	
Civilian Accounts Maintained:	88,227
Active Military Accounts Maintained:	2,142,704
Retired Military Accounts Maintained:	1,924,150
Reserve Military Accounts Maintained:	1,259,815

Accounts maintained do not correspond exactly to the number of military on-board due to changes due to accessions and separations.

In addition to paying personnel, DFAS' mission of providing accounting and finance procedures and practices impacts on all the finance and accounting offices and operations within DoD.

Size of Program As of September 30, 1992

Obligations:	$689 million
Personnel employed:	
Civilian:	10,599
Military:	408

Population Served: All DoD finance and accounting offices and operations.

Organization

Headquarters, Washington, DC

DFAS Cleveland, Cleveland, Ohio

DFAS Columbus, Columbus, Ohio

DFAS Denver, Denver, Colorado

DFAS Indianapolis, Indianapolis, Indiana

DFAS Kansas City, Kansas City, Missouri

All of the above activities directly support DFAS' major programs which promote overall effective and efficient finance and accounting services during times of peace and conflict.

Source of funds

During FY 1992, the principal source of funds for DFAS was revenue received from the DoD Components for which DFAS performed accounting and finance services. The sources of DFAS revenue were as follows:

	Amount
Air Force	$132,077,241.19
Army	213,282,840.03
Navy	164,744,517.04
Department of Defense (DoD)	138,994,027.36
Non-DoD	2,201,127.57
Total	$651,299,753.19

I-6-8 Overview

PROGRAM PERFORMANCE MEASURES

Retired Military Pay:

Percent of initial claims processed within 30 days.

Center	FY 92 Monthly Average	Weighing (see below)
Cleveland	93.4 %	X 25.5 = 2,381.7
Denver	99.3 %	X 33.7 = 3,346.4
Indianapolis	87.5 %	X 35.3 = 3,088.8
Kansas City	88.1 %	X 5.5 = 484.6
		9,301.5/100
Overall DFAS weighted average:	93 %	

Percent of inquiries to total accounts maintained.

Center	FY 92 Inquiries	FY 92 Total Accounts	%
Cleveland	368,400	5,857,000	6.3
Denver	15,800	7,737,000	.2
Indianapolis	67,700	8,094,000	.8
Kansas City	7,200	1,263,000	.5
Total DFAS	459,100	22,951,000	2%

Weighing

CL: 5,857/22,951 = 25.5
DE: 7,737/22,951 = 33.7
IN: 8,094/22,951 = 35.3
KC: 1,263/22,951 = 5.5

FINANCIAL PERFORMANCE MEASURES

Retired Military Pay:

Cost per retired military pay account maintained.

Center	FY 92 Cost	Total Accounts	FY 92 Unit
Cleveland (CL)	$11,512,000	5,857,000	1.92
Denver (DE)	15,991,100	7,739,300	2 07
Indianapolis (IN)	12,181,500	8,094,000	1.51
Kansas City (KC)	3,565,100	1,262,800	2.82
Total DFAS	$43,249,700	22,953,100	1.88

Weighing

CL: 1.92 X 25 5 = 48.96
DE: 2.07 X 33.7 = 69.76
IN: 1.51 X 35.3 = 53.31
KC: 2.82 X 5.5 = 15.51
187.54/100 = 1.88

I-6-10 Overview

DFAS ISSUES OF THE 1990'S

The DFAS is a service organization and must be flexible to meet the changing needs of customers supported with efficient operations in peacetime and the capability to expand rapidly to meet any type of military emergency. If, as expected, the size of the military establishment is reduced, the workload of DFAS will also be reduced. As user funding becomes operational, major efforts will be required to adjust operations to produce only cost effective products that are required by law or for which customers want and are willing to pay.

The Finance and Accounting business processes will be revolutionized in the 1990's, both vertically within the finance and accounting functional areas and laterally across functional lines. The business processes will be improved on a phased basis in conjunction with fielding migratory systems and evolvement of new systems implementing Corporate Information Management functional requirements and concepts. Finance and accounting systems will be standardized and integrated and operations will be centralized in a small number of locations. Use of technology will be applied to reduce or eliminate paper and improve efficiency. At the same time, the quality of service and internal controls will be improved. This will involve substantial reductions in personnel and require some relocations of people in the work force. However, a higher level of technical and professional qualifications will be required of the remaining staff.

One of the challenges will be downsizing staff with minimum impact on people and operations while upgrading the qualification of the remaining work force. With so much change going on both within DFAS and the organizations we serve, the environment will be highly vulnerable to breakdowns. Extraordinary measures will be required to avoid breakdowns in internal controls and services as standard migratory systems are implemented and operations are relocated to central sites. We must develop a capability to deal rapidly with problem areas and staffing imbalances.

As implementation of the Chief Financial Officers Act progresses, more focus will be placed on management of budget execution. A closer relationship should evolve between the budget and accounting reports, including audited financial statements. Both budgeting and accounting will become more oriented to performance measures. The operating personnel within DFAS must gain a broader and deeper understanding of agency missions to accommodate this transition.

The DFAS has made remarkable progress within the past two years toward consolidating and standardizing finance and accounting within DoD while at the same time accommodating numerous new requirements. Change is accelerating and major new issues and challenges are ahead.

OPERATING EFFICIENCY
UNIT COST GOALS TO ACTUALS

	GOAL	ACTUAL	PERCENT VARIANCE
Civilian Pay Accounts Maintained per Month	7.96	6.63	0.82
Civilian Pay Accounts Maintained per Month - DeCA	14 53	12.23	0.84
Active Military Pay Accounts Maintained per Month	4.48	4 70	1.05
Retired Military Pay Accounts Maintained per Month	2.01	1.96	0 98
Reserve Military Pay Accounts Maintained per Month	1.73	1.70	0.98
Contract Invoices Paid - MOCAS	67.85	70.40	1.04
Travel Voucher Paid	20.51	20.21	0.99
Transportation Bill Paid	5.67	6.07	1.07
Commercial Invoice Paid	19 41	20.77	1.07
Out-of-Service Debt Case Closed	287.02	112 46	0.39
Trial Balance Preparation	1915.20	2058.94	1.08
Monthly A&F Support Per Commissary	2388.58	2284.29	0.96
Contract Invoice Paid - SAMMS	26.57	25.67	0.97

Dollars in Thousands

Departmental Level Accounting	$46,000	$45,013	0.98
Network Support - Systems	$56,900	51,393	0.90
Network Support- Policy	$23,600	$22,902	0.97
Over-ocean Transportation	$600	$548	0.91
Support to Others	$26,400	$25,585	0.97
FMS Accounting & Finance Support	$21,800	$21,677	0.99
Problem Area Teams	$1,900	$1,876	0.99
DMRD 910	$4,000	$4,151	1.04

Total Earned Authority	$594,200
Total Obligations	$565,370
Difference	$28,830 or 95.1 %

I-6-12 Overview

In its first year of operation under the unit cost concept, DFAS was able to successfully execute under its total program. While there were variances between program and actual obligations by output, the overall execution remained on-track and within reasonable limits. In fact, most of the difference between program and obligations resulted from one output - Out-of-Service Debt. Additional year-end workload in this category generated excess earned authority which was efficiently handled without a commensurate increase in costs. DFAS placed significant emphasis on unit cost management in FY 1992 and will continue to do so in the future.

DEFENSE FINANCE AND ACCOUNTING SERVICE - FINANCIAL OPERATIONS DEFENSE BUSINESS OPERATIONS FUND

FINANCIAL STATEMENTS

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Financial Position
as of September 30, 1992
(Dollars)

ASSETS	1992
1. **Financial Resources:**	
a. Fund Balances with Treasury (Note 2)	$120,954,990
b. Cash (Note 2)	
c. Foreign Currency (Note 2)	
d. Other Monetary Assets (Note 3)	
e. Investments, Non-Federal (Note 4)	
f. Accounts Receivable, Net - Non-Federal	170,000
g. Inventories Held for Sale, Net (Note 5)	
h. Loans Receivable, Net - Non-Federal (Note 6)	
i. Advances and Prepayments, Non-Federal	533,062
j. Property Held for Sale (Note 7)	
k. Other, Non-Federal (Note 8)	
l. Intragovernmental Items:	
(1) Accounts Receivable, Federal	46,800,200
(2) Loans Receivable, Federal	
(3) Investments, Federal (Note 4)	
(4) Other, Federal	
m. **Total Financial Resources**	$168,458,252
2. **Non-Financial Resources:**	
a. Resources Transferable to Treasury	
b. Inventories Not Held for Sale (Note 5)	
c. Property, Plant and Equipment, Net (Note 9)	111,729,351
d. Other (Note 10)	
e. **Total Non-Financial Resources**	$111,729,351
3. **Total Assets**	$280,187,603
LIABILITIES	
4. **Funded Liabilities**	
a. Accounts Payable, Non-Federal	26,420,033
b. Accrued Interest Payable	
c. Accrued Payroll and Benefits	3,907,184
d. Accrued Entilement Benefits	
e. Lease Liabilities (Note 11)	
f. Debt (Note 12)	
g. Guarantees Payable (Note 6)	
h. Other Funded Liabilities, Non-Federal (Note 13)	

The accompanying notes are an integral part of these statements.

V-6-4 Financial Statements

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Financial Position
as of September 30, 1992
(Dollars)

LIABILITIES Continued	1992
i. Intragovernmental Liabilities	
(1) Accounts Payable, Federal	$67,004,671
(2) Debt (Note 12)	
(3) Deferred Revenue	
(4) Other Funded Liabilities, Federal (Note 13)	
j. **Total Funded Liabilities**	$97,331,888
5. **Unfunded Liabilities:**	
a. Accrued Leave (Note 15)	20,104,399
b. Lease Liabilities (Note 11)	
c. Pensions and Other Actuarial Liabilities (Note 14)	
d. Other Unfunded Liabilities	
e. **Total Unfunded Liabilities**	$20,104,399
6. TOTAL LIABILITIES	$117,436,287
NET POSITION	
7. **Fund Balances: (Note 16)**	
a. Revolving Fund Balances	182,855,715
b. Trust Fund Balances	
c. Appropriated Fund Balances	
d. **Total Fund Balances**	$182,855,715
8. **Less Future Funding Requirements (Note 17)**	20,104,399
9. **Net Position (Note 16)**	$162,751,316
10. **Total Liabilities and Net Position**	$280,187,603

The accompanying notes are an integral part of these statements.

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Operations (and Changes in Net Position)
for Period Ended September 30, 1992
(Dollars)

REVENUES AND FINANCING SOURCES	1992
1. Appropriations Expensed	
2. Revenues from Sales of Goods	
a. To the Public	
b. Intragovernmental	$651,299,753
3. Interest and Penalties, Non-Federal	
4. Interest, Federal	
5. Taxes (Note 18)	
6. Other Revenues and Financing Sources (Note 19)	
7. Less: Taxes and Receipts Returned to the Treasury	
8. Total Revenues and Financing Sources	$651,299,753
EXPENSES	
9. Cost of Goods or Services Sold	
a. To the Public	
b. Intragovernmental	
10. Program or Operation Expenses (Note 20)	493,171,135
11. Depreciation	13,837,078
12. Bad Debts and Write-offs	
13. Interest	
a. Federal Financing Bank/Treasury Borrowing	
b. Federal Securities	
c. Other	9,625,950
14. Other Expenses (Note 21)	20,104,399
15. Total Expenses	$536,738,562
16. Excess (Shortage) of revenues and Financing Sources Over Total Expenses Before Adjustments	$114,561,192
17. Plus (Minus) Adjustments:	
a. Extraordinary Items (Note 22)	
b. Prior Period Adjustments (Note 22)	
18. Excess (Shortage) of Revenues and Financing Sources over Total Expenses	$114,561,192
19. Plus: Unfunded Expenses	33,677,596
20. Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses	$148,238,788

The accompanying notes are an integral part of these statements.

V-6-6 Financial Statements

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Operations (and Changes in Net Position)
for Period Ended September 30, 1992
(Dollars)

EXPENSES Continued	1992
21. Net Position, Beginning Balance	
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	$114,561,192
23. Plus (Minus) Equity Transfers	48,190,124
24. Net Position, Ending Balance	$162,751,316

The accompanying notes are an integral part of these statements.

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Cash Flows (Indirect)
for the Period Ended September 30, 1992
(Dollars)

Cash Flows from Operating Activities:	**1992**
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	$114,561,192
Adjustments affecting Cash Flow:	
2. Appropriations Expensed	
3. Decrease (Increase) in Accounts Receivable	(46,970,200)
4. Decrease (Increase) in Loans Receivable	
5. Decrease (Increase) in Other Assets	(533,062)
6. Increase (Decrease) in Accounts Payable	93,424,703
7. Increase (Decrease) in Debt	
8. Increase (Decrease) in Other Liabilities	3,907,184
9. Depreciation and Amortization	13,837,078
10. Other Unfunded Expenses	20,104,399
11. Other Adjustments	
12. **Total Adjustments**	$83,770,102
13. **Net Cash Provided (Used) by Operating Activities**	$198,331,294
Cash Flows from Non-Operating Activities:	
14. Proceeds from Sales of Investments	
15. Proceeds from Sales of Property, Plant and Equipment	
16. Purchases of Investments	
17. Purchases of Property, Plant and Equipment	77,376,304
18. **Net Cash Provided (Used) by Non-Operating Activities**	($77,376,304)
CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES	
19. Appropriations (Current Warrants)	
20. Add:	
a. Restorations	
b. Transfers of Cash from Others	
21. Deduct:	
a. Withdrawals	
b. Transfers of Cash to Others	
22. Net Appropriations	

The accompanying notes are an integral part of these statements.

V-6-8 Financial Statements

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Cash Flows (Indirect)
for the Period Ended September 30, 1992
(Dollars)

CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES Continued	1992
23. Borrowing from the Public	
24. Repayments on Loans	
25. Borrowing from the Treasury and the Federal Financing Bank	
26. Repayments on Loans from the Treasury and the Federal Financing Bank	
27. Other Borrowings and Repayments	
28. Net Cash Provided (Used) by Financing Activities	
29. Net Cash Provided (Used) by Operating, Non-Operating and Financing Activities	$120,954,990
30. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	
31. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	$120,954,990

The accompanying notes are an integral part of these statements.

Department/Agency: Department of Defense
Reporting Entity: Defense Finance and Accounting Service - DBOF
Statement of Budget and Actual Expenses
for the Period Ended September 30, 1992
(Dollars)

Program Name (s)	BUDGET Resources	Obligations Direct	Obligations Reimbursed	ACTUAL Expenses
Financial Operations	$651,299,753		$698,860,169	$536,738,562
Totals	$651,299,753		$698,860,169	$536,738,562

Budget Reconciliation

A. Total Expenses	$536,738,562
B. Add:	
(1) Capital Acquisitions	
(2) Loans Disbursed	77,376,304
(3) Other Expended Budget Authority	
C. Less:	
(1) Depreciation and Amortization	13,837,078
(2) Unfunded Annual Leave Expense	20,104,399
(3) Other Unfunded Expenses	
D. Expended Appropriations	$580,173,389
E. Less Reimbursements	651,299,753
F. Expended Appropriations, Direct	($71,126,364)

The accompanying notes are an integral part of these statements.

DEFENSE FINANCE AND ACCOUNTING SERVICE FINANCIAL OPERATIONS DEFENSE BUSINESS OPERATIONS FUND

FOOTNOTES

DEFENSE FINANCE AND ACCOUNTING SERVICE DEFENSE BUSINESS OPERATIONS FUND CONSOLIDATING STATEMENTS FOOTNOTES

Note 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

On November 26, 1990, DoD Directive 5118.5, Defense Finance and Accounting Service, established the Defense Finance and Accounting Service (DFAS) as an Agency of the Department of Defense (DoD) with responsibilities, functions, authorities, and relationships. The DFAS was established as an Agency of the DoD under the direction, authority, and control of the Comptroller of the DoD. The primary responsibilities and functions included: (1) DFAS shall direct finance and accounting requirements, systems, and functions for all appropriated, nonappropriated, working capital, revolving, and trust fund activities, including security assistance, (2) DFAS shall provide finance and accounting services for DoD Components and other Federal activities, as designated by the Comptroller, DoD, (3) DFAS shall execute statutory and regulatory financial reporting requirements and render financial statements, and (4) DFAS shall perform other functions as the Secretary of Defense, Deputy Secretary of Defense, or the Comptroller, DoD, may prescribe.

Fiscal Year 1992 represents the first full operational year for DFAS. Thus, these financial statements represent the first year that DFAS has prepared audited financial statements as required by Section 252 of Title 10, United States Code. Section 252 of Title 10, U.S.C., requires the Comptroller of the DoD to annually issue four consolidated financial statements: (1) Statement of Financial Position, (2) Statement of Operations, (3) Statement of Cash Flows and (4) Statement of Budget and Actual Expenses. The audited financial statements are presented on the accrual basis of accounting as required by General Accounting Office's Title 2, of the Policy and Procedures Manual for Guidance of Federal Agencies.

The Defense Business Management System (DBMS), an automated management information system, is used by the Agency to develop the financial and other managerial information. DBMS was designated as the migratory system for the Defense Business Operations Fund and unit cost businesses.

B. Accounting Standards

These financial statements are presented in accordance with the DoD Accounting Manual's prescribed accrual basis as the basis of accounting to be used by DoD Components. To the extent that guidance is not provided in the DoD Accounting Manual, DoD Components are to follow GAO, the Office of Management and Budget, the Department of the Treasury, and the Federal Accounting Standards Board (FASB), guidance and proce-

dures. These statements are also presented in accordance with the Acting Chief Financial Officer, DoD memorandum of October 27, 1992, subject: DoD Guidance on Form and Content of Financial Statements for FY 1992 Financial Activity.

Furthermore, to implement the Federal Managers' Financial Integrity Act (FMFIA) program, DFAS developed and implemented an Internal Management Control (IMC) Program at all of our Centers which satisfies or exceeds FMFIA requirements. A detailed operating manual was implemented in February 1992 and Standard Assessable Units were established. All of the Center's IMC coordinators were trained in the implementation and execution of the Program by April 1992.

C. Budgets and Budgetary Accounting

The Department expanded the use of businesslike financial management practices through the establishment of the Defense Business Operations Fund on October 1, 1991. The Business Operations Fund operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The Business Operations Fund builds on the revolving fund principles previously used for industrial and commercial-type activities.

The Agency's major budget activity is the financial operations business operating under the Business Operations Fund (Account Symbol 97X4730.5L), a revolving fund. The Agency's initial funding was accomplished by the transfer of funds from other DoD Components. These transfers or reimbursements amounted to $651,299,753 in FY 1992.

D. Basis of Accounting

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Also, when costs are incurred on a relatively uniform basis over the life of an order, revenue may be recognized as a percentage of incurred costs to total projected costs. At a minimum, the customer shall be billed and revenue recognized at the end of each fiscal year quarter. In summary, the Business Operations Fund shall operate under financial policies and responsibilities currently in effect for stock and industrial funds, except as modified by DoD Comptroller policy documents.

E. Revenues and Other Financing Sources

Financing sources for general funds are provided through congressional appropriations which are received on both annual and multi-year basis. Currently, the congressional budgetary process under which the Department operates does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of resources (outlays). For financial reporting purposes under accrual accounting, operat-

ing expenses for activities are recognized in the period incurred. Expenditures for capital and other long-term assets are not recognized as expenses until consumed in the Department's operations. Unexpended appropriations are recorded as equity of the U.S. Government.

F. Accounting for Intra-Government Activities

DFAS, as the Department's accountant, interacts with the other DoD Components in a typical business manner, i.e. provides accounting service to the Program Managers and DoD Comptroller. Our service includes the accounting and finance service for approximately 300 fund accounts, from the relatively smaller funds such as the Fisher House Trust Fund to the larger funds such as the Business Operations Fund. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department or the Business Operations Fund. These statements reflect the Financial Operations business portion of the Business Operations Fund.

Like the other DoD Components, the DFAS employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while assigned military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security.

G. Funds with the U.S. Treasury and Cash

The Agency's fund resources as part of the Business Operations Fund are maintained in the Treasury account. The Fund's cash receipts and disbursements are processed by the Treasury, and the balance with the Treasury represents the aggregate of all unexpended balances at the summary level.

H. Foreign Currency

Not applicable.

I. Accounts Receivable

As presented in the statements, accounts receivable includes services rendered to our customers. We will establish an allowance for uncollectible accounts, i.e. bad debts, when we have more experience with the different types and obtain enough information to perform an analysis. As a new agency and a Business Operations Fund business, we need to analyze our receivables and ascertain a realistic allowance for unit cost considerations. Accounts Receivable, constitute the largest receivable category, approximately $47M.

V-6-16 Footnotes

J. Loans Receivable

Not applicable.

K. Inventories

Not applicable.

L. Investments in U.S. Government Securities

Not applicable.

M. Property and Equipment

These assets are valued and reported at standard or average procurement costs. As a new agency, some of our equipment assets and associated records were transferred from other DoD Components. We do not own property. We lease our property through another federal government entity. Personal Computers and office furniture are two examples of our equipment. We have approximately $111.7M of equipment purchased.

A weighted average concept, using DoD Component budgetary records to identify and capture costs, has been developed, and will be used, to revalue more recently acquired major equipment items and weapons systems for presentations in financial statements for FY 1993. The rationale for selecting more recent acquisitions is that reasonably accurate records of costs should be available that would account for most of the dollars invested in that equipment. Depreciation is calculated by the straight-line method.

We recorded $13.8M in depreciation for this Fiscal Year. This amount represents the net book value of equipment purchased and put in-use during FY 1992.

N. Prepaid and Deferred Charges

Not applicable.

O. Leases

Not applicable.

P. Contingencies

All DoD Components are obligated for goods and services which have been ordered but not yet received (undelivered orders). As of September 30, 1992, DFAS had $134.6M of undelivered orders.

Q. Accrued Leave

Civilian employee annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for the civilian annual leave and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned, but not taken.

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. We have approximately $20M in this unfunded liability category.

Sick leave and other types of nonvested leave are expensed as taken.

R. Equity

Equity consists of invested capital, cumulative result of operations, and unexpended appropriations. Invested capital, as presented in the consolidated statement of financial position, represents the value of the Agency's capital assets. Increases to invested capital are recorded when capital assets are acquired or constructed or when asset valuations increase as a result of increases in standard prices/costs. Decreases occur as capital assets are depreciated or consumed in operations, or when standard prices/costs are decreased.

S. Aircraft/Ship Crashes

Not applicable.

T. Treaties for Use of Foreign Bases

Not applicable.

U. Comparative Data

Comparative data for the prior year has not been presented because this is the first year for which financial statements are prepared using the Office of Management and Budget format and because this is the first complete year of operation for DFAS. In future years, comparative data will be presented in order to provide an understanding of changes in the financial position and business operations.

V-6-18 Footnotes

Note 2. FUND BALANCE WITH TREASURY, CASH and FOREIGN CURRENCY

A. Fund Balance with Treasury:

(1) Trust Funds	
(2) Revolving Funds	$120,954,990
(3) Appropriated Funds	
(4) Other Fund Types	
Total	$120,954,990

B. Cash:

(1) Restricted Cash
(2) Unrestricted Cash
Total Cash

C. Foreign Currency

D. Other Information: The DFAS fund balance with the Treasury is only at the total Business Operations Fund level.

Note 3. OTHER MONETARY ASSETS:

A. Gold
B. Special Drawing Rights
C. U.S. Reserves in the International Monetary Fund
D. Other
Total Other Monetary Assets

E. Other Information: Not applicable.

Note 4. INVESTMENTS:

Not Applicable.

Note 5. INVENTORIES:

Not Applicable.

Note 6. LOANS AND LOAN GUARANTEES, NON FEDERAL:

Not Applicable.

Note 7. PROPERTY HELD FOR SALE:

Not Applicable.

Note 8. OTHER FINANCIAL RESOURCES - NON-FEDERAL:

Not Applicable.

Note 9. PROPERTY, PLANT AND EQUIPMENT, NET:

	(1) Depreciation Method	(2) Service Life	(3) Acquisition Value	(4) Accumulated Depr.	(5) Net Book Value
Classes of Fixed Assets					
A. Land					
B. Structures, Facilities, & Leasehold Improvements					
C. Military Equipment	SL	10Yrs.	$13,851,542	$5,463,648	$8,387,894
D. ADP Software	SL	10Yrs.	$61,706,946	35,477,912	$26,229,034
E. Equipment					
F. Assets Under Capital Lease					
G. Other					
H. Natural Resources					
I. Construction in Progress					
Total			$75,558,488	$40,941,560	$34,616,928

J. Other Information: Only classes C. and D. apply. Of the above amount, assets of $35M were not in-use.

Note 10. OTHER NON-FINANCIAL RESOURCES:

Not applicable.

Note 11. LEASES:

Not applicable.

Note 12. DEBT:

Not applicable.

V-6-20 Footnotes

Note 13. OTHER FUNDED LIABILITIES:

Not applicable.

Note 14. PENSIONS AND OTHER ACTUARIAL LIABILITIES:

Not applicable.

Note 15. OTHER UNFUNDED LIABILITIES:

A. Other Unfunded Liabilities:	
(1) Accrued Leave	$20,104,399
Total Unfunded Liabilities	$20,104,399

B. Other Information: DFAS has one Unfunded Liability category, i.e. Accrued Leave. Due to the characteristics of this category, we expect to have this liability each year. Also, with the implementation of DMRD 910, DFAS is expected to increase the number of employees in FY 1993. Therefore, this category should increase for DFAS in the total amount as we capitalize employees with a corresponding decrease for the DoD Component transferring employees to DFAS.

NOTE 16. Fund Balances:

Trust Funds and Appropriated Funds are not applicable. Only a revolving fund, Business Operations Fund, applies (Refer to Program Attributes).

NOTE 17. Future Funding Requirements:

The Accrued Leave liabilities is $20,104,399 (See note 15).

NOTE 18. Taxes:

Not applicable.

NOTE 19. Other Revenues and Financing Sources:

Not applicable.

NOTE 20. Program or Operating Expenses:

Operating Expenses by Object Class is not available.

NOTE 21. Other Expenses:

DFAS has "Other Expenses" of $20,104,399. This amount applies to the accrued annual leave.

NOTE 22. Extraordinary Items and Prior Period Adjustments:

Not applicable

NOTE 23. Transfers (and Donations):

A. Increases;	
(1) Transfers-In	$48,190,124
(2) Donations Received	
(3) Total Increases	$48,190,124
B. Decreases:	
C. Net Transfers	$48,190,124

NOTE 24. Intrafund eliminations:

Information is not available.

NOTE 25. Other Disclosures:

After the close of this reporting period, DFAS made an adjustment to reflect the DoD Comptroller directed transfer of funds from the DFAS Operating Budget to the DFAS Capital Budget. This transfer was treated as a capital equipment surcharge and was therefore deducted from the net operating results.

DEFENSE FINANCE AND ACCOUNTING SERVICE-FINANCIAL OPERATIONS DEFENSE BUSINESS OPERATIONS FUND

SUPPLEMENTAL

Supplemental VI-6-3

PROGRAM ATTRIBUTES

Supplemental VI-6-5

Financial Attributes
DFAS- Defense Business Operations Fund (Financial Operations)
Operating Costs Attribute

	FY 92	Average
Current Dollars		
Total Costs and Expenses	$536,738,562	$536,738,562
Revenues and Reimbursements	(651,299,753)	(651,299,753)
Net Operating Costs	($114,561,191)	($114,561,191)

VI-6-6 Supplemental

Financial Attributes
DFAS- Defense Business Operations Fund
(Financial Operations)
Operating Results Attribute

	FY 92
Revenues:	
Federal Sources	$651,299,753
Public Sources	0
Other	0
Total Revenue	$651,299,753
Expenses and Losses	536,738,562
Net Operating Income (Deficit)	$114,561,191
Additional Appropriations	0
Operating Surplus (Deficit)	$114,561,191

Supplemental VI-6-7

Financial Attributes of DFAS
DFAS- Defense Business Operations Fund
(Financial Operations)
Financial Obligations Attribute

	FY 92
[1] Total Current Assets	$46,970,200
[3] Total Current Liabilities	$93,424,704
Current Ratio	.50
[2] Total Quick Assets	$46,970,200
[3] Total Current Liabilities	$93,424,704
Acid Test Ratio	.50

[1] Total Current Assets consist of cash, accounts receivables, and inventories.

[2] Total Quick Assets consist of cash and accounts receivable.

[3] Current Liabilities include accounts, notes and other obligations payable within a year.

VI-6-8 Supplemental

Financial Attributes of DFAS
DFAS- Defense Business Operations Fund
(Financial Operations)
Financial Condition Attribute

	FY 92
Available Sources of Cash	$168,458,252
Future Requirements for Cash	$117,436,287
Cash Surplus (Shortfall)	1.43
Total Assets	$280,187,603
Total Liabilities	$117,436,287
Debt to Asset Ratio	2.39

Part VI - Other Issuances Related to this Audit

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

OCT 14 1992

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Management Advisory Memorandum Regarding Preparation of the FY 1992 Financial Statements for the Defense Finance and Accounting Service Revolving Fund (Project No. 2FG-2004)

We are providing this management advisory memorandum on the Defense Finance and Accounting Service Fund's financial statements for FY 1992 for your comments and use. This memorandum is not an audit report, but discusses issues that could impair the ability of the Defense Finance and Accounting Service (DFAS) to develop information needed to prepare FY 1992 financial statements in accordance with Office of Management and Budget Bulletin No. 91-14, the General Accounting Office's (GAO's) "Policy and Procedures Manual for Guidance of Federal Agencies (Title 2)," and the "DoD Accounting Manual" (DoD Manual 7220.9-M). This memorandum is not subject to the provisions of DoD Directive 7650.3, but is being provided to give management an opportunity to correct conditions noted and minimize the effect on the financial statements.

Our primary objective is to determine whether financial statement accounts (such as inventory, capital assets, accounts receivable, and accounts payable) present fairly the financial position for those accounts. Additional objectives are to determine whether the DFAS has established adequate internal controls and to ensure compliance with laws and regulations that have a material effect on the financial statements.

Our review of the financial and accounting operations and records showed the following.

- Inventory records were inaccurate.
- Assets were not capitalized in accordance with Title 2 and DoD Manual 7220.9-M.
- Non-reimbursed services received and rendered by the DFAS centers were not shown in the accounting records.
- Accounts payable were overstated.
- Some support agreements were not documented.

Inventory. Inventory records were inaccurate. Total inventory for the DFAS was shown as $179.3 million. Tests showed that the error rates at the five DFAS centers varied between 0

and 21 percent. To test the accuracy of the inventory records, we selected records for 870 items for review. The 870 records showed no values for 449 items, with the remaining 421 items valued at a total of $20.7 million. We could not physically locate 124 items (14 percent); of these, the values for 79 items were not shown and the remaining 45 items were valued at a total of $.6 million.

Conversely, we selected items for comparison to the inventory records. Of the 541 items we selected, 153 had no assigned values and 388 were valued at a total of $1.7 million. The comparison further showed 66 items (12 percent) were not recorded in the inventory records. The value of 16 items totalled $80,451, while the value of the other 50 items was not shown. One DFAS center estimated its inventory at more than $60 million, but showed no cost for each item on the inventory listing. There was no documentation to support the methodology used by the center in arriving at its estimate. The Washington center and the DFAS headquarters had recorded estimated inventories valued at $4.1 million and $3.2 million, respectively, but did not have inventory listings to support the estimates.

Our review of receiving documents showed 1,422 items, total value $4.7 million, had been received during FY 1992, but not recorded in the inventory listing. Because of the inaccuracies, the DFAS hired a contractor to assist in correcting the inventory records. No specific recommendations are being made at this time, pending the results of the corrective action.

Capital Assets. Policy and practices of the DFAS for capitalization of assets did not comply with the GAO Title 2 and the DoD Manual 7220.9-M. The guidance of the Comptroller of the Department of Defense to the DFAS for capitalizing assets sets a threshold of $15,000. GAO Title 2 and DoD 7220.9-M require a threshold of $5,000. This threshold applies to purchases of a single item, or multiple items that collectively cost over $5,000. We identified about $5.0 million in assets valued between $5,000 and $15,000 that were not capitalized. If the $5,000 threshold is not used, Title 2 requires a footnote disclosure to the financial statements. Failure to comply with Title 2 would have a material effect on the financial reporting requirements.

Valuation of Capital Assets. The DFAS did not comply with the valuation policy of capital assets. GAO Title 2 and DoD Manual 7220.9-M require that all assets acquired be recorded at full cost. In addition to the acquisition cost, the full cost includes transportation, installation, and other related costs. These related costs, which include costs of additions, alterations, betterments, rehabilitations, or replacements that extend the useful life of the asset or its service capacity, are also to be capitalized as property, plant, and equipment.

Our review of obligated and paid expenditures showed total costs of $11.0 million, of which $5.0 million was not capitalized. These costs were for installation, replacement of existing systems, and improvements, as well as other related costs. For

example, at the DFAS Columbus center, acquisition of a relocatable structure was charged to the Investment-Capital Equipment, Furniture (Accountable) object class code, while the installation was charged to Other Purchased Services and Facilities Maintenance. This occurred because the incorrect object class code and cost account code were assigned. As a result, the capitalized value of assets was understated, while operating expenses were overstated.

Non-Reimbursed Services. Title 2 requires that all costs of operations be disclosed either in the financial statements or notes to the financial statements. Accordingly, the value of non-reimbursed services received and rendered by the DFAS centers and the use of facilities furnished to the centers at no cost should be disclosed. We identified over $21.0 million of non-reimbursed services received by the DFAS centers and over $305.0 million of non-reimbursed services rendered by the DFAS centers to customers. Failure to disclose the value of those non-reimbursed services would have a material effect on the financial statements. In addition, the facilities used by the DFAS centers in Columbus, Ohio; Denver, Colorado; and Indianapolis, Indiana were provided rent-free. The value of the "rent-free" use should be disclosed in the notes to the financial statements.

Accounts Payable. Accounts payable at the DFAS Columbus center were overstated by $7.2 million. This occurred because transactions were shown as expenses before items were received (accounts payable were created at the time of commitment). Transactions should be shown as accounts payable only when items have been received. The DFAS center has initiated corrective action; therefore, no recommendation is made at this time.

Support Agreements. Some support services were received and rendered by the DFAS centers without written support agreements. At the DFAS Columbus center, there was no written agreement between the DFAS center and the Defense Logistics Agency Information Processing Center concerning the responsibilities for data file backup. Also, there was no written agreement between the DFAS and the Defense Logistics Agency Systems Automation Center for software support services.

Support agreements should be written for all services to ensure a clear understanding between the parties on what will be provided and the cost of each specific service. For example, because the DFAS is responsible for the integrity of its data, it should be agreed in writing that a DFAS representative either perform or participate in the final acceptance testing of all software changes affecting its data.

Support agreements should be detailed enough to ensure that each party knows the specific duties and responsibilities of each. For example, in order for the DFAS center to be responsible for penalty payments and lost discounts, all required documents should be received by the center by a stated number of days in advance of the due date; in payroll processing,

validation responsibilities of each party should be specifically stated in writing to ensure adequate internal controls; and the DFAS Columbus center should have a written agreement whereby it is notified of each instance where programmers have had access to the DFAS application software or data files.

Recommendations

We recommend that the Director, Defense Finance and Accounting Service:

1. Either use a threshold of $5,000 for capitalization of assets or include a footnote disclosure to the financial statements as required by the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies (Title 2)" and Office of Management and Budget Bulletin Number 91-14, "Audit Requirements for Federal Financial Statements."

2. Include all costs required by the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies (Title 2)" for capitalized assets. Those costs include transportation, installation, and other related costs.

3. Require the Defense Finance and Accounting Service centers to determine the cost of all non-reimbursed services and disclose those costs in the financial reports.

4. Develop support agreements for all services received and rendered by Defense Finance and Accounting Service centers and ensure that the centers receive copies of the agreements.

A meeting was held with the Defense Finance and Accounting Service on August 21, 1992, to discuss the issues identified in this memorandum. Comments were received from the Defense Finance and Accounting Service (Resource Management) on September 2, 1992, and are at the Enclosure. If you wish to make any additional comments on these issues, we would appreciate receiving your comments within 15 days of the date of this memorandum. These issues, if not adequately addressed, will affect the audit opinion of the financial statements. If you have any questions or wish to discuss the memorandum, please contact Mr. F. Jay Lane, Program Director, at (703) 693-0430 (DSN 223-0430) or Mr. Carl F. Zielke, Project Manager, at (703) 693-0453 (DSN 223-0453).

Nancy L. Hendricks

Nancy L. Hendricks
Director,
Financial Management Directorate

Enclosure

4

DEFENSE FINANCE AND ACCOUNTING SERVICE

WASHINGTON, DC 20376-5001

(Resource Management) SEP 2 1992

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE

SUBJECT: Management Advisory Memorandum Regarding Preparation of the FY 1992 Financial Statements for the Defense Finance and Accounting Service Fund (Project No. 2FG-2004)

Our comments on your draft management advisory memorandum follow. We believe it is very important for our financial statements to accurately reflect the financial position of the Defense Finance and Accounting Service (DFAS) and appreciate this opportunity to respond to the conditions found by your staff.

Recommendation 1: Concur. The threshold of $15,000 for capitalization of assets is Defense Business Operations Fund (DBOF) policy; therefore, DFAS will provide the required footnote disclosure to the financial statements. For your information, the contracted assets inventory of DFAS property at each of the Centers which should be completed before September 30, 1992, will cover all property over $5,000.

Recommendation 2: Concur. We will provide reinforcing guidance to all Centers to ensure that transportation, installation, and other related costs are included in the cost of capital items. Our Centers were initially provided this guidance through the DBOF Unit Cost Resourcing Guidance Memorandum dated October 15, 1990. DFAS Headquarters Accounting Deputate has draft guidance under development which outlines how the installation and other related costs can be captured as capital costs in the Automated Payroll, Cost and Personnel System. Upon final coordination in the Headquarters, the Columbus Center will be tasked to provide the accounting procedures to effect outlined actions. To complete our follow-up on this issue, please provide detailed information collected during your review to my staff on the $5,799,810 which was not capitalized.

Recommendation 3: Concur. We recognize that DFAS needs to document all support it receives without reimbursement and disclose those values in the financial statements and will work toward achievement prior to September 30, 1992. Our Centers were advised during monthly meetings held from March through September in 1991 of the need to capture these elements under the Unit Cost concept. In order to completely satisfy this issue, please provide details supporting the $21 million of non-reimbursed services received and the $305 million non-reimbursed services rendered and we will task our Centers to perform an in-depth.

Enclosure
Page 1 of 2

review. Also, Columbus, Denver and Indianapolis Centers will be tasked to value the "rent-free" use of their facilities prior to the end of the year for disclosure in the notes to the financial statements.

Recommendation 4: Concur. DFAS has continually worked since it was chartered to establish and document service-provider customer relationships between DFAS and external organizations. As indicated in the response to Recommendation 3 above, monthly Unit Cost meetings were held with each of our Centers from March through September 1991 which documented the need to have formal agreements in place. As a matter of fact, guidance was promulgated in our Memorandum, Subject: Support Agreement Negotiations, dated August 22, 1991, and is intended for annual publication. We have drafted a DFAS Supplement to DoD Instruction 4000.19 on support agreements for distribution to the Centers before October 1, 1992, to provide supplementary guidelines on the development, promulgation and negotiation of agreements at all levels within the organization. Additionally, we have drafted standard, automated support agreement formats so that the Centers can more quickly draft and update agreements without extensive rewrites. Standard formats should be available for Center usage before October 1, 1992. These actions should improve both agreement processing time and agreement development and formatting. The end result should be improved service-provider customer relationships and better identification of the currently identified non-reimbursed services in Recommendation 3 above.

In summary, all Centers will be advised to redouble their efforts to rectify cited conditions found during your review prior to the closure of this fiscal year.

Lorraine Lechner
Lorraine F. Lechner
Deputy Director

Enclosure
Page 2 of 2

Audit Team Members

Nancy L. Hendricks	Director, Financial Management
F. Jay Lane	Program Director
Carl F. Zielke	Project Manager
Robert M. Anastasi	Team Leader
Priscilla G. Sampson	Team Leader
Robert L. Hoss	Auditor
Rhonda K. Mead	Auditor
Daniel L. Simon	Auditor
Jody A. Miller	Auditor
Cynthia L. Hines	Auditor
Joan E. Fox	Editor
Sheila L. Hampton	Administrative Support

INTERNET DOCUMENT INFORMATION FORM

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