Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL REPORTING PROCEDURES FOR DEFENSE DISTRIBUTION DEPOTS - DEFENSE LOGISTICS AGENCY BUSINESS AREA OF THE DEFENSE BUSINESS OPERATIONS FUND

Report No. 94-035 February 8, 1994

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Acronyms

DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DFAS-CO	DFAS-Columbus Center
DLA	Defense Logistics Agency
IG	Inspector General

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

Report No. 94-035 February 8, 1994

MEMORANDUM FOR COMPTROLLER AND CHIEF FINANCIAL OFFICER, DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Financial Reporting Procedures for Defense Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund (Project No. 2LD-2022)

Introduction

In our audit of the FY 1993 Financial Statements for the Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund, we evaluated procedures and controls used by the Defense Finance and Accounting Service (DFAS) to prepare the distribution depots' FY 1992 Statement of Financial Position. FY 1992 ending balances represent FY 1993 opening balances for the depots' asset and liability accounts. Our review was made to determine the effect existing procedures and controls will have on the preparation of the FY 1993 financial statements.

Results of Audit

Since establishment of the Defense Business Operations Fund (DBOF), the General Accounting Office; Inspector General (IG), DoD; and Service audit agencies have completed several audits on the preparation of financial statements for activities of the DBOF. The audits identified the lack of adequate procedures, controls, and accounting systems to produce reliable financial statements. Our audit disclosed material inaccuracies in the distribution depot asset and liability accounts. Additionally, needed improvements, identified by prior audits, had not been implemented as of the date of our audit. Until the DoD financial community has had the opportunity to correct long standing problems with its financial systems and financial reporting procedures, additional audit efforts on the distribution depots' FY 1993 financial statements has been curtailed. As discussed with Office of Management and Budget officials, we have modified our future financial statement audit approach to evaluate only certain major DBOF accounts on an Agency-wide basis for FY 1993.

Objectives

The overall objective of the audit was to determine whether the FY 1993 financial statements for the distribution depots are presented fairly in accordance with generally accepted accounting principles for Federal agencies. As part of

the overall objective, we reviewed the adequacy of internal controls, whether applicable laws that have a material effect on the financial statements were being complied with, and the reliability of the information reported.

Scope

Our review was limited to the procedures and controls used to prepare the distribution depots' FY 1992 statements. FY 1992 ending balances represent FY 1993 opening balances for the depots' asset and liability accounts. Accordingly, we evaluated internal control policies and procedures that the DFAS-Columbus Center (DFAS-CO) and the Defense Logistics Agency (DLA) used to prepare the FY 1992 financial statements. We also evaluated selected FY 1992 balance sheet accounts and tested selected transactions to determine if procedures were adequate to ensure that the financial transactions were accurately reflected in accounting records, and properly summarized to support financial statement account balances. The accounts we evaluated encompassed $1.48 billion (99 percent) of the assets and $290 million (97 percent) of the liabilities shown on the FY 1992 Statement of Financial Position. We reviewed the DFAS-CO implementation of the Federal Managers' Financial Integrity Act, and its compliance with the requirements of Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements" and the "DoD Accounting Manual" (DoD Manual 7220.9-M).

Our audit, conducted from September 1992 through July 1993, was made in accordance with Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," and auditing standards issued by the Comptroller General of the United States as implemented by the IG, DoD. The organizations visited or contacted are in Enclosure 1.

Internal Controls

The audit identified material internal control weaknesses as defined by Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982"; Office of Management and Budget Circular A-123, "Internal Control Systems"; and DoD Directive 5010.38, "Internal Management Control Program." Controls were not established or effective to accurately report account balances on the financial statements. The internal control weaknesses were identified in previous audit reports. DFAS recognized and reported its inability to produce reliable financial statement data in its FY 1992 annual statement as required by the Federal Managers' Financial Integrity Act. No quantifiable monetary benefits will be realized by correcting the internal control weaknesses. However, the accuracy of reported financial data should be significantly improved. A copy of this final report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense, DFAS, and DLA.

Related Audits and Other Reviews

During this audit, we issued Report No. 93-169, "Quick-Reaction Report on the Construction of a Distribution Operations Center at the Red River Depot," September 20, 1993. We reported that the economic analysis used to support the construction of the facility contained overstated workload estimates and did not appropriately consider stock positioning plans. We recommended that the Director, DLA, suspend contract awards for the center construction, update the economic analysis, and notify Congress of the suspension unless the project can be economically justified. The Director, DLA, subsequently updated the economic analysis and other supporting documentation to justify construction of the project.

No prior audits have been made on distribution depot financial statements. However, since the inception of the DBOF in FY 1992, the General Accounting Office; IG, DoD; and Service audit agencies have completed several audits related to DFAS accounting controls. The audits identified lack of internal controls for preparing financial statements and weaknesses in accounting systems. The principal audits are summarized in Enclosure 2.

Background

The major mission of the distribution depots is to receive, store, maintain, pack, and issue supplies to support U.S. Armed Forces worldwide. The distribution depots earn funds to cover their expenses by charging customers, primarily the military components, for services provided. For FY 1992, distribution depot earnings were based on the DBOF supply management areas' (that is, the Services and DLA's supply management activities) counts of materiel issues and receipts by the distribution depots. The charge for services provided by the distribution depots is added to the cost of material sold to customers by the DBOF supply management activities.

DFAS-CO provides financial services for the distribution depots; and has to rely on distribution depots' input to the DFAS accounting system. Distribution depot personnel forward documentation to DFAS-CO and make data entries into the DFAS Defense Business Management System. DFAS-CO maintains the data system, makes payments and collections, processes documentation, and prepares financial statements.

Over the last 3 years, DoD organizations and financial accounting requirements for the organizations have undergone substantial changes. For example, the Chief Financial Officers Act of 1990 (Public Law 101-576) required, for the first time, preparation and audit of annual financial statements for Federal revolving and trust funds and commercial activities, such as the distribution depots. In January 1991, DFAS was established by combining the Services and DLA's financial centers to improve finance and accounting services and to reduce costs by adopting standard policies, procedures, and systems. Formation of the distribution depots' business area under DLA was completed in

March 1992 with the consolidation of 23 Service depots with 7 DLA depots. Due to the newness and significance of the changes, many of the management and financial reporting procedures and systems are still being developed.

Discussion

Our review of selected balance sheet accounts of the distribution depots' FY 1992 financial statement showed that the financial statement contained material misstatements and omissions. As stated in previous audit reports and as recognized in its 1992 Federal Managers' Financial Integrity Act statement, the DFAS had not yet developed adequate internal control procedures and an accounting system capable of producing reliable financial statements. Until the DFAS implements improved procedures and systems, the reliability of financial data presented in the distribution depots' FY 1993 financial statements and the usefulness of the statements will be limited. Conditions disclosed during our review that affect the adequacy of internal controls and the reliability of the financial data are discussed below.

Cash. We could not verify the accuracy of the negative $766.9 million balance of cash with the Department of the Treasury (Treasury). The general ledger showed that the balance should have been a negative $641.9 million, or a difference of $125 million. DFAS-CO personnel could not provide details on the difference and stated that reconciliations, as required by the DoD Accounting Manual, of differences between the general ledger and Treasury records had never been performed. To balance the financial statements, the DFAS-CO made an unsupported increase to accounts receivable-Federal ($417,650) and a decrease to net position ($124.6 million). Additionally, because the DFAS did not prepare a journal voucher and enter the adjustments into the accounting system, the beginning general ledger balance for FY 1993 did not match the reported ending balance of FY 1992. The lack of reconciliations was reported previously in the IG, DoD, Report No. 93-134, "Audit Report on the Principle and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," June 30, 1993, (Enclosure 2). The DoD Acting Chief Financial Officer concurred with the report findings and indicated that corrective actions would be taken.

Accounts Receivable. In addition to the unsupported adjustment to accounts receivable discussed above, our review of 50 judgmentally selected receivables indicated that the balance of $629.2 million was materially misstated. Of the 50 receivables, 20 were inappropriately valued at a negative $3.2 million. The remaining 30 receivables with positive values represented $95.1 million of the accounts receivable balance. For the 30 receivables, 27, valued at $90.5 million, did not have documentation supporting the validity of the receivable. The 27 receivables were based on Military Interdepartmental Purchase Requests or other funding documents on which services had not been certified as performed. The Military Interdepartment Purchase Request and other funding transactions should be recorded in budgetary accounts. An accounts receivable should be recorded only upon completion of the delivery of goods or services that entitle activities to collect amounts owed. Similar problems were reported previously in the IG, DoD, Report No. 93-134.

Accounts Payable. The accounts payable balance of $266.6 million was materially inaccurate. Our review of 30 judgmentally selected payables, valued at $118.4 million, disclosed that 29 payables, valued at $118.39 million, were not valid. As with accounts receivable, $86.9 million of the payables were invalid because the payables were based on a purchase order, travel order, or InterService Support Agreement for which no goods or services had been certified as delivered. Payables valued at $29.3 million had been paid before the end of the fiscal year, so they were no longer valid payables. Four of the payables were inappropriately valued at a negative $61,450; and seven payables, valued at $2.1 million, were established without supporting documentation and could not be explained by DFAS-CO personnel. In a management advisory memorandum issued during the audit, and in the IG, DoD, Report No. 93-110, "Audit Report on the Consolidating Financial Statements of the Defense Finance and Accounting Service Revolving Fund of the Defense Business Operations Fund - FY 1992," June 11, 1993, the IG, DoD, disclosed that accounts payable were overstated due to creating a payable at the time of commitment of funds (Enclosure 2).

Unfunded Liabilities. The unfunded liabilities account of $23.5 million for accrued leave was significantly understated. The DoD Accounting Manual, chapter 43, requires the recognition of an annual leave accrual for all DoD activities, and sick leave accrual for activities recovering full operating costs, such as DBOF activities. DFAS used the accrued annual leave balance for FY 1991 and did not adjust the balance for pay rate increases realized during FY 1992. Additionally, the balance was not appropriately increased to recognize employee fringe benefit rates. The account did not include the accrued sick leave nor the accrued annual leave for 20 of the 30 distribution depots. Similar problems were described in the IG, DoD, Report No. 93-128, "Pentagon Reservation Maintenance Revolving Fund Financial Statements - FY 1992," June 25, 1993.

Property, Plant, and Equipment. We could not ascertain the propriety of the asserted $84.1 million balance for property, plant, and equipment. The account was significantly understated because not all equipment was included and real property, including plant, and software were excluded. Until an apparent conflict between public law and the Comptroller of the DoD guidance is resolved, the proper amount to be shown for this capital asset account is indeterminable. Details on our observations follow.

Real Property. Instructions issued by the Comptroller of the DoD in "Capital Asset Accounting Guidance for the Defense Business Operations Fund," July 21, 1992, required that DBOF activities capitalize and reflect on financial statements the value of real property assets for which they can substantiate preponderant use in the production of goods or services for its customers. Compliance with the guidance would require the distribution depots to report additional hundreds of millions of dollars in facilities used by the distribution depots. To illustrate, the estimated value of three distribution facilities recently constructed at the Susquehanna and San Joaquin distribution depot complexes was $149 million.

The Comptroller guidance, however, was contrary to the provisions of United States Code, title 10, section 2682, "Facilities for Defense Agencies," which provides:

> A real property facility under the jurisdiction of the DoD which is used by an activity or agency of the DoD (other than a military department) shall be under the jurisdiction of a military department designated by the Secretary of Defense.

Thus, the Military Departments, not DLA, should report the distribution depots' real property. The condition was reported in the IG, DoD, Report No. 93-134. In response to the report, the DoD Acting Chief Financial Officer stated that inclusion of real property items in financial statements was intended to reflect the full range of assets and costs associated with the operations of DBOF activities. Additionally, the Office of the Comptroller of the DoD would seek the advice of the Office of the General Counsel before taking action.

Equipment. The $84.1 million reflected on the financial statements included only those equipment items that had been entered into the Defense Business Management System accounting system. Because of the relatively recent consolidation of the Service distribution depots with the DLA distribution depots, all equipment and software assets transferred to the distribution depot business area of the DBOF had not been entered into the accounting system. Thus, the value reflected on the statements was significantly understated. For example, the estimated value of the materiel handling equipment and software programs at the Susquehanna and San Joaquin Depots, alone, was about $210 million.

Until the issue on proper accounting for real property assets is resolved and equipment and software assets of the newly acquired depots are capitalized, we cannot ascertain the appropriate value that should be reflected on the financial statements.

Summary

Significant inaccuracies existed in the Distribution Depot FY 1992 Statement of Financial Position. The conditions and causes disclosed during our audit are not new. Prior audits of DBOF financial statements by the General Accounting Office; IG, DoD; and Service audit agencies have repeatedly reported on the DFAS centers and DBOF activities' inability to provide accurate, reliable, and auditable financial statements. Moreover, the DFAS recognizes the problems and reported in its 1992 Federal Managers' Financial Integrity Act risk assessment that the DBOF accounting systems had "... material problems that significantly affected their performance and prevented the certification of those systems as being in substantial conformance with GAO [General Accounting Office] accounting principles, standards, and related requirements." The statement concluded, "... DoD's mission to produce complete, reliable and accurate financial statements is not being satisfied." Corrective actions were underway, but had not been implemented as of the date of this report. Therefore, we are not making additional recommendations at this time and are curtailing additional audit effort on the distribution depot FY 1993 financial

statements. As discussed with the Office of Management and Budget officials, we plan to modify our audit approach to evaluate only certain major DBOF accounts on an Agency-wide basis each year until FY 1996. The goal of this approach is to assist in producing reliable financial statements on which an opinion can be issued by FY 1996.

Management Comments

The DoD Deputy Comptroller (Management Systems) provided comments to the draft report on the issue of reporting real property on Defense agency financial statements. He stated that property used by DBOF activities to produce goods or services and earn revenue should be reported as an asset on the financial statements of those activities. To do otherwise would be failure to disclose the full range of assets and costs associated with the operation of such activities. The complete text of the Deputy Comptroller's comments is in Enclosure 3.

Audit Response

The issue of proper financial statement reporting for real property is one that still needs to be resolved by the DoD financial, audit, and legal communities. To facilitate the necessary decisions on that matter, we requested the assistance of the General Accounting Office on January 11, 1994. No comments are required to this final report. However, if management desires to provide comments they must be received by March 8, 1994.

The courtesies and cooperation extended to the audit staff are appreciated. If you have any questions on this report, please contact Mr. Charles Hoeger, Program Director, in our Philadelphia Office, at (215) 737-3880 (DSN 444--3880) or Mr. John Issel, Project Manager, in our Columbus Office, at (614) 337-8009. The planned distribution of the final report is in Enclosure 4.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

Organizations Visited or Contacted

Office of the Secretary of Defense

Deputy Under Secretary of Defense for Logistics, Washington, DC
Deputy Comptroller of the Department of Defense (Management Systems), Washington, DC

Department of the Army

U.S. Army Depot System Command, Chambersburg, PA
  Red River Army Depot, Texarkana, TX
U.S. Army Corps of Engineers, Sacramento, CA

Defense Agencies

Headquarters, Defense Finance and Accounting Service, Washington, DC
  Defense Finance and Accounting Service, Columbus Center, Columbus, OH
  Defense Finance and Accounting Service, Cleveland Center, Cleveland, OH
  Defense Finance and Accounting Service, Indianapolis Center, Indianapolis, IN
Headquarters, Defense Logistics Agency, Alexandria, VA
  Defense Distribution Depot Region East, New Cumberland, PA
  Defense Distribution Depot Region West, Stockton, CA
  Defense Distribution Depot Columbus, Columbus, OH
  Defense Distribution Depot Memphis, Memphis, TN
  Defense Distribution Depot Ogden, Ogden, UT
  Defense Distribution Depot Red River, Texarkana, TX
  Defense Distribution Depot Richmond, Richmond, VA
  Defense Distribution Depot Susquehanna, New Cumberland, PA
  Defense Distribution Depot Tooele, Tooele, UT
Defense Information Technology Service Organization, Columbus, OH

Related Audit Coverage

The DBOF was established on October 1, 1991. Since then, audit reports have been issued by the General Accounting Office (GAO); IG, DoD; and Service audit agencies that included reportable conditions similar to the conditions we found during our review. Prior audit coverage indicated that DoD did not have an effective system for gathering financial information and producing reliable and useful financial statements. The Comptroller of the DoD; the Director, DFAS; and other DBOF activities generally agreed with the reportable conditions; however, corrective actions had not been fully implemented. The principal audits (from the most recent to the oldest) are summarized below.

IG, DoD, Report No. 93-164, "Report on the Financial Statements of the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund (Defense Fuel Supply Center Financial Data) - FY 1992," September 2, 1993. The report addressed internal control weaknesses in ensuring that Defense Fuel Supply Center (DFSC) general ledger account balances were properly reconciled to subsidiary records; that DFSC subsidiary records were periodically verified to supporting documentation; and that DFSC reviewed unusual balances such as negative unliquidated obligations. In addition, in analyzing the financial statements taken as a whole, $2.7 billion related to accounts receivable, accounts payable, undistributed collections, and undistributed disbursements were either not supported by subsidiary records or not developed from official accounting records.

GAO Report No. T-AIMD-93-1 (OSD Case No. 9276-F), "DoD Has Not Responded Effectively to Serious Long-Standing Problems," July 1, 1993. The report stated that better financial reporting has not resulted from the creation of the DFAS. DoD still cannot prepare accurate financial statements. DBOF was intended to bring greater economies and efficiencies, but DoD's failure to correct long-standing financial management system problems prevents the fund from achieving its objectives.

GAO Report No. AIMD-93-1 (OSD Case No. 9276-E), "Examination of the Army's Financial Statements for Fiscal Years 1992 and 1991," June 30, 1993. The report stated that the Army lacked adequate internal controls and an accurate, reliable accounting system. The Army did not materially comply with DoD financial policies, record retention requirements, or program activity reporting requirements. The Army had weak internal controls that limited the Army's ability to protect its reported assets, prevent material misstatements in its financial statements, and ensure material compliance with its budget authority.

IG, DoD, Report No. 93-145, "Defense Commissary Surcharge Collections Fund Financial Statements for FY 1992," June 30, 1993. The IG, DoD, was unable to determine whether the financial statement accounts presented fairly the financial position of the Surcharge Collections Fund for FY 1992. Neither the DFAS nor the Defense Commissary Agency had established an adequate internal control structure and system of financial accounts to provide reasonable assurance that material misstatements would be prevented or detected in a timely

manner. Specifically, significant financial account balances were developed off line; manually gathered and incomplete data were used to control and report financial transactions; and a normal financial system of source documents, journals, and ledgers did not flow into the financial statements.

IG, DoD, Report No. 93-142, "Audit Report on the Principal Financial Statements of the Defense Security Assistance Agency - FY 1992," June 30, 1993. The Principal Financial Statements did not accurately account for revenues, expenses, or net position of the Foreign Military Sales Trust Fund. Accounts payable was materially understated because accounts payable for the Army and Navy sales cases were not included in the financial statements. The audit addressed the lack of written standard operating procedures for recording accounts receivable and recognizing revenues and expenses. DFAS stated that it would establish written procedures on the conditions by November 1, 1993.

IG, DoD, Report No. 93-140, "Audit Report on the Defense Homeowners Assistance Fund Financial Statements for FY 1992," June 30, 1993. The report stated that DFAS did not have an adequate accounting system to accumulate and report financial information. The general ledger used to prepare the financial statements was unreliable and account balances did not agree with amounts recorded in the accounting system. The report also stated that material internal control weaknesses existed. The IG, DoD, recommended that DFAS require all adjusting entries to the financial statements be properly documented and posted to the appropriate accounts. DFAS generally concurred with the recommendations.

IG, DoD, Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," June 30, 1993. This report identified several material weaknesses in the internal control structure of the DBOF. Among the weaknesses described were cash transactions could not be verified; transactions by or for others were not recorded in a timely manner; depreciation was not computed correctly; accounts receivable were not confirmed; transactions were not executed in compliance with existing guidance; and reconciliations were not performed. The DoD Acting Chief Financial Officer generally agreed with the report and indicated that corrective actions would be implemented.

IG, DoD, Report No. 93-128, "Audit Report on the Pentagon Reservation Maintenance Revolving Fund Financial Statements - FY 1992," June 25, 1993. The report addressed the lack of reconciliation of and procedures for reconciling, the general ledger fund balances with actual Treasury balances. The report also noted internal control weaknesses in the validity of the data bases supporting the general ledger accounts for disbursements and collections, recording capital assets, and accruing annual leave.

IG, DoD, Report No. 93-121, "Special Defense Acquisition Fund Financial Statements for FY 1992," June 21, 1993. The IG, DoD, disclaimed an opinion on the financial statements because the value of inventory could not be ascertained. The DBOF did not have a general ledger system that was in compliance with laws and regulations, and certain account balances were combined and not separately presented in the financial statements. Additionally,

the DBOF financial statements were not prepared using the accrual method of accounting, and did not comply with accounting principles in the DoD Accounting Manual. The Comptroller of the DoD acknowledged problems with the general ledger accounting system and stated that changes were planned and that effective procedures would be established.

GAO Report No. T-AFMD-93-6 (OSD Case No. 9339-B), "Opportunities to Strengthen Management of the Defense Business Operations Fund," June 16, 1993. The report stated that DoD has acknowledged that the DBOF's systems are inadequate, but it has not developed a comprehensive cash management policy for the DBOF. Billings to customers for services provided by the DBOF have not been timely; and the DBOF's financial reports do not accurately reflect the DBOF's financial condition. Further, DoD has selected the DBMS to support the DBOF's implementation without evaluating the system's benefits and technical risks or defining all of the features needed.

IG, DoD, Report No. 93-110, "Audit Report on the Consolidating Financial Statements of the Defense Finance and Accounting Service Revolving Fund of the Defense Business Operations Fund - FY 1992," June 11, 1993. The report specified that DFAS had not completed a physical inventory of property, plant, and equipment in FY 1991 or FY 1992 to support the account's closing balance. Reliable evidence supporting the cost of property, plant, and equipment acquired before January 1991 was no longer available. DBOF's internal control weaknesses hampered the reconciliation of the DBOF's balances with the Treasury balances. Additionally, during the audit, a management advisory memorandum was issued on Preparation of the FY 1992 Financial Statements for the DFAS Revolving Fund (Project No. 2FG-2004). The memorandum reported that inventory records were inaccurate, assets were not appropriately capitalized, nonreimbursed services that the DFAS centers received and rendered were not shown in the accounting records, accounts payable were overstated, and some support agreements were not documented. The DFAS concurred with the memorandum's finding and recommendations and stated that corrective actions would be taken.

GAO Report No. T-AFMD-93-4 (OSD Case No. 9339-A), "Opportunities to Strengthen Management of the Defense Business Operations Fund," May 13, 1993. The report summarized the DoD progress in implementing and operating the DBOF. GAO stated that DoD has not corrected long-standing problems in the DBOF because of vacant management positions, underestimates of the magnitude and complexity of implementing the DBOF, and severe systems and financial control problems within DoD that have not been addressed.

GAO Report No. AFMD-93-61R (OSD Case No. 9389), "DoD's Federal Manager's Financial Integrity Act (FMFIA) Assertions," April 17, 1993. The report stated that the FMFIA report overstates the effectiveness of DoD internal controls and financial systems and is inconsistent with GAO audit reports. The report pointed out extremely serious accounting control weaknesses in the Services' operations and the DBOF's activities. DoD accounting systems do not comply with accounting principles and standards.

FMFIA managerial self-assessments have not identified serious internal control weaknesses nor has DoD addressed the root causes of its internal control problems, such as failure to carry out existing control procedures.

GAO Report No. AFMD-93-52R (OSD Case No. 9339), "Defense Business Fund," March 1, 1993. The report stated that DoD has not completed policies to govern the DBOF's operations. DoD has persistent problems in its financial and accounting systems, which hamper implementation of the DBOF. Congress and auditors cannot rely on DoD financial reports due to the reports' inaccuracy, incompleteness, inconsistency, and untimeliness. Financial report inaccuracy was due to the lack of DoD guidance, the failure of accounting systems to provide all necessary information, and inadequate field staffing.

IG, DoD, Report No. 92-129, "Defense Stock Fund Financial Statements (Material Managed Under the Standard Automated Material Management System) for FY 1991," August 26, 1992. The report specified that there were internal control weaknesses in ensuring that general ledger account balances were reconciled to subsidiary records; that subsidiary records were periodically verified to supporting documentation; and that unusual account balances such as negative inventories were reviewed. In response to the audit, management made recommended changes to the financial statements. Management actions taken or planned to improve internal control deficiencies and operational issues were considered generally responsive.

IG, DoD, Report No. 92-121, "Defense Industrial Fund - Communications Services Activity Financial Statements for FY 1991," June 30, 1992. The report stated that except for some specific adjustments, the principal statements, including the notes to the principal statements, present fairly in all material respects, the financial position of the Communication Services Industrial Fund. However, the auditors identified some deficiencies in the internal control structure and its operation. Specifically, internal controls did not ensure the proper classification of transactions and adherence to regulations. A Military Interdepartmental Purchase Request and a contract for installing a new automated accounting system during FY 1992 were classified as liabilities (accounts payable). The contractual obligations should be controlled through budget accounts because an obligation to pay (accounts payable) for goods or services does not occur until the goods or services are received.

GAO Report No. AFMD-92-79 (OSD Case No. 9089-A), "Status of the Defense Business Operations Fund," June 15, 1992. The report stated that key policies and systems necessary to run the DBOF in a businesslike manner have not been fully developed and implemented. Policies involving cash management, intrafund transactions, and capital asset accounting were needed but had not been finalized. Additionally, accounting systems will not be fully operational for another 3 years. The GAO suggested that if Congress extended the DBOF beyond the April 1994 date called for in the National Defense Authorization Act for FYs 1992 and 1993, the DoD should not be permitted to add new activities to the DBOF in FY 1994.

Office of the Comptroller, Department of Defense Comments

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

DEC - 9 1993

(Management Systems)

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR ANALYSIS AND FOLLOWUP

SUBJECT: Draft Audit Report on the Audit of Financial Reporting Procedures for Defense Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund (Project No. 2LD-2022)

This is in response to your memorandum, dated October 1, 1993, requesting comments on the subject draft audit report.

The draft report concludes that the capital asset policy promulgated by the Office of the DoD Comptroller does not comply with the Title 10, United States Code, section 2682, because real property used by the Defense Logistics Agency (DLA)--and other Defense Agencies--is reported on financial statements of the Agency although title rest with a Military Department.

As you are aware, Defense Agencies cannot hold title to real property. Therefore, real property used by Defense Agencies is titled with a Military Department. The inclusion of real property on financial statements of the Military Department holding legal title, but not using the property or responsible for day-to-day accountability of the property, would distort the results of the applicable Military Department's financial statements. Conversely, the exclusion of such property from the financial statements of the Business Operations Fund activity to which the day-to-day accountability of the property is entrusted also would distort the results of of the applicable Defense Agency's financial statements.

Property used by Business Operations Fund activities used to produce goods or services and earn revenue should be reported as an asset on the financial statements of those activities. To do otherwise would be to fail to disclose the full range of assets and costs associated with the operation of such activities. Of course, proper controls must be in place to preclude any dual reporting of real property by DoD activities.

My staff contact for this subject is Mr. Eric Gibson. He may be reached on (703) 697-7296.

Alvin Tucker
Deputy Comptroller
(Management Systems)

ENCLOSURE 3

Report Distribution

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

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400 Army Navy Drive (Room 801)
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D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ **Preparation Date 04/10/99**

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