

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**FINANCIAL ACCOUNTING FOR THE
DEFENSE NUCLEAR AGENCY**

Report No. 96-039

December 11, 1995

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Department of Defense

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Acronyms

| | |
|--------|---|
| CFO | Chief Financial Officers |
| CTR | Cooperative Threat Reduction |
| DFAS | Defense Finance and Accounting Service |
| DNA | Defense Nuclear Agency |
| CAFRMS | Centralized Accounting and Financial Resource Management System |



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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December 11, 1995

MEMORANDUM FOR DIRECTOR, DEFENSE NUCLEAR AGENCY

SUBJECT: Audit Report on Financial Accounting for the Defense Nuclear Agency
(Report No. 96 - 039)

We are providing this audit report for information and use. We considered management comments on a draft of this report in preparing the final report.

Management comments on a draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Marvin L. Peek, Audit Project Manager, at (703) 604-9587 (DSN 664-9587). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96- 039
(Project No. 5RF-6010.05)

December 11, 1995

Financial Accounting for the Defense Nuclear Agency

Executive Summary

Introduction. Public Law 103-356 requires DoD to provide consolidated financial statements for FY 1996 to the Office of Management and Budget. Financial Statements for the Defense Nuclear Agency (DNA) will be included in the consolidated financial statements for DoD. The DNA operates a financial accounting system that, with minor modifications, can provide information necessary to produce financial statements. During FYs 1994 and 1995, DNA received \$1.1 billion and \$0.8 billion, respectively, in appropriated and reimbursable funding.

Objectives. The audit objective was to review the financial accounting system DNA used and related management controls to determine whether the DNA financial accounting system can produce reliable information necessary to prepare financial statements.

Audit Results. The financial accounting system used by DNA was in substantial compliance with DoD accounting requirements, and the system was capable of providing information required for monthly budgetary reporting. However, correction of certain deficiencies was essential to produce accurate and auditable financial statements needed to support DoD consolidated statements. The general ledger module contained computer programming errors and omissions; necessary subsidiary records and general ledger accounts had not been established; some recorded account balances were incorrect or unsupported; and general ledger transaction histories were erased at the end of each fiscal year, preventing easy access to transactions supporting general ledger balances. As a result, the general ledger and supporting information could not be relied on for information necessary to produce auditable and accurate financial statements required by the Chief Financial Officers Act.

Recommendations in the report, if implemented, will assist DNA in preparing accurate and meaningful financial statements to be used to support the consolidated DoD financial statements required by Public Law 103-356. See Part I for a discussion of the audit results and Appendix B for a summary of the potential benefits resulting from the audit.

Summary of Recommendations. We recommend that DNA correct computer logic errors in its financial accounting system, adjust general ledger accounts for incorrect and unsupported balances, establish necessary subsidiary records to support specific assets and liability accounts shown in the general ledger, retain general ledger transaction histories, and determine ownership for assets transferred under the Cooperative Threat Reduction program.

Management Comments. The Director, DNA, concurred with the finding and all recommendations and stated corrections had been taken or were in process to correct all problems identified in the report. See Part I for a discussion of management comments and Part III for the complete text of management comments.

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Part I - Audit Results

Audit Background

The Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576) requires Federal Government organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, the Federal Financial Management Act of 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The consolidated DoD financial statements for FY 1996 will include the Defense Nuclear Agency (DNA) financial statements.

The DNA uses the Centralized Accounting and Financial Resource Management System (CAFRMS) to perform accounting, financial reporting, budgeting, and planning functions. The DNA developed the CAFRMS with the assistance of Arthur Young & Company and initiated operation of CAFRMS at the end of FY 1985. The staff for the Assistant Secretary of Defense (Comptroller) [now the Under Secretary of Defense (Comptroller)] determined that CAFRMS was in substantial compliance with DoD accounting requirements in July 1986 and again in December 1987. In March 1993, a review by the Federal Managers' Financial Integrity Act Division, Richmond Detachment, Defense Finance and Accounting Service (DFAS), concluded that CAFRMS substantially met the standards and requirements of the General Accounting Office, Office of Management and Budget, DoD, and the Federal Managers' Financial Integrity Act.

During FY 1993, as a result of Defense Management Report Decision 910, DFAS assumed responsibility for many accounting and finance functions performed by DNA. However, because DFAS did not have a system that could accommodate DNA information requirements and security concerns, it was agreed that CAFRMS would be left in place and maintained by DNA, until "a standard migratory¹ accounting system is deployed in DoD which can meet DNA's financial system requirements based on current operations." At the time of our audit, both DFAS and DNA personnel input and extracted data from CAFRMS.

The DNA received \$1.1 billion and \$0.8 billion in appropriated and reimbursable funding during FYs 1994 and 1995, respectively. The DNA expects to receive about \$0.8 billion in appropriated funding during FY 1996.

Audit Objectives

The audit objective was to review the DNA financial accounting system and related management controls to determine whether the DNA financial

¹An existing or planned and approved automated information system that has been designated to support a functional process on a DoD-wide basis.

accounting system can produce reliable information necessary to prepare financial statements required by the CFO Act. Appendix A discusses the audit scope and methodology and the review of the management control program.

The Defense Nuclear Agency Financial Accounting System

The general ledger module of CAFRMS contained computer programming errors and omissions; DNA did not establish necessary subsidiary records; some recorded account balances were incorrect or insupportable; and the general ledger module of CAFRMS was erased after the end of each fiscal year, preventing easy access to transactions supporting general ledger balances. Also, ownership of assets transferred to the republics of the former Soviet Union was not resolved. These conditions occurred because DNA had not established management controls to ensure accuracy and supportability of general ledger proprietary accounts. As a result, the general ledger and supporting information could not be relied on for information necessary to produce auditable and accurate financial statements required by the CFO Act.

Capabilities of CAFRMS

The DNA has been using CAFRMS since October 1985 for its accounting functions. The CAFRMS is a real-time, on-line, fully integrated, accounting and management information system. The CAFRMS provides for a single point of entry; by linked data bases, CAFRMS updates the general ledger and management resource modules. Each transaction generates a historical record that provides an audit trail to track transactions to source documentation and operating reports.

The CAFRMS produces a separate general ledger² with both budgetary and proprietary accounts for each appropriation by fiscal year for each of the three facilities DNA uses to administer funding: Headquarters, the Field Command, and the Test Facility. The CAFRMS uses standard DoD general ledger account numbers. Computer programmers within the Information Management Directorate of DNA make all programming changes to CAFRMS.

²Although the CAFRMS recorded transactions in separate general ledgers, the general ledgers will be referred to collectively as the "general ledger" in this report.

Programming Changes Needed for CAFRMS

When DNA began using CAFRMS in October 1985, the system still had several errors that needed to be corrected to produce viable data. DNA personnel made adjustments to CAFRMS as problems were identified and new requirements were established. However, DNA management did not consider adjustments to CAFRMS for general ledger proprietary accounts a high priority. Also, when DNA personnel made programming changes to CAFRMS, they frequently did not make adjustments to the general ledger for erroneous entries previously posted. In addition, DNA had not programmed CAFRMS to produce a consolidated general ledger and trial balance or an Appropriated Capital Used account.

Annual Closing Entries. When the CAFRMS program made closing entries to the general ledger at the end of each fiscal year, Miscellaneous Reimbursements (a revenue account) was not closed. As a result, \$158 million was in the Miscellaneous Reimbursements account for active³ appropriations at the end of FY 1994 after closing entries were completed. Review of general ledger accounts at the end of FY 1994 also showed that \$30 million in expenses for FY 1994 and prior years had not been closed. Both revenues and expenses should have a zero balance after yearly closing entries have been posted.

In addition, the CAFRMS automated computer program erroneously made an entry to the fund equity account, zeroing out the fund equity balance at the end of each fiscal year. As a result, the general ledger for active appropriations was out of balance by \$1.1 billion at the end of FY 1994. This type of error had been occurring since CAFRMS became operational in FY 1985. Personnel in the DNA Comptroller Office stated that they became aware of this problem in early FY 1995. In May 1995, those personnel requested that CAFRMS programmers correct the problem.

Failure to close expenses and revenues to a fund equity account misrepresents the results of operations, and annual closure of fund equity accounts significantly distorts the financial position of an agency.

Accrued Payroll and Benefits Payable. Programming errors in the general ledger module of CAFRMS prevented estimated accrued payroll and benefits from being properly reversed when DNA posted actual amounts after the end of the period. As a result, Accrued Payroll and Benefits Payable accounts for prior years were incorrect and could not be supported. As of September 30, 1994, Accrued Payroll and Benefits Payable for FY 1993 and prior years showed a liability totaling \$709,000, and a negative liability totaling \$1.2 million that could not be supported. Although DNA programmers corrected the CAFRMS program during FY 1993, erroneous balances for prior years remained to be corrected.

³Appropriations are considered "active" until canceled by the U.S. Treasury 5 years after authority to obligate expires.

While trying to verify balances during the audit, the Chief, Analysis and Support Office at DNA found another computer programming error that required correction in order for accrued payroll and other accounts payable to be reported correctly. The Chief immediately requested that computer programmers correct the problem.

Accounts Receivable. A computer programming error caused many receivables to be accumulated in Accounts Receivable-Public, but recorded in Accounts Receivable-Government when received. As a result, 19 of the 27 Accounts Receivable-Government for years prior to FY 1993 had negative balances. Although the error was corrected during FY 1993, receivables incorrectly posted during prior years were not corrected, and to determine the correct accounts receivable, Accounts Receivable-Public and Accounts Receivable had to be netted.

Consolidated General Ledger. The CAFRMS had not been programmed to produce a consolidated general ledger, combining all appropriations and DNA activities. Personnel in the DNA Comptroller office had written query programs capable of combining all accounts for each appropriation. However, the query program that was used to assist DFAS in preparing the FY 1994 Statement of Financial Position (Standard Form 220) produced erroneous information. A consolidated trial balance and general ledger is necessary to produce a financial statement representing DNA as a separate entity.

Appropriated Capital Used Account. The DNA had not established an Appropriated Capital Used account in the CAFRMS general ledger. The Financial Management Regulation (DoD 7000.14-R) volume 1, shows the account as part of the Standard DoD General Ledger. The Appropriated Capital Used account is a revenue account used "to record accrued expenses (versus outlays) of appropriated funds. The purpose of the account is to match current period expenses against the use of appropriated funds used to finance those expenses." Failure to use the Appropriated Capital Used account caused no adverse effects for DNA. However, when Defense agencies begin reporting trial balances to DFAS at the end of FY 1995, that information is essential for preparing financial statements required by the CFO Act.

Ability to Trace Transactions and Subsidiary Records

General Ledger Module. Shortly after the end of each fiscal year when year-end posting was completed, CAFRMS programmers routinely erased general ledger transactions histories for the previous fiscal year. Although DNA archived other records, those records were not formatted to easily research transactions to support reported general ledger balances. Personnel from the

The Defense Nuclear Agency Financial Accounting System

Information Management Directorate stated that the general ledger transaction history could be easily saved at the end of each year and agreed to save general ledger transaction histories at the end of FY 1995.

Plant, Property, and Equipment. As of May 31, 1995, general ledger accounts from CAFRMS showed \$441 million in capitalized equipment in use by DNA and \$22.6 million in DNA equipment with contractors. However, CAFRMS did not produce subsidiary records, as required by the DoD Financial Management Regulation, for capital equipment reported in general ledger accounts.

Equipment in Use. Various directorates within DNA maintained property records for the property under their responsibility. As of June 1995, the property records showed \$35 million⁴ in equipment and vehicles, which was significantly less than the \$441 million recorded in CAFRMS. However, DNA had not consolidated the records, could not track the amounts shown in the general ledger, and made no distinction between equipment that met the DoD capitalization criteria and equipment that should have been charged to expense.

The Director, DNA, reported as a material weakness in the FY 1994 Annual Statement of Assurance that inventories of capital equipment had not been reconciled to the general ledger control accounts. (Reporting the weakness is required under the Federal Managers' Financial Integrity Act.) However, the Annual Statement of Assurance showed that DNA did not plan to finish correcting the problem until March 1996. At the time of our audit in July 1995, DNA had not yet begun to reconcile detailed property records with the general ledger accounts or to change CAFRMS to produce the subsidiary records needed to trace purchased equipment to DNA property books. The Logistics and Engineering Director stated that he was awaiting guidance from DoD on how to account for and record Government equipment held by DNA contractors before trying to solve the problem of general ledger accountability for equipment held by DNA.

Accounting for and recording Government equipment held by contractors should not preclude DNA from developing a system to properly account for equipment in use and held by DNA.

Personnel from the DNA Information Management Directorate stated that CAFRMS could be reprogrammed to produce subsidiary ledgers for equipment purchased in the future.

Property Held by Contractors. The DNA maintained no supporting documentation to show the source of the \$22.6 million balance shown in CAFRMS, and most of the balance dated to FY 1988 appropriations. Part 45 of the Federal Acquisition Regulation requires contractors to maintain the

⁴This amount does not include equipment purchased with funds from the Cooperative Threat Reduction program, which will be or has been transferred to republics of the former Soviet Union. That equipment is discussed in a subsequent section of the report.

official records of Government assets in the contractors' possession and to annually report the total acquisition cost of those assets. However, DNA had not established procedures to incorporate information from contractors' annual reports into CAFRMS or into financial reports sent to DFAS.

DoD Manual 4161.2-M, "Performance of Contract Property Administration," December 1991, has established detailed procedures for Government oversight and requires contractors to report Government-owned assets as of September 30 each year on DD Form 1662, "DoD Property in Custody of Contractors." As of September 30, 1994, contractors reported to the Defense Logistics Agency \$133.7 million of Government-owned assets from DNA contracts.

A judgmental sample of records of two contractors that reported \$50.6 million of the \$133.7 million in contractor-held assets as of September 30, 1994, showed no discrepancies in contractor records. Specifically, we located all items and verified the cost to supporting documentation in a judgmental sample of 79 items from contractor records supporting the DD Forms 1662. While verifying the existence of the equipment, we also found 54 items that we traced to contractor records supporting the DD Forms 1662 for September 30, 1994.

DD Form 1662 asset reporting requirements are not consistent with asset capitalization criteria established by DoD.⁵ For example, Applied Research Associates reported 827 line items valued at \$4.9 million on DD Form 1662 as of September 30, 1994. However, of the 827 line items, 758, costing a total of \$1.2 million, had an acquisition cost of less than \$15,000 per item. Also, because information from the DD Forms 1662 is not directly tied to the general ledger, the data are not compatible with information requirements for general ledger reporting.

Since the scope of our review included only two contractors that reported about 38 percent of the total reported amount for DNA contracts, we cannot provide an opinion on the overall accuracy of information reported by the contractors to the Defense Logistics Agency. The Inspector General, DoD, plans a DoD-wide audit in FY 1996 of Government-provided property, to include contractor-acquired and Government-furnished property. We are deferring recommendations concerning accounting and reporting of Government-provided property until the completion of that audit.

Subsidiary Records for Receivables and Payables. Although subsidiary records for receivables and payables reconciled with the receivable and liability balances shown in the general ledger, CAFRMS was not programmed to produce a separate subsidiary ledger for each general ledger account. For example, a consolidated subsidiary record for the Operation and Maintenance appropriation for FY 1990 showed a liability of \$18,371 as of July 6, 1995, for the DNA Headquarters account (see Table 1). That amount agreed with the amount payable shown in the general ledger for DNA Headquarters. However,

⁵DoD requires assets with a useful life of at least 2 years and an acquisition cost of at least \$15,000, when procured with FYs 1992 and 1993 appropriations, or at least \$25,000, when procured with FY 1994 appropriations, to be capitalized.

The Defense Nuclear Agency Financial Accounting System

one could not discern from the subsidiary records the specific transactions comprising each account without going to the specific referenced document to verify the type of payable.

Table 1. Liabilities in the FY 1990 General Ledger for DNA Headquarters

| <u>Account</u> | <u>Amount Payable</u> |
|-----------------------------|-----------------------|
| Accounts Payable-Government | \$(513,080) |
| Accounts Payable-Public | 384,227 |
| Accrued Payroll | 142,223 |
| Accrued Payroll Benefits | <u>5,001</u> |
| Total liabilities | \$ 18,371 |

The CAFRMS did not produce detailed subsidiary records for each account. Therefore, the DFAS office located at DNA estimated the breakout (see Table 2) between Accounts Payable-Government and Accounts Payable-Public on the Report on Financial Position (Standard Form 220) for FY 1994 rather than using the amounts shown in the general ledger. Personnel from the DNA Information Management Directorate stated that CAFRMS could be easily programmed to produce the required subsidiary records.

Table 2. Comparison of General Ledger Balances with Amounts Reported on the Standard Form 220.

| | <u>General Ledger Balance</u> | <u>Reported on Standard Form 220</u> |
|---|-----------------------------------|--|
| Accounts Payable-Government | \$ 2,424,010 | \$22,341,592 |
| Accounts Payable-Public | 27,796,986 | 10,513,691 |
| Accrued Payroll and Benefits | 2,634,287 | 2,609,287 |
| Accrued Payroll and Benefits incorrectly included in Accounts Payable | <u>0</u> | <u>(2,609,287)</u> |
| Total Payable | \$32,855,283 | \$32,855,283 |

Reporting and Verification of Balances in the General Ledger

Our review and testing of balances reported in the general ledger showed that corrections were needed in the Fund Balance with Treasury, advances, and liabilities.

Fund Balance with Treasury. The Fund Balance with Treasury account in the DNA general ledger included funds from appropriations which the U.S. Treasury was required to cancel in accordance with United States Code, title 31, section 1552(1a).⁶ On September 30, 1994, \$8.1 million shown in the DNA general ledger became eligible for cancellation by the Treasury. The general ledger also included an additional \$24.3 million in Fund Balance with Treasury accounts for appropriations eligible for cancellation since FY 1985 when CAFRMS was established. The DoD Financial Management Regulation, volume 4, requires that the Fund Balance with Treasury be reduced upon the cancellation of expired appropriations.

Advances to Grantees. The general ledger showed \$1.9 million in receivables in the Advances to Grantees account. However, DNA could not provide support for \$1.3 million of the amount. Because administration of grants was not a common occurrence, DNA had not established procedures to reconcile the Advances to Grantees account to supporting documentation.

Accrued Unfunded Annual Leave Payable. The DNA had not established a liability for accrued unfunded annual leave payable. Because the payroll system providing information to DNA did not directly interface with CAFRMS, a liability (and the related expense) had never been established for unpaid annual leave for DNA civilian employees. We estimated that a \$2 million liability for unfunded annual leave existed at the end of May 1995. The DoD Financial Management Regulation, volume 4, requires that accrued unpaid annual leave be estimated at the end of each operating period and recorded as a liability. The Regulation also requires an Annual Leave Expense account to be established to record the net amount of unfunded annual leave earned by civilian employees during the operating period.

Accounts Payable for Travel by Others. About \$363,000 in accounts payable related to travel by others was not valid from the FY 1991 Operation and Maintenance appropriation for Headquarters, DNA. For example, \$242,000 had been accrued both as an expense and as a payable for travel for personnel from the U.S. European Command for support to DNA in two training exercises. However, only \$51,000 of the accrued payable had been paid, leaving a remaining payable of \$191,000 that DNA should not have established and could not support.

⁶According to section 1552(a), on September 30th of the 5th fiscal year after an appropriation's period of availability for incurring new obligations expires, both the obligated and unobligated balances of that appropriation are required to be canceled and will no longer be available for obligation or expenditure for any purpose.

The DNA personnel recorded a payable in CAFRMS when DNA sent a message to Headquarters, U.S. European Command, authorizing funds to be spent for a training exercise. Although the message required the Headquarters, U.S. European Command, to provide a list of all travelers who had completed travel, DNA received only copies of paid travel vouchers and no detailed information on the amount of funds that had been obligated for travel. The DNA should not have established a liability until DNA was assured that travel would begin. Consequently, DNA was unable to reconcile specific obligations to completed travel. Because DNA had not established procedures to validate liabilities outstanding for extended periods, DNA had not recognized the problem.

Accounts Payable for Work Performed by Others. We reviewed four DNA accounts payable totaling \$345,000 from FY 1989 and FY 1991 appropriations for the DNA Headquarters account. Two accounts payable, totaling \$196,000, were not valid. The accounts payable were invalid because personnel entering transactions into CAFRMS failed to reduce accrued expenses and accounts payable when a refund was received for invoices totaling \$196,000 that DNA had already paid.

Assets Acquired with Cooperative Threat Reduction Program Funds

As of July 1995, DNA had received \$1.2 billion in funds for support of the Cooperative Threat Reduction (CTR) program⁷ to assist four republics from the former Soviet Union in the elimination of weapons of mass destruction and the prevention of weapons proliferation. Portions of the funds were used for items of equipment that were or would be provided to the four republics. As of August 15, 1995, CTR personnel in DNA had prepared an incomplete data base showing \$166 million in equipment, parts, and instructional manuals that had been purchased.

Legislation establishing the objectives and funding for the CTR program did not specifically relate to ownership of assets provided to the republics. Also, implementing agreements with the four republics stated that the United States would "provide at no cost" material and services in accordance with the terms of the agreement. However, the agreements sometimes give DoD the right to audit and examine the use of materials provided under the agreements.

The DNA personnel assigned to the CTR program considered the assets as the property of the four republics when custody was transferred. However, because the DNA Comptroller had not been given specific guidance on how to record

⁷Congress authorized funding for the CTR program objectives in title II of Public Law 102-228, title XIV of Public Law 102-484, and title XII of Public Law 103-160. Congress provided for CTR funding in Public Laws 102-229, 102-396, and 103-139. Other related legislation is included in title V of the Freedom of Support Act (Public Law 102-511).

equipment purchased from CTR funds, DNA personnel recorded those assets in CAFRMS in the same manner as assets purchased by DNA for its own use. The DNA should determine legal ownership of assets purchased for the four republics with CTR funds and make appropriate adjustments, if necessary, in CAFRMS.

Recommendations for Corrective Action

We recommend that the Director, Defense Nuclear Agency:

1. Correct computer logic errors and reprogram the Centralized Accounting and Financial Resource Management System to:

a. Close all expense and revenue accounts to fund equity at the end of each fiscal year.

b. Correct the error that zeroed out fund equity accounts at the end of each fiscal year.

c. Produce subsidiary records for each receivable and liability account in the general ledger.

d. Establish subsidiary ledgers for Military Equipment in Use reported in the general ledger so the equipment can be traced easily to specific equipment on property books.

e. Produce a consolidated general ledger combining all reportable appropriations and accounting entities of the Defense Nuclear Agency.

f. Establish an "Appropriated Capital Used" account as required by the DoD Financial Management Regulation.

2. Adjust general ledger accounts for erroneous balances shown for prior years because of errors in computer logic or operator error.

3. Perform an inventory of equipment on hand, and remove equipment balances from the general ledger that cannot be supported.

4. Retain general ledger transaction histories for at least 1 year to provide a necessary audit trail for any required reviews.

5. Reduce the Fund Balance with Treasury for expired appropriations subject to cancellation by the U.S. Treasury in accordance with the DoD Financial Management Regulation, volume 4.

6. Validate receivables and liabilities in the general ledger, and perform periodic reconciliations of amounts reported in the general ledger to supporting documentation.

7. Record a liability for accrued unfunded annual leave payable at the end of each accounting period, and establish an expense account for the net amount of annual leave earned during the period.

8. Discontinue accruing a liability for travel and transportation by others until documentation is received that validates the existence of a payable, and make frequent reviews to validate liabilities for travel by others.

9. Determine the legal ownership of assets provided to the republics of the former Soviet Union under the Cooperative Threat Reduction program, and adjust accounting records, if necessary, to include only assets that are owned by the Defense Nuclear Agency.

Management Comments and Audit Response

Management Comments. The Director, Defense Nuclear Agency, concurred with all recommendations and stated that corrections in computer programming, adjustments to accounting records, required inventories, and validation of accounts had been or would be completed by December 31, 1996. Further, the Director requested that the Inspector General, DoD, discuss with the Under Secretary of Defense (Comptroller) how and when to notify field organizations of required adjustments to accounting records for appropriations subject to cancellation. For a complete text of comments see Part III.

Audit Response. We discussed the issue of appropriations subject to cancellation with the Office of the Under Secretary of Defense (Comptroller) during the audit, and a copy of this report will be sent to the Under Secretary's Office.

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Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Audit Process

We reviewed financial information produced by the CAFRMS as of September 30, 1994, and May 31, 1995, and support for DNA financial reports sent to DFAS for FY 1994. Also, we also compared subsidiary records for assets and liabilities to general ledger accounts for other dates during the audit because CAFRMS was an on-line system and reconciliations between general ledger accounts and subsidiary records had to be performed simultaneously.

Except for a review of selected liabilities for FYs 1989 through 1991 that did not appear current, we limited our review to management controls considered necessary, procedures used, and the capability of DNA to produce required supportable financial information from general ledger proprietary accounts in CAFRMS. Also, we visited two contractors who reported \$50.6 million of the \$133.7 million in assets held by DNA contractors as of September 30, 1994. For those two contractors, we evaluated oversight by the Government Property Administrator, and we selected a judgmental sample of 79 items to verify the acquisition cost and existence of the assets. Additionally, we selected 54 items of equipment found at the contractors' facilities for verification that the items were reported by the contractor.

Because this audit was not intended to provide an overall opinion on the reported balances in the general ledger and accompanying financial reports, no comprehensive review or statistical sampling of transactions supporting general ledger balances was performed, and the results of our audit are not projected to all balances shown in the general ledger produced by CAFRMS.

Use of Computer-Processed Data. We performed enough reviews of data produced by the CAFRMS to conclude that the system contained programing errors and incorrect account balances, which caused erroneous information to be shown in the general ledger accounts. As discussed in the finding, the information could not be relied on to produce accurate financial statements.

Audit Period and Standards. We performed this financial-related audit from June through August 1995. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, based on the objectives of the audit, and the limitations in the scope described in this appendix. Appendix C lists the organizations we visited or contacted.

*Allied Signal Technical Services Corporation (contract DNA001-91-C-0013) and Applied Research Associates, Incorporated (contract DNA001-93-C-0147).

Management Control Program

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

Scope of Review of Management Control Program. We reviewed supporting documentation for the DNA Annual Statement of Assurance required under the Federal Managers' Financial Integrity Act of 1982. We also reviewed general management controls over financial information shown in the general ledger produced by CAFRMS. We examined administrative controls, the plan of organization, and policies and procedures for authorization of transactions. Additionally, we examined accounting controls directly related to the evidence supporting specific transactions under review.

Adequacy of Management Controls. The CAFRMS had built-in controls to ensure that transactions could be traced and that the person responsible for input of transactions could be identified. However, adequate subsidiary records were not established, general ledger transaction histories were not retained, and procedures were not established to verify balances shown in the general ledger. Therefore, management controls were not fully effective to assure the reliability and auditability of financial information produced by the CAFRMS general ledger. In addition, management had not performed vulnerability risk assessments during FYs 1993 and 1994 through July 1995 as scheduled in the DNA 5-year Management Control Plan. The DNA did not perform the assessments because it was reidentifying its assessable units to coincide with changes in the DNA mission.

We identified material management control weaknesses for DNA as defined by DoD Directive 5010.38. Controls over recording, reconciliations, and reporting capitalized equipment in use by DNA and Government-owned property held by DNA contractors were not adequate to ensure accurate and supportable financial statements. Recommendations 1.d. and 3., if implemented, will improve management control of equipment being used by DNA. Recommendations concerning recording and reporting of Government-owned property held by contractors are being deferred because this problem is a concern throughout DoD. We plan to conduct a DoD-wide audit in FY 1996 on Government property held by contractors. Recommendations issued as a result of that report should assist DoD and DNA with this material management control weakness.

Adequacy of Management's Self-Evaluation. As part of the FY 1994 Annual Statement of Assurance, DNA correctly reported as a material weakness that capital equipment had not been reconciled to general ledger accounts as required by the DoD Financial Management Regulation. The Annual Statement of Assurance showed DNA planned to finish correcting the weakness by March 1996. The DNA was also awaiting guidance from DoD on proper procedures for recording DNA property held by contractors.

Prior Audits and Other Reviews

Only one review of CAFRMS has been conducted during the last 5 years. The Federal Managers' Financial Integrity Act Division, Richmond Detachment, of the Accounting Directorate of DFAS, issued an "Evaluation of the Centralized Accounting and Financial Resource Management System (CAFRMS)," March 31, 1993. The report concluded that CAFRMS was substantially in compliance with the principles, standards, and related requirements of the General Accounting Office, Office of Management and Budget, DoD, and the Federal Managers' Financial Integrity Act.

Appendix B. Summary of Potential Benefits Resulting From Audit

| Recommendation Reference | Description of Benefit | Type of Benefit |
|-------------------------------------|---|------------------------|
| 1. | Program Results, Management Control, and Compliance with Regulations. Corrects computer program errors in CAFRMS and reprograms CAFRMS to provide needed information for agency financial statements. | Nonmonetary. |
| 2. and 3. | Compliance with Regulations and Management Control. Corrects erroneous and unsupportable balances shown in the general ledger. | Nonmonetary. |
| 4. | Management Control. Retains transaction histories to provide required audit trails for general ledger balances. | Nonmonetary. |
| 5. | Compliance with Laws and Regulations. Removes funds of canceled appropriations from the general ledger. | Nonmonetary. |
| 6. | Management Control. Assures that balances reported in the general ledger are valid and supported. | Nonmonetary. |
| 7. | Compliance with Regulations. Assures that liabilities and expenses are accurately reported. | Nonmonetary. |

Appendix B. Summary of Potential Benefits Resulting From Audit

| Recommendation Reference | Description of Benefit | Type of Benefit |
|-----------------------------|--|-----------------|
| 8. | Management Control. Establishes better controls over reporting of liabilities for travel by others. | Nonmonetary. |
| 9. | Compliance with Laws and Regulations. Makes legal determination on the ownership of equipment transferred under the CTR program. | Nonmonetary. |

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Defense Agencies

Defense Finance and Accounting Service, Arlington, VA

Defense Finance and Accounting Service Center, Indianapolis, IN

Defense Logistics Agency, Fort Belvoir, VA

Defense Contract Management Command, Fort Belvoir, VA

Operations and Policy Group, Fort Belvoir, VA

Defense Contract Management Area Office, Albuquerque, NM

Defense Nuclear Agency, Alexandria, VA

Non-Government Organizations

Allied Signal Technical Services Corporations, White Sands, NM

Applied Research Associates, Incorporated, Albuquerque, NM

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Assistant Secretary of Defense (Atomic Energy)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program and Budget)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, Defense Nuclear Agency
Director, National Security Agency
Inspector General, National Security Agency

Non-Defense Federal Organizations

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

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

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Part III- Management Comments

Defense Nuclear Agency Comments



Defense Nuclear Agency
6801 Telegraph Road
Alexandria, Virginia 22310-3398



NOV 28 1995

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT,
OFFICE OF THE DOD INSPECTOR GENERAL

SUBJECT: Draft Audit Report, "Financial Accounting for the Defense Nuclear Agency,"
dated September 20, 1995 (Project No. 5RF-6010.05)

I wish to convey the appreciation of my staff to your audit project manager and his team for their assistance and insight in reviewing the capabilities of DNA's financial management system to produce auditable financial statements by the end of FY 1996, as required under the Chief Financial Officer's (CFO) Act.

Your audit disclosed several previously undetected weaknesses, which will receive immediate attention.

Additionally, since your field work was completed, the Defense Finance and Accounting Service has promulgated new reporting requirements which feature general ledger trial balance reporting. In addressing the weaknesses your audit identified, we will be able to meet these new requirements more effectively, accurately, and within established deadlines.

We encourage you to complete your planned DoD-wide audit of government provided equipment in FY 1996. Lengthy discussions held between my staff and your auditors identified several perceived disconnects among guidance provided by the acquisition, logistic, and comptroller communities within DoD. Until these issues receive top management attention, DoD field level activities will be handicapped by this systemic deficiency.

Our comments on your specific findings and recommendations are attached. We especially agree with your conclusion in the executive summary, that upon completing actions outlined in your report, the DNA financial accounting system, the Centralized Accounting and Financial Resource Management System (CAFRMS), can provide information necessary to produce financial statements required by the CFO Act.

GARY L. CURTIN
Major General, USAF
Director

Attachment
As stated

Defense Nuclear Agency Comments
on DoD IG Draft Report, "Financial Accounting for the
Defense Nuclear Agency," dated September 20, 1995
(Project No. 5RF-6010.05)

RECOMMENDATION 1: Correct computer logic errors and reprogram the Centralized Accounting and Financial Resource Management System to:

a. Close all expense and revenue accounts to fund equity at the end of each fiscal year.

DNA COMMENTS: CONCUR. Computer posting logic and programming errors within the general ledger module of the Centralized Accounting and Financial Resource Management System (CAFRMS) that prevented the proper closure of all revenue and expense accounts have been corrected.

Completion date: 30 September 1995.

b. Correct the error that zeroed out fund equity accounts at the end of each fiscal year.

DNA COMMENTS: CONCUR. Computer posting logic and programming errors within the CAFRMS general ledger that distorted the fund equity balances in account 3100, "Appropriated Capital", have been corrected.

Completion date: 30 September 1995.

c. Produce subsidiary records for each receivable and liability account in the general ledger.

DNA COMMENTS: CONCUR. While accounting subsidiary records are currently available to support each receivable and liability account in the general ledger using ad hoc data query retrievals, use of this technique requires in-depth knowledge of file structures and process on the part of the user. To the extent that the use of pre-defined batch reports in lieu of ad hoc queries would provide more consistent and reliable information, DNA agrees to begin development of such reports.

Estimated completion date: 15 May 1996.

d. Establish subsidiary ledgers for Military Equipment in Use reported in the general ledger so the equipment can be traced easily to specific equipment on property records.

DNA COMMENTS: CONCUR. DNA agrees to develop pre-defined batch accounting reports similar to those discussed in response 1.c.; however, complete compliance with this recommendation will also require revision to each of the systems supporting individual Agency property accounts.

Estimated completion date: 1 June 1996.

Defense Nuclear Agency Comments

e. Produce a consolidated general ledger combining all reportable appropriations and accounting entities of the Defense Nuclear Agency.

DNA COMMENTS: CONCUR. Because DNA is funded by numerous specific appropriations which require individual reporting, a unified trial balance as requested in this recommendation has limited usefulness beyond the DoD IG identified requirement for annual Chief Financial Officer's (CFO) financial statement reporting. CAFRMS' file structures should permit the production of a consolidated general ledger trial balance; however, accomplishment will be delayed by the limited amount of available programming resources.

Estimated completion date: 31 August 1996.

f. Establish an "Appropriated Capital Used" account as required by the DoD Financial Management Regulation.

DNA COMMENTS: CONCUR. DNA has amended its chart of accounts to include general ledger account 5700, "Appropriated Capital Used", and has developed the required posting logic to accurately capture appropriate transaction amounts in that account.

Completion date: 30 September 1995

RECOMMENDATION 2: Adjust general accounts for erroneous balances shown for prior years because of errors in computer logic.

DNA COMMENTS: CONCUR. Prior fiscal year general ledger accounts with erroneous balances will be reconciled and adjusted on a priority basis within limits of available resources.

Estimated completion date: 31 December 1996.

RECOMMENDATION 3: Perform an inventory of equipment on hand, and remove equipment balances from the general ledger that cannot be supported.

DNA COMMENTS: CONCUR. Equipment on hand will be inventoried and applicable general ledger account balances reconciled and adjusted.

Estimated completion date: 1 August 1996.

RECOMMENDATION 4: Retain general ledger transaction histories for at least 1 year to provide a necessary audit trail for any required reviews.

DNA COMMENTS: CONCUR. General ledger log records which provide annual transaction histories of all general ledger account activity will be retained for 5 years beginning with log records retrieved for FY 1993.

Completion date: 30 September 1995.

RECOMMENDATION 5: Reduce the "Fund Balance with Treasury" account for expired appropriations subject to cancellation by the US Treasury in accordance with DoD Financial Management Regulation, volume 4.

DNA COMMENTS: CONCUR. DNA will reduce balances in general ledger account 1010, "Fund Balance with Treasury", in accordance with governing regulations. As recent history has indicated, however, cancellation of appropriations is not always automatic. Request DoD IG initiate a dialogue with USD(C) to discuss the timing and notifications to field activities required for these adjustments.

Estimated completion date: 31 January 1996.

RECOMMENDATION 6: Validate receivable and liabilities in the general ledger, and perform periodic reconciliations of amounts reported in the general ledger to supporting documentation.

DNA COMMENTS: CONCUR. DNA will validate all balances in general ledger receivable and liability accounts. A standard operating procedure will be developed to insure amounts in these accounts are periodically reconciled to supporting documentation.

Estimated completion date: 30 April 1996.

RECOMMENDATION 7: Record a liability for accrued unfunded annual leave payable at the end of each accounting period, and establish an expense account for the net amount of annual leave earned during the period.

DNA COMMENTS: CONCUR. DNA recorded a liability for accrued unfunded annual leave in general ledger account 2221, "Accrued Annual Leave-Civilian (Unfunded)", and a corresponding expense to account 6130, "Annual Leave".

Completion date: 30 September 1995.

RECOMMENDATION 8: Discontinue accruing a liability for travel and transportation by others until documentation is received that validates the existence of a payable, and make frequent reviews to validate liabilities for travel by others.

DNA COMMENTS: CONCUR. DNA will amend its procedures for accruing travel and transportation expenses related to funds provided to external activities. Accrual recognition will be postponed until accrued expenditure documentation is received by DNA. Validation of such liabilities will be specifically included in procedures for validating unliquidated obligations.

Estimated completion date: 31 January 1996.

RECOMMENDATION 9: Determine the legal ownership of assets provided to the republics of the Former Soviet Union under the Cooperative Threat Reduction program, and adjust accounting records, if necessary, to include only assets that are owned by the Defense Nuclear Agency.

DNA COMMENTS: CONCUR. DNA will make a determination of ownership for assets provided to republics of the Former Soviet Union under the Cooperative Threat Reduction

Defense Nuclear Agency Comments

program. Appropriate adjustments will be made to "Equipment in Use" general ledger account balances to ensure they reflect only assets owned by this Agency.

Estimated completion date: 31 September 1996.

Audit Team Members

This report was prepared by the Readiness and Operational Support Directorate,
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