

April 1988

FINANCIAL REPORTING

Defense Agencies' Reports on Financial Position Need To Be Improved





United States
General Accounting Office
Washington, D.C. 20548

**Accounting and Financial
Management Division**

B-228764

April 14, 1988

The Honorable Frank C. Carlucci
The Secretary of Defense

Dear Mr. Secretary:

This report presents the results of our review of the defense agencies' fiscal year 1986 Reports on Financial Position, commonly referred to as a balance sheet. This review, one segment of the Department of Defense section in a governmentwide effort, was performed to determine the extent of compliance with the General Accounting Office's (GAO's) and the Department of the Treasury's annual financial reporting requirements.

The defense agencies had not exercised effective control over the process of preparing and consolidating their Reports on Financial Position. The reports did not include data on all assets and liabilities, contained inaccurate data for some of these accounts, and did not fully comply with title 2 and the Treasury Financial Manual requirements. Agencies relied on ad hoc sources of financial data rather than on a general ledger to prepare the Reports on Financial Position. The primary causes for these reporting weaknesses were the absence of specific guidelines and procedures on how to prepare the reports, lack of supervision, and, with the exception of one defense agency, the absence of a general ledger.

The Importance of Financial Statements

Comprehensive financial statements at the agency level are important, if not crucial, to providing discipline and cohesiveness in financial management and accounting. Financial statements consistently prepared in accordance with accounting standards offer assurance of quality, reliability, and comparability of data presented. The requirement for such statements will, in turn, provide a strong impetus for agencies to improve the reliability of information produced by their financial management reporting systems. Reliable financial information is needed not only by program managers to more effectively manage their programs but also by external users such as the Congress and the central control agencies, primarily the Office of Management and Budget (OMB) and Treasury, to make better-informed decisions.

GAO's accounting standards (title 2 of its Policy and Procedures Manual for Guidance of Federal Agencies) and Treasury's reporting requirements (Treasury Financial Manual) require that agency Reports on

(1) Report on Financial Position, (2) Report on Operations, (3) Report on Cash Flow, and (4) Report on Reconciliation.

The Report on Financial Position shows an entity's assets, liabilities, and equity as of the reporting date. The Report on Operations shows the annual financial results of an entity's activities including expenses, revenues, and other financing sources such as appropriations. The Report on Cash Flow summarizes all significant resources available to an agency and the uses made of those resources during the reporting period. The Report on Reconciliation reconciles expenses reported in the Report on Operations with the cash outlays reported to the Treasury.

Adequate implementation of the above initiatives are intended to establish a sound financial management foundation for improving the reliability of accounting systems and, therefore, the financial reports they produce.

Objectives, Scope, and Methodology

Our objectives were (1) to assess how well the Department of Defense (DOD) implemented GAO's and Treasury's annual financial reporting requirements, (2) to determine if there were any problems encountered in meeting these requirements and standards, and (3) to identify any actions needed to improve compliance.

We reviewed the procedures used in compiling the activity level Reports on Financial Position to determine whether the process was reliable and whether the reports were prepared in accordance with Treasury's requirements. We also judgmentally selected 16 of the 19 activity level reports submitted for compilation by four defense agencies. We then chose certain report elements from these based on their relative materiality in dollars and risk (See appendix II.) For the selected elements, we determined whether DOD's or the defense agency's accounting procedures conformed to our accounting standards. As part of this effort, we developed a structured interview guide as the basis for gathering information by interviewing officials from the Accounting Divisions and DOD's Office of Inspector General. In addition, we traced amounts shown on the 16 reports to a general ledger, where available, or to other records. We did not test the transactions nor did we study and evaluate existing related internal controls and so we are not commenting on the reliability of the reported data. Our review was performed in accordance with generally accepted government auditing standards.

Table 1: Contents of WHS Reports on Financial Position

	Activity level reports	Reports sent to Treasury
Consolidated reports:		
General and deposit funds	75	1
Revolving funds	3	1
Trust funds	5	1
Total consolidated	83	3
Unconsolidated reports:		
Revolving fund	1	1
Total reports	84	4

Nine reports covering forty-six accounts were not included in the general and deposit fund consolidated Report on Financial Position. One report covering thirty-eight of these accounts should have been submitted by a centralized accounting staff in WHS but was not. A WHS Accounting Chief told us that these accounts were not reported because there had been no decision reached within WHS on which administrative level certain program information would be reported to.

Because these accounts were not included, we were not able to determine with any degree of certainty the total effect their omission had on the general and deposit fund consolidated report. However, we were able to obtain some asset and liability data for 31 of the 38 missing accounts from annual budget execution reports for fiscal year 1986. Based on those data, we believe that at least \$46.9 million in assets and \$13.7 million in liabilities were not reported.

Although separate reports on the remaining eight accounts were submitted by defense agencies and military services and provided to WHS, WHS omitted these data from the consolidated report sent to the Treasury. These reports listed assets of \$127 million and liabilities of \$218.8 million.

Based on this information, assets totaling at least \$173.9 (\$46.9 + \$127.0) million and liabilities of at least \$232.5 (\$13.7 + \$218.8) million were excluded from the general and deposit fund consolidated report. If adequate procedures on preparing and consolidating activity level reports had been developed, documented, and implemented, we believe that it is less likely that these financial data would have been omitted.

We believe that compilation and double counting errors could have been detected if supervisors had reviewed the consolidated reports before they were submitted to the Treasury.

Noncompliance With Prescribed Accounting Requirements

Title 2 and the Treasury Financial Manual (TFM) require Reports on Financial Position to be prepared according to accounting standards and requirements. These standards and requirements are intended to create consistency and comparability of information and to achieve integrity in financial reporting. Not following these requirements can result in reports containing unreliable information.

During our agency level review of the 16 Reports on Financial Position, we found several instances of noncompliance.

- Title 2 requires receivables and payables to be recorded when events giving rise to such receivables and payables like delivery and receipt of goods and services are completed. In reality, receivables in the DLA Stock Fund were recorded when authorization was granted to release materials, an event which occurs prior to actual shipment or delivery. Also, six DLA activities and four activities at the Defense Mapping Agency (DMA) and at DCA record accounts payable at the time an obligation is recognized which is also prior to receipt of goods. Both of these practices cause overstatement on the Report on Financial Position.
- Title 2 requires that costs of transporting assets be included in the amount capitalized. However, DLA's Operations and Maintenance activity treats these costs as current expenses, thereby understating the equipment account.

Preparers of Reports on Financial Position told us that there were no specific DOD or agency instructions and that they did not know how to implement or interpret title 2 or TFM requirements when preparing the reports. The Accounting Policy staff within the Office of the Assistant Secretary of Defense, Comptroller, told us that revisions of the DOD Accounting Manual necessary to implement title 2 and instructions for preparing DOD Reports on Financial Position were released as of December 14, 1987.

The DLA accountant who prepared the report believed that information required by the Report on Financial Position was more easily obtained from reports on budget execution submitted by field activities.

We compared the balances of accounts on the six agency level Reports on Financial Position prepared by DLA from these sources to the general ledger balances and found that \$58.7 million in assets and \$234.7 million in liabilities appearing in the general ledger were omitted from the agency level reports. (See table 3.)

Table 3: Amounts in DLA's General Ledger Omitted From the Report on Financial Position

(Dollars in thousands)	
Accounts	Amount
Operations and maintenance	\$3,778
Procurement assets	54,775
Research, development, test and evaluation assets	166
Omitted assets	\$58,719
Operations and maintenance liabilities	\$227,305
Procurement liabilities	1,425
Research, development, test and evaluation liabilities	5,386
Other liabilities	583
Omitted liabilities	\$234,699

In contrast, the DMA, DCA, and DOD Dependent Schools did not maintain a general ledger or any other form of centrally controlled proprietary and budgetary accounts. Each of these three agencies relied on other military department accounting systems to provide them the needed accounting information. We found that the DCA's Operations and Maintenance; Procurement; and Research, Development, Test, and Evaluation agency level Reports on Financial Position did not report \$69 million of equipment purchased in fiscal year 1986.

The accountant who prepared the DCA report told us that he did not have ready access to the accounting information on equipment. There is no general ledger from which DCA can obtain accounting information. He also told us that there were no specific instructions or guidelines identifying all the sources containing the necessary information to be included in the Report on Financial Position.

The Accounting Policy staff within the Office of the Assistant Secretary of Defense, Comptroller, stated that they are currently planning how to implement the U.S. Government Standard General Ledger throughout

accounts, as a primary source of information in preparing the Reports on Financial Position, as an interim measure until full implementation of the U.S. Government Standard General Ledger.

3. Implement supervisory review of the preparation and consolidation of Reports on Financial Position to ensure that procedures and instructions are followed and accurate information is reported.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD expressed general agreement with our overall message. (A copy of DOD's comments appears in appendix IV of this report.) It had taken action at the department level on one segment of our recommended management improvements. In this regard, DOD had modified chapter 94 of its accounting manual to clearly identify which reports on financial position (by fund type) were to be combined for Treasury reporting purposes. Pending full implementation of the standard general ledger, it had identified the specific accounts that were to be included in each line item of the standardized form for the Report on Financial Position. At a meeting to discuss its comments on a draft of this report, DOD's Director of Accounting Policy said that the WHS, the designated accounting entity for the numerous defense agencies, had followed a more structured approach to ensure that its 1987 Report on Financial Position included all of the relevant accounts and thus was a more accurate presentation of its financial condition. However, WHS had not taken action to formalize these requirements to ensure that future-year reporting would be as comprehensive.

DOD did not agree with our recommendation that it record accounts receivable in DLA stock fund transactions when goods were actually delivered instead of when DLA approves release of the goods, as is now the case. Its stated reasons were (1) the amounts in accounts receivable would not be materially misstated because these involve low dollar items, (2) accounts receivable are adjusted for undelivered items, and (3) the stock fund is reimbursed monthly from customer funds. While we agree that the amounts involved may not be material, DOD's treatment of accounts receivable is not consistent with generally accepted accounting and reporting standards as specified by title 2 and the Treasury Financial Manual.

We also recommended that defense agencies use alternate general ledgers or centrally controlled data as a primary source for preparing Reports on Financial Position until full implementation of the standard

Selected Reports and Line Items Reviewed

Reports on Financial Position Sent to Treasury	Supporting Reports on Financial Position	Line Items
Defense Stock Fund	Defense Logistics Agency Stock Fund	Inventories Accounts Receivable Accounts Payable
General and Deposit Funds Consolidated Report	Defense Communications Agency	
	Operations and Maintenance	Accounts Receivable Accounts Payable
	Procurement	Same as above
	Research, Development Test and Evaluation	Same as above
	Military Construction	Accounts Payable Property, Plant, and Equipment
	Defense Mapping Agency	
	Operations and Maintenance	Accounts Receivable Accounts Payable Inventories Accrued Unfunded Annual Leave
	Procurement	Accounts Receivable Accounts Payable Property, Plant, and Equipment
	Research, Development Test and Evaluation	Accounts Receivable Accounts Payable
	Military Construction	Accounts Payable Property, Plant, and Equipment
	Defense Logistics Agency	
	Operations and Maintenance	Accounts Receivable Accounts Payable Inventories Accrued Unfunded Annual Leave Other Accrued Liabilities
	Procurement	Accounts Payable
	Research, Development Test and Evaluation	Accounts Receivable Accounts Payable
	Military Construction	Accounts Payable Property, Plant, and Equipment
	Family Housing	Accounts Payable
	Environmental Restoration	Accounts Payable

Title 2 Revisions

GAO is charged by law to establish accounting standards executive agencies are to follow. In November 1984, GAO issued revised accounting standards (title 2). These revisions include changes to the reporting requirements, addition of new accounting standards, and changes to previously issued standards. A summary of the revisions follows.

Reporting

One of the most significant requirements of the revised title 2 is for summary level financial statements to be prepared annually by all executive agencies as well as for the entire federal government. These statements are required to be prepared from disciplined accounting systems that have effective internal controls and reliable financial data.

The revised title 2 requires four basic financial statements to be prepared in accordance with the accounting standards. They are the (1) Statement of Financial Position, (2) Statement of Operations, (3) Statement of Changes in Financial Position, and (4) Statement of Reconciliation to Budget Reports.

The Statement of Financial Position, also known as a balance sheet, shows an entity's assets, liabilities, and equity as of the reporting date. The Statement of Operations shows the financial results of an entity's activities including expenses, revenues, and other financing sources such as appropriations. The Statement of Changes in Financial Position presents significant resources and uses of resources available to an agency and the uses made of those resources during the reporting period. The purpose of the Statement of Reconciliation to Budget Reports is to ensure that the financial information presented in the financial statements is consistent with the information presented in budget reports.

It should be emphasized that the revised title 2 is not imposing any sweeping comprehensive reporting requirements on agencies. While the previous title 2 requirements for financial statements were not as explicit or as emphatic as the new requirements, they did, nevertheless, definitely imply such financial reporting by agencies. The previous title 2 included reports similar to those required in the current title with the exception of the Statement of Reconciliation to Budget Reports. Furthermore, year-end financial statements similar to our revised title 2 requirements have been required by Treasury for some time. The Treasury requires all agencies to provide a Report on Financial Position (TFS Form 220) which is similar to the Statement of Financial Position required by the revised title 2. Treasury further required all "business-

- entitlement,
- fair value,
- investments,
- loan guarantees and commitments, and
- regulatory accounting.

Changes to Accounting Standards

The final type of changes involved amending previously issued accounting standards. These changes were made to be consistent with those accounting practices used by state and local governments and the private sector which are also applicable to the federal sector. Other changes were made to respond to agencies' inquiries.

These include changes made to the following standards:

- property, plant, and equipment;
- leases;
- transfer of assets and liabilities between federal agencies; and
- equity of the U.S. government.

GAO DRAFT REPORT DATED DECEMBER 1, 1987
(GAO CODE 922801) OSD CASE 7475

"FINANCIAL REPORTING" THE DEFENSE AGENCIES
CAN IMPROVE COMPLIANCE
WITH TREASURY AND GAO REQUIREMENTS AND STANDARDS

DOD RESPONSE TO THE GAO DRAFT REPORT
FINDINGS AND RECOMMENDATIONS

* * * *

FINDINGS

- o **FINDING A: The Importance of Financial Statements.** The GAO noted that the accounting standards (title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies) and the Treasury reporting requirements (Treasury Financial Manual) require that agency reports of financial position include the total assets, liabilities, and equity of the unit reporting. The GAO further noted that the report must be prepared from accounting systems containing sufficient discipline, effective internal controls, and reliable data. The GAO observed that properly done, the reports offer assurance that the entire spectrum of activities associated with statement preparation receives attention. The GAO reported that, quite often, the accounting systems or processes are identified as containing weaknesses, which demonstrate the need for agencies to improve their financial management reporting systems. The GAO concluded that the comprehensive financial statements at the agency level are important, if not critical, to providing discipline and cohesiveness in financial management and accounting.

See comment 1

DOD Response: Concur

- o **FINDING B: A Joint Effort By Oversight Agencies to Improve Financial Management And Reporting.** The GAO reported that the Treasury Department and the Office of Management and Budget (OMB) have taken several initiatives to improve Federal financial management and reporting. According to the GAO, one of the primary changes (in title 2) is the requirement that each agency prepare annual financial statements, reflecting its overall financial position and yearly operations. The GAO also stated that, in August 1986, the OMB issued the U.S. Government Standard General Ledger, which included a basic chart of accounts, a uniform set of accounting definitions, a summary of data elements, and a cross-reference to standard external reports. The GAO reported that, also in August 1986, as a part of the effort to upgrade accounting and financial reporting, the Treasury Department issued the revised reporting requirements, which directs Federal agencies to prepare their financial statement from a budgeting and accounting system that is an

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See comment 2

- The one missing Treasury report of the five Treasury reports required had assets of only \$7,197. This amount is immaterial in relation to the \$25.5 billion of assets reported to Treasury on the other four reports. The finding should either be deleted or the \$7,197 added to the footnote on page 5.

See comment 3

- The 46 Component reports omitted from the Treasury report should really be shown as 9 Component reports. Thirty-eight of the 46 Component reports prepared by the WHS staff would have actually been rolled into only one Component report that covered 38 activities. The other 8 of the 46 Component reports were received after the reporting deadline and after WHS had already submitted its annual report to Treasury; therefore, they were not included. However, the audit provided a useful service in that it pointed out the problem of missing reporting activities. In reviewing the GAO report, WHS determined that some Component reports were missing for fiscal year 1987 reporting to Treasury. WHS prepared and submitted revised fiscal year 1987 reports to Treasury.

See comment 1

- o **FINDING D: Millions of Dollars In Computational Errors Existed In Reports Submitted To The Treasury.** The GAO found that the WHS staff made numerous computational errors and did not detect double counting in consolidating agency level reports into the consolidated reports forwarded to the Treasury. The GAO reported that the errors resulted in overstating the total assets by \$1.7 million and understating total liabilities by \$113,000. In addition to computational errors, the GAO found that \$8.6 million in the "other liability" element in the DIA Stock Fund report was omitted from the report forwarded to the Treasury. The GAO was told by the WHS staff that the \$8.6 million was inadvertently omitted when information was transferred manually from the DIA stock fund report onto another report form. The GAO observed that there was no supervisory review of the statement or other verification procedures that took place prior to submission to the Treasury. The GAO also found that the WHS double counted certain asset, liability, and equity items because it had received, but not identified, duplicate reports regarding general and deposit fund activities. According to the GAO, this had a net effect of overstating assets by \$395 million, liabilities by \$11.6 million and equity by \$250.1 million. The GAO concluded that these errors (i.e., computational and double counting errors) could have been detected if supervisors had reviewed the consolidated reports before they were submitted to the Treasury.

DoD Response: Concur. The WHS has established procedures to insure that all reporting activities are included in future Treasury reports and that only one financial statement from each agency is used for Treasury report consolidation purposes.

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system, the method of recording accounts receivable would not materially misstate assets. Accordingly, a procedure change is not justified.

See comment 4

- The DoD Accounting Manual, Chapter 42, section B.6, authorizes an accounts payable when a delivery is expected in a short time and the amount is \$1,000 or less.

See comment 5

- All DMA travel advances are recorded as receivables. The net advance owed after travel vouchers are processed is recorded as Accounts Receivable. The outstanding travel advance before the travel is performed is recorded as Advances-Public. For September 30, 1986, the DMA reported Advances-Public as \$612,200.00.

See comment 1

- The DoD agrees that transportation costs should be included in the amount of asset capitalized, except for property disposal items that are being shipped to the Military Services and other Defense Agencies. When the contract for equipment includes transportation costs, these costs are capitalized. When the transportation costs are paid separately from the contract price, they are not always captured and capitalized. In the future these costs will be included in the amount of the asset capitalized.

- o **FINDING F: Not Having or Not Using Existing General Ledger Data Results in Unreliable Reports.** The GAO reported that an August 29, 1986, OMB memorandum, announced the completion of the development of the U.S. Government Standard General Ledger, which is to be used in all Executive Branch financial systems to ensure that agencies account for similar activities in the same way. The GAO further reported that implementing the standard general ledger requires an integrated data base of all budgetary asset and liability information, thus establishing an effective general ledger for reporting purposes. The GAO found that three of the four Defense Agencies it visited (i.e., the DLA, the Defense Mapping Agency, the Defense Communications Agency, the Department of Defense Dependent Schools) did not have a general ledger and, although the DIA had one, it was not used for reporting purposes. The GAO further found that the same four agencies prepared their reports from eight different sources, such as inventory accounting system reports or reports on liability for accrued annual leave. The GAO also found the agencies did not have detailed instructions or guidelines to identify the sources for the information that had to be included in the Report on Financial Position. For example, the GAO found that \$58.7 million in assets and \$234.7 million in liabilities appearing in the DLA general ledger were omitted from the activity level reports. In another example, the GAO also found that the DCA Operations and Maintenance, Procurement, and Research Development, Test, and Evaluation Activity Reports on Financial Position did not report \$69 million of equipment purchased in FY 1986. The GAO, however, reported that the Accounting Policy staff within the Office of Assistant Secretary

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system, the method of recording accounts receivable would not materially misstate assets. The current procedures for recording accounts receivables in the DIA Stock Fund are adequate and change is not required.

- o **RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense direct defense agencies to obtain access to, and use, systems containing general ledgers, or a centrally controlled data base containing proprietary and budgetary accounts, as a primary source of information in preparing the Reports on Financial Position, as an interim measure until full implementation of the U.S. Government Standard General Ledger.

See comment 1

DoD Response: Concur. The DoD has already issued guidance requiring all DoD activities to implement the U.S. Government Standard General Ledger. When the project to implement and maintain a central WHS general ledger in support of centralized reporting is completed in the OSD, the WHS will prepare all OSD financial reports based on this central general ledger.

- o **RECOMMENDATION 3:** The GAO recommended that the Secretary of Defense direct defense agencies to implement supervisory review of the preparation and consolidation of Reports on Financial Position to ensure that procedures and instructions are followed and accurate information is reported.

See comment 1

DoD Response: Concur. The DASD(MS) ASD(C) has initiated a project to integrate the Defense Agencies general ledger. Through the Task Force established, the requirement to implement supervisory review of the preparation and consolidation of Reports on Financial Position to ensure that procedures and instructions are followed and accurate information is reported will be emphasized.

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The following are GAO's Comments on the Department of Defense's letter dated February 3, 1988.

GAO Comments

1. No change to the report is necessary.
2. We incorporated certain technical clarifications as DOD suggested.
3. DOD points out that 38 of the 46 component reports omitted would have been rolled into one report. Thus, only 9 reports would have been omitted. However, the point of the finding is that financial information from 46 accounts was still omitted. To more clearly convey this, we have changed the word "reports" to "accounts." Additionally, our documentary evidence shows that 7 of the 8 remaining reports had been received by WIS by the time the preparer compiled the consolidated reports.
4. DOD's comments do not refute the statements made in the report concerning title 2 and TFM noncompliance with recognition of accounts receivable in the Stock Fund and accounts payable. We agree with DOD that amounts involved may not be material. While we acknowledge this fact, we believe that DOD's treatment of these accounts receivable and payable is not consistent with title 2 and TFM.
5. The paragraph concerning DMA's travel advances has been deleted.

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of Defense (Comptroller) were currently planning how to implement the U.S. Government Standard General Ledger throughout DoD, but the plan would not be finished until sometime between 1989 and 1991. The GAO concluded that inaccurate and incomplete reporting at the activity level contributed to the reporting problems and in many instances, the reporting units could not obtain the required financial information from an accounting system containing a centrally controlled data base with asset, liability, and budgetary data.

See comment 1

DoD Response: Concur. The DoD has now incorporated the U.S. Government Standard General Ledger into the DoD Accounting Manual. In addition, the Office of the Assistant Secretary of Defense (Comptroller) has undertaken a project to ensure that the Standard General Ledger is implemented by the Defense Agencies.

RECOMMENDATIONS

- o **RECOMMENDATION 1:** The GAO recommended that the Secretary of Defense direct defense agencies to: Develop and implement agency-specific procedures and instructions for preparing and consolidating Reports on Financial Position which delineate:

- the unit responsible for preparing each Report on Financial Position;
- a method of preparing and consolidating reports which minimizes the risk of omissions and errors; and
- a method to ensure compliance with TFM and title 2 requirements in the areas of reporting advances, receivables and accounts payable, and capitalizing transportation costs of capitalized assets.

DoD Response: Partially concur.

See comment 1

- The DoD has issued guidance to all DoD activities requiring them to use the U.S. Government Standard General Ledger as implemented in the DoD Accounting Manual, and provided detailed guidance for preparation of Treasury reports. When the project to implement and maintain the central WHS general ledger in support of centralized reporting is completed in the OSD, the WHS will prepare all OSD financial reports based on this central general ledger.

See comment 4

- The DoD disagrees with the recommendation that the DLA Stock Fund change its procedures for recording accounts receivable. The DLA Stock Fund deals in high volume and low dollar items. Accounts receivable are recorded in the DLA Stock Fund when a material release order is issued. If a material release denial is received, the accounts receivable is reversed. Given the fact that the Stock Fund reimburses itself each month from customer funds, through the interagency billing

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o **FINDING E: Noncompliance With Prescribed Accounting Requirements.** The GAO found several instances of noncompliance with the Treasury Financial Manual (TFM). According to the GAO, these standards and requirements are intended to create consistency and comparability of information and to achieve integrity in financial reporting and, if not followed, can result in reports containing unreliable information. The GAO cited the following examples:

- Title 2 requires receivables to be reported when delivery of goods and services are completed. The GAO found, however, that receivables in the DLA Stock Fund activity level report are based on authorizations to release materials (prior to shipment and delivery). In addition, the GAO found that six DLA activities, four activities at the Defense Mapping Agency (DMA) and the DCA record accounts payable at the time an obligation is recognized, which is also prior to receipt of goods. The GAO concluded that both of these practices cause overstated accounts payable on the Report on Financial Position.
- Title 2 and the TFM require that cash advances be reported as assets on the Report on Financial Position. The GAO found, however, that the Operations and Maintenance activity at the DMA only reports as an asset those net travel advances owed by employees after travel was completed and the voucher processed, which resulted in understated advances in the report on Financial Position.
- Title 2 requires that costs of transporting assets be included in the amount capitalized. The GAO found, however, that the DLA Operations and Maintenance activity treats these costs as current expense, thereby, understating the equipment account.

The GAO was advised by the preparers of Reports on Financial Position that there were no specific DoD or Agency instructions and they did not know how to implement or interpret title 2 or TFM requirements when preparing the reports.

DoD Response: Partially concur.

- The DoD Accounting Manual implements GAO Title 2 and TFM requirements. It has recently been revised to include all new GAO and Treasury reporting requirements.
- The DLA Stock Fund deals in high volume and low dollar items. Accounts receivable are recorded in the DLA Stock Fund when a material release order is issued. If a material release denial is received, the accounts receivable is reversed. Given the fact that the Stock Fund reimburses itself each month from customers' funds, through the interagency billing

See comment 1

See comment 4

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integral part of their financial management system. In addition, the GAO reported that the Treasury augmented its FY 1987 reporting requirements by requiring agencies to submit four required reports, as follows:

- a report on financial position;
- a report on operations;
- a report on cash flow; and
- a report on reconciliation.

The GAO concluded that adequate implementation of these initiatives is intended to establish a sound financial management foundation for improving the reliability of accounting systems and financial reports produced.

See comment 1

DoD Response: Concur.

- o **FINDING C: Forty-Six Reports Omitted From Consolidated Report.** The GAO reported that the Washington Headquarters Services (WHS) is the designated accounting entity for preparing and consolidating the Defense Agencies' Reports on Financial Position and submitting them to the Treasury. The GAO noted that the reports are presented by type of fund -- revolving, trust, and general and deposit funds. According to the GAO, in FY 1986, the WHS submitted four of the five required consolidated Reports on Financial Position to the Treasury, showing a total of \$10.5 billion in assets and \$3.9 billion in liabilities. The GAO found that, during FY 1986, the WHS received or prepared 84 activity level reports on financial position, which it either consolidated by fund type into three reports sent to the Treasury or sent to the Treasury unconsolidated. The GAO further found, however, that 46 activity level reports were not included in the General and Deposit Fund Consolidated Report on Financial Position, including 38 that should have been prepared by the WHS staff, but were not. The GAO stated that the remaining eight reports were prepared by Defense Agencies and the Military Services and provided to the WHS, but were omitted from the consolidated report sent to the Treasury (i.e., omitted assets totaled \$127 million, and omitted liabilities totaled \$218.8 million). The GAO reported that, according to a WHS Division Director, the 38 reports were not prepared because there has been no decision reached within the WHS on which activity level was to report certain program information. The GAO concluded that, if adequate procedures on preparing and consolidating activity level reports had been developed, documented, and implemented, it would have been less likely that the financial data would have been omitted.

DoD Response: Partially concur.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, DC 20301-1100

FEB 3 1988

Mr. Frederick D. Wolf
Director, Accounting and Financial
Management Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Wolf:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled, "FINANCIAL REPORTING: The Defense Agencies Can Improve Compliance With Treasury and GAO Requirements and Standards," dated December 1, 1987, (GAO Code 922801), OSD Case 7475.

The DoD basically concurs with the draft report. The DoD, however, nonconcurs in the finding and recommendation that accounts receivable are recorded improperly in the Defense Logistics Agency Stock Fund, and the procedures should be changed.

Detailed comments on the findings and recommendations are enclosed. Corrective actions have been taken on the findings and recommendations as outlined in the detailed comments. Thank you for the opportunity to review and comment on the draft report.

Sincerely,

Robert W. Helm
Assistant Secretary of Defense
(Comptroller)

Enclosure

type” agencies to provide a Report on Operations (TFS Form 221) which is also similar to the Statement of Operations required by the revised title 2. Beginning in fiscal year 1987, Treasury is requiring all agencies to submit the TFS Form 221.

New Accounting Standards

Other changes made to title 2 were the incorporation of new accounting standards. These changes were made to recognize the standards developed by the accounting profession since title 2 was last revised and to address numerous inquiries received by GAO since that time.

The most significant new standard is actuarially computed liabilities. This standard applies to federal benefit programs that determine their liabilities by making actuarial calculations. In general, the standard requires responsible agencies to recognize in their accounting records, and report in the financial statements, a liability for unpaid and estimated claims and future program benefits as well.

As with the revised reporting requirements previously discussed, it is important to recognize that this new standard for federal benefit programs is not new to the federal community. Treasury has been required for years to report to the Congress all of the federal government’s liabilities and financial commitments, including actuarially based liabilities, for pension programs and social security in the Statement of Liabilities and Other Financial Commitments report. The Treasury prepares this report from TFS Form 220s submitted by agencies and other reports.

Other new standards have been added to help implement existing standards and to address issues raised by users in recent years. These include:

- comparative financial statements;
- consolidated statements;
- prior-period adjustments to financial statements;
- reporting appropriations in the Statements of Financial Position, Operations, and Changes in Financial Position; and
- unusual and infrequent items.

Other new standards that are rather narrow in scope and for the most part cover accounting practices being followed but were not in the previous title 2 include

- debt agreement modifications,

Appendix II
Selected Reports and Line Items Reviewed

Reports on Financial Position Sent to Treasury	Supporting Reports on Financial Position	Line Items
	DOD Dependent Schools ^a	
	Operations and Maintenance	Accounts Receivable Accounts Payable
	Procurement	Same as above
	Military Construction	Accounts Payable Property, Plant, and Equipment

^aThe DOD Dependent Schools submitted one consolidated report for these three funds

List of Military Agencies

Major Defense Agencies

Defense Advanced Research Projects Agency
Defense Communications Agency
Defense Contract Audit Agency
Defense Intelligence Agency
Defense Investigative Service
Defense Legal Services Agency
Defense Logistics Agency
Defense Mapping Agency
Defense Nuclear Agency
Defense Security Assistance Agency
National Security Agency/Central Security Service
Strategic Defense Initiative Organization

Field Activities, Office of Secretary of Defense

American Forces Information Service
Department of Defense Dependents Schools
Defense Information Services Activity
Defense Medical Systems Support Center
Defense Technology Security Administration
Office of Civilian Health and Medical Program of the Uniformed Services
Office of Economic Adjustment
Washington Headquarters Services
Joint Tactical Command, Control and Communications Agency
Technical Research Institute

DOD Components

Office of the Secretary of Defense
Organization of the Joint Chiefs of Staff
U.S. Court of Military Appeals
Office of the Inspector General
Uniformed Services University of the Health Sciences

Military Services

Department of the Army
Department of the Air Force
Department of the Navy (the U.S. Marine Corps is a component of the Department of the Navy)

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Abbreviations

DCA	Defense Communications Agency
DLA	Defense Logistics Agency
DMA	Defense Mapping Agency
DOD	Department of Defense
GAO	General Accounting Office
OMB	Office of Management and Budget
TFM	Treasury Financial Manual
WHHS	Washington Headquarters Services

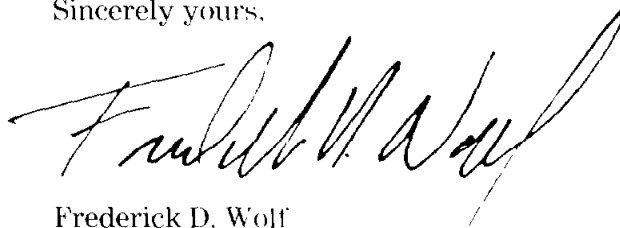
general ledger. DOD said it had required all of its components to implement the standard general ledger and that upon its completion, now estimated for 1992, all defense agencies' financial reports would be based on a centralized general ledger. In view of this time frame, we believe it would be appropriate for agencies that do not now use or have access to accounting systems with general ledgers to acquire such services from other DOD components.

DOD stated that it would improve supervisory review over the preparation of Reports on Financial Position. This will be emphasized as part of its ongoing project to incorporate the standard general ledger into defense agencies' accounting systems.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of action taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report. A written statement must be submitted to the House and Senate Committees on Appropriations with an agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Director, Office of Management and Budget, and the Secretary of the Treasury. Copies will also be made available to others upon request.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Frederick D. Wolf". The signature is fluid and cursive, with a large, sweeping "F" and "W".

Frederick D. Wolf
Director

DOD, but that implementation would not be completed until some time between 1989 and 1991. Instructions for preparing DOD Reports on Financial Position, contained in a draft of the revised DOD Accounting Manual, were released as of December 14, 1987.

Conclusions

The defense agencies did not have a systematic way of compiling their Reports on Financial Position. As a result, these reports contain errors and do not provide complete information for each fund type represented. Developing and implementing detailed written procedures which would provide for supervisory review and verification procedures would help ensure that these reports are completed more effectively and efficiently.

Inaccurate and incomplete reporting at the agency level contributed to the reporting problems. In many instances, the reporting units could not obtain the required financial information from an accounting system which contained a centrally controlled data base with asset, liability, and budgetary data.

With the release of the revised DOD Accounting Manual incorporating our title 2 and the Treasury Financial Manual requirements, we believe that the defense agencies we visited can improve reporting compliance with both title 2 and Treasury's requirements.

Recommendations

We recommend that the Secretary of Defense direct defense agencies to:

1. Develop and implement agency-specific procedures and instructions for preparing and consolidating Reports on Financial Position which delineate

- the unit responsible for preparing each Report on Financial Position;
- which reports are to be consolidated into the reports forwarded to Treasury;
- a method of preparing and consolidating reports which minimizes the risk of omissions and errors; and
- a method to ensure compliance with title 2 and TFM requirements in the areas of reporting advances, receivables, and accounts payable and capitalizing transportation costs of capitalized assets.

2. Obtain access to, and use, systems containing general ledgers, or a centrally controlled data base containing proprietary and budgetary

Not Having or Not Using Existing General Ledger Data Can Result in Unreliable Reports

Preparing Reports on Financial Position and Operations without access to a general ledger can lead to inaccurate and incomplete reports. According to an August 29, 1986, OMB memorandum, announcing the completion of the development of the U.S. Government Standard General Ledger, the general ledger is to be used in all executive branch financial systems to ensure that agencies account for similar activities in the same way. The standard general ledger was developed to address the inconsistent accounting systems which resulted in different accounting treatment for the same types of transactions, increase the capacity to compare activities, and fill information gaps.

For 1986, the TFM required that reports to the Treasury be prepared from a budgeting and accounting system with a data base that is part of the agency's financial management system. Implementing the standard general ledger requires an integrated data base of all budgetary, asset, and liability information, thus establishing an effective general ledger for reporting purposes.

Three of the four defense agencies we visited did not have a general ledger. Although DLA had one, it did not use it for reporting purposes. Instead, the four organizations we visited prepared their reports from eight different types of sources. The different sources from which estimates and figures were derived included: budget execution reports, inventory accounting system reports, and reports on liability for accrued annual leave.

They also did not have detailed instructions or guidelines to identify the sources for the information that had to be included in the Report on Financial Position. As noted earlier, some agency level reports we reviewed omitted certain required information. We identified the amounts of a few of these omissions by comparing information that should have been reported on the fiscal year 1986 Report on Financial Position with that year's budget execution document. In our opinion, using varied sources without adequate verification of their accuracy and completeness results in greater risk of omissions than transferring the information directly from a centrally controlled data base.

DLA has a general ledger, the General Ledger Accounting Code System, containing financial and budgetary accounts for all its activities. However, it was not used to prepare the six DLA reports we reviewed. Instead, other sources, such as the report on budget execution, the report on liability for accrued annual leave, and memorandums and telephone conversations served as the basis.

Millions of Dollars in Compilation Errors

WHS staff made numerous computation errors and did not detect double counting in compiling agency level reports into the consolidated reports forwarded to the Treasury. As shown in table 2, these types of errors resulted in overstating assets by \$1.7 million and understating liabilities by \$113,000.

Table 2: Results of Compilation Errors in Selected Line Items During Report Preparation

(Dollars in thousands)

Selected line items	DCA Industrial Fund	DLA Industrial Fund	Consolidated report sent to Treasury	Correct amount that should have been reported to Treasury	Compilation errors
Assets					
Fund balance with Treasury	\$107,083	\$3,523	\$114,879	\$110,606	\$(4,273)
Accounts receivable	131,385	70	131,526	131,455	(71)
Other assets	1,199	(670)	(2,089)	529	2,618
Total	\$239,667	\$2,923	\$244,316	\$242,590	\$(1,726)
Liabilities					
Accounts payable	\$243,947	\$1,040	\$245,572	\$244,987	\$(585)
Accrued payroll and benefits	222	1,015	1,015	1,237	222
Accrued unfunded annual leave	476	429	429	905	476
Total	\$244,645	\$2,484	\$247,016	\$247,129	\$113

Note: DCA refers to the Defense Communications Agency and DLA refers to the Defense Logistics Agency.

In addition, we noted that \$8.6 million in the “other liability” element in the DLA’s Stock Fund report was omitted from the report forwarded to the Treasury. WHS staff told us that they inadvertently omitted this amount when they transferred information manually from DLA’s Stock Fund report onto another report form. The WHS staff also said that no supervisory review or other verification procedures of the statements took place prior to submission to the Treasury.

We also found that WHS double counted certain asset, liability, and equity items because it had received but not identified duplicate reports regarding general and deposit fund activities. For example, fund balances with the Treasury, accounts receivable, accounts payable, and unexpended appropriations were added twice. WHS staff told us that this was done inadvertently. They attributed this mistake to the lack of an edit or other verification procedures. The net effect was that assets were overstated by \$395 million, liabilities by \$11.6 million, and equity by \$250.1 million in the general and deposit fund consolidated report.

Lack of Effective Procedures and Supervisory Review Yields Inaccurate and Incomplete Reports

DOD had not developed guidelines for implementing Treasury's reporting requirements. As a result, Washington Headquarters Service (WHHS) staff did not know which reports were to be prepared by them, and preparers of reports at the agency level did not know how to report certain elements, such as accounts payable. We also found that there was no provision for supervisory reviews to verify the accuracy of the reports submitted to Treasury. Consequently, three of these reports contained either computational errors or double counting.

Forty-Six Accounts Omitted From Consolidated Report

WHHS, an organization reporting to the Assistant Secretary of Defense, Comptroller, is the designated accounting entity for preparing and consolidating the defense agencies' Reports on Financial Position. For fiscal year 1986, the military agencies receiving defense agency funds (organizations comprising 12 major defense agencies, 10 field activities, 5 DOD components, and 3 military services) were required to submit 5 consolidated reports by fund type to Treasury. (See appendix I for a list of these agencies.) WHHS submitted four of the five¹ required Reports on Financial Position. These reports included a total of \$25.5 billion in assets and \$3.9 billion in liabilities.

To provide the financial information for these five reports, numerous agency level reports must be prepared for funds the military agencies manage. We attempted to determine the total number of agency level reports that should have been prepared and reported. We were unable to obtain a total because WHHS did not prepare for inclusion or include prepared agency level reports in the Reports on Financial Position if, during the fiscal year, the particular fund or activity completed no transactions, or received no funding (in the case of general funds).

In addition, there was no control listing of accounts and agencies for which an agency level report was required. Therefore, WHHS staff had no mechanism to monitor the submission of the required agency level reports necessary for complete reporting to Treasury.

For fiscal year 1986, WHHS received or prepared 84 agency level Reports on Financial Position that it either consolidated by fund type (general and deposit, revolving, or trust) into 3 reports sent to the Treasury or sent to the Treasury unconsolidated as shown in table 1.

¹One report, Defense Production Guarantees, was not submitted because there was no activity in the fund in fiscal year 1986. This report would have reported assets of only \$7,197.

Financial Position include the total assets, liabilities, and equity of the unit reporting and that the report be prepared from accounting systems containing sufficient discipline, effective internal controls, and reliable data. These reports are intended to provide meaningful information helpful in assessing management's stewardship and accountability for the resources entrusted to it.

Efforts by Oversight Agencies to Improve Financial Management and Reporting

GAO's work has often identified problems with financial management systems and reporting in the federal government. GAO, the Treasury, and OMB have taken several initiatives to improve federal financial management and reporting.

In November 1984, we issued changes to title 2, which applies to all federal executive agencies. (See appendix III for a discussion of these changes.) One of the primary changes was a requirement that each agency prepare annual financial statements reflecting its overall financial position and operations. In August 1986, OMB issued the U.S. Government Standard General Ledger with instructions to begin implementation. This general ledger includes a basic chart of accounts, a uniform set of account definitions, a summary of data elements, and a cross-reference to standard external reports. The purpose of the general ledger is to standardize federal agency accounting and to support the preparation of all standard external financial reports required by the Treasury and OMB, as well as those needed for internal agency operations.

Also, in August 1986, the Treasury issued its revised requirements for agencies to prepare annual financial statements as a part of the effort to upgrade accounting and financial reporting within the federal government. Beginning in fiscal year 1986, agencies must prepare their financial statements from a budgeting and accounting system which is an integral part of their financial management system. In addition, agencies must eliminate intra-agency balances from their consolidated statements and use accrual accounting in preparing their reports.

For fiscal year 1986, as in prior years, all agencies were required to submit Reports on Financial Position. Government corporations and agencies with revolving fund activities were also required to submit Reports on Operations. The Treasury augmented its reporting requirements for fiscal year 1987 to include two additional reports and to require all agencies to submit Reports on Operations. The four required reports are:

