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Report to the Committee on National Security, House of Representatives

April 1996

DEFENSE BUSINESS OPERATIONS FUND

DOD Is Experiencing Difficulty in Managing the Fund's Cash

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April 10, 1996

The Honorable Floyd D. Spence
Chairman
The Honorable Ronald V. Dellums
Ranking Minority Member
Committee on National Security
House of Representatives

In the committee's report[1] on the fiscal year 1996 Defense authorization, you raised concerns about the management of the Defense Business Operations Fund's cash and directed that we review the Fund's cash management practices. This report responds to your request and provides our (1) assessment of the Department of Defense's (DOD) efforts to manage the Fund's cash and (2) recommendations to DOD which, if properly implemented, will provide additional management oversight of the Fund's cash operations.

Since April 1991, we have reported and testified on the challenges and problems confronting DOD in the management of the Fund.[2] One area of continuing concern has been DOD's management of the Fund's cash. An enterprise that collects and disburses about $75 billion annually must have the mechanisms in place to ensure that it fulfills its responsibilities to DOD management, the Congress, and the American taxpayers.

Results in Brief

The Fund's cash management problems we and the DOD Inspector General (IG) have reported on in the past persist and are symptomatic of DOD's long-standing financial management weaknesses. These problems could affect decisions impacting DOD's programs. We found that the Fund's managers do not have timely, accurate, and complete data on cash balances for individual business areas. In addition, the Fund's monthly financial reports did not fully disclose $5.4 billion in adjustments that were made to its accounts receivable and payable balances. While these problems exist throughout the Department, the Navy—and the Defense Finance and Accounting Service (DFAS), which provides accounting services for the Navy—consistently had the most severe problems in accurately accounting for and reporting on the Fund's cash.

[1]House Report 104-131, June 1, 1995.

[2]See Related GAO Products listed in the back of this report.

DOD has continued to rely on advance billing to generate sufficient cash for day-to-day operations. At the end of fiscal year 1995, DOD had $2.6 billion in outstanding advance billings with Navy having almost $2 billion of that total. At the same time, the Fund had about $1 billion in outstanding accounts receivable that were over 120 days old and is unable to collect over $200 million for work performed because the billing documents did not identify the specific activities to bill.

Until DOD moves to enhance accountability and employs tools to more effectively manage its cash, managers will continue to receive inaccurate, incomplete, and untimely information on the Fund's business areas' cash balance, collections, and disbursements. If current practices persist, this could lead to DOD requiring excessive amounts of cash to maintain ongoing Fund operations, heighten opportunities for Antideficiency Act violations, and, most importantly, limit DOD's opportunity to fulfill the objectives of the Fund—enhancing readiness capability through improved efficiencies in business operations.

Background

In October 1991, DOD implemented the Fund which consolidated the nine existing industrial and stock funds operated by DOD as well as DFAS, the Defense Industrial Plant Equipment Service, the Defense Reutilization and Marketing Service, the Defense Commissary Agency, and the Defense Technical Information Service. The Army, Navy, Air Force, and Defense agencies industrial and stock funds have maintained their individual identities as part of the Fund. The Fund's estimated fiscal year 1996 revenue of $75 billion makes it equivalent to one of the world's largest corporations.

Effective cash management is directly dependent on DOD managers receiving accurate and timely data on the Fund's cash balances, collections, and disbursements. According to DOD's Financial Management Regulation, Volume 11B, the Fund is to maintain the minimum cash balance necessary to meet both operational requirements and to meet disbursement requirements in support of the capital asset program. In essence, the Fund is to maintain a minimum cash balance which, at the same time, is sufficient to cover expenses, such as paying employees for repairing ships and aircraft and vendors for inventory items. Currently, DOD's policy requires the Fund to maintain cash levels to cover 7 to 10 days of operational costs ($1.5 billion to $2.1 billion) and 4 to 6 months of capital asset disbursements ($.5 to $.9 billion). The regulation further provides that if the overall cash level of the Fund falls below $1 billion,

DFAS will take immediate actions to resolve cash shortages by advance billing customers.

Cash generated from the sale of goods and services is the primary means of the Fund maintaining an adequate level of cash. The ability to generate cash consistent with DOD policy is dependent on (1) accurately setting prices to recover the full costs of producing goods and services, (2) accurately projecting workload, such as the number of aircraft to be repaired during the year, and (3) collecting funds in a timely manner from customers for work performed. To the extent that (1) the Fund is not paid for work performed in a timely manner or (2) DOD cannot produce accurate and timely information on the Fund's collections and disbursements, unanticipated fluctuations or, worse yet, cash shortages will occur.

DOD has experienced continual difficulties in effectively implementing and operating the Fund. Since the concept of the Fund was first put forth in February 1991, we have monitored and evaluated its implementation and operations. From its inception, over 4 years ago, we have pointed out that DOD did not have the procedures and systems in place to operate the Fund. In March 1995,[3] we further reported that DOD's ability to properly manage the Fund continued to be hindered in part because of its inability to adequately manage the Fund's cash.

In May 1995, we testified[4] that we continued to have concerns about DOD's management of the Fund's cash. When the Fund was established, the responsibility for managing cash was placed under the Office of the Secretary of Defense (Comptroller). However, on February 1, 1995, cash management and related Antideficiency Act[5] responsibilities were returned to the military service and DOD component level. This change was a major departure from the benefits of a single cash balance DOD cited in establishing the Fund. According to DOD officials, the policy was changed to better align accountability and responsibility for cash management. DOD pointed out that the operational control of actions taken by each Fund

[3]Defense Business Operations Fund: Management Issues Challenge Fund Implementation (GAO/AIMD-95-79, March 1, 1995).

[4]Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-143, May 16, 1995, and GAO/T-AIMD-95-146, May 23, 1995).

[5]The Antideficiency Act, 31 U.S.C. 1341(a) (1), 1517, provides that no officer or employee of the government shall make or authorize an expenditure or obligation exceeding the amount of an appropriation or fund available for the expenditure or obligation.

activity, which results in cash disbursements and collections, always has and continues to reside with the military services and DOD components.

While this report focuses on cash management problems, they are symptomatic of the persistent weaknesses in DOD's and the Fund's financial management operations. DOD's fiscal year 1995 Federal Managers' Financial Integrity Act (FMFIA) report highlighted a number of serious weaknesses in DOD's financial management operations and systems. GAO's High-Risk Report Series also pointed out that DOD has serious, long-standing problems in providing reliable financial and cost information to those responsible for carrying out and overseeing DOD's missions and programs.[6] With regard to the Fund, the FMFIA report identified that it had inadequate accounting and reporting. Having systems and reports that provide timely and accurate information on the Fund's cash balances for individual business areas and on collections and disbursements is integral to having effective controls over cash management.

Objective, Scope, and Methodology

The overall objective of this assignment was to evaluate the Fund's cash management practices with respect to the functions that impact on cash, such as billing customers and collecting receivables. To accomplish our objective, we (1) interviewed officials in the Office of the Secretary of Defense (Comptroller), DFAS, the military services, and Defense components regarding their reporting of monthly collection and disbursement information for the Fund, (2) reviewed DOD's cash management policies and procedures to obtain an understanding of the Fund's cash management practices, and (3) collected and analyzed for selected Fund business areas financial information related to collections, disbursements, accounts receivables, and accounts payable. In addition, through discussions with appropriate DOD officials and a review of pertinent documents, such as the Report on Budget Execution Defense Business Operation Fund (DD Form 1176) and the Defense Business Operations Fund Accounting Report (1307), we determined whether the Fund's systems provided managers with information conducive to managing cash.

We performed our work at the headquarters, Office of the Under Secretary of Defense (Comptroller); Departments of the Army, Navy, and Air Force; Defense Logistics Agency (DLA); Defense Finance and Accounting Service (DFAS); the Cleveland, Columbus, Denver, and Indianapolis DFAS Finance Centers; DFAS operating locations in Norfolk and San Diego; and selected

[6] High-Risk Series: An Overview (GAO/HR-95-1, February 1995).

Fund business activities. Our review was performed from July 1995 through February 1996, in accordance with generally accepted government auditing standards. The quantitative financial information used in this report on the Fund's financial operations was produced from DOD's systems and was not independently verified by GAO. DOD's fiscal year 1995 FMFIA report acknowledges inadequacies in the Fund's accounting and reporting. In addition, the DOD IG has cited system deficiencies as one of the major obstacles to the preparation of financial statements that fairly present the Fund's financial position.[7]

We provided a draft of this report to DOD for comment. On March 20, 1996, we discussed the facts, conclusions, and recommendations in our draft report with cognizant DOD officials and have incorporated their comments where appropriate.

Cash Management Information Lacking

The Fund's financial reports are untimely, incomplete, and inaccurate and, therefore, do not provide Fund managers with the information they need to manage cash. Specifically, we found that (1) the monthly financial reports do not contain cash balances for each individual Fund business area, (2) collection and disbursement data are not timely since the data are reported approximately 3 to 4 weeks after the month in which the transaction took place, and (3) monthly financial reports do not fully disclose billions of dollars of adjustments made to accounts receivable and payable balances, which could mask the actual amount of future collections and disbursements. Effective cash management is dependent on the availability of timely and accurate information that impact the Fund's cash balance. The absence of this information could (1) result in an increase in the Fund's cash requirements to cover the day-to-day fluctuations in the Fund's cash balance and (2) impact major programmatic decisions which may be driven largely by cash balance considerations.

DOD Reports Used for Managing Cash Are Inadequate

In accordance with DOD policy, the Fund's monthly financial reports provide cash balance information at the military service and DOD component level who presently have cash management responsibility. However, the Fund's monthly financial reports do not provide cash balance information on the Fund's individual business areas although most decisions that impact cash, such as buying inventory items from vendors,

[7]Financial Management: Challenges Facing DOD in Meeting the Goals of the Chief Financial Officers Act (GAO/T-AIMD-96-1, November 14, 1995).

are made at the business area or activity level. Instead, the monthly financial reports only show collections and disbursements. As such, the reports lack key information such as the amount of the initial allocation of the cash by DOD to the military services and DOD components in February 1995, when cash management responsibility was decentralized. The initial allocation—a substantial amount of the Fund's cash—was $1.7 billion,[8] or 39 percent of the Fund's $4.4 billion cash balance at the end of September 1995.

Lacking this basic information can put entities charged with Antideficiency Act responsibilities in the position of having to comply with the Act without the tools to do so. For example, since the Antideficiency Act responsibility was passed from DLA to the Transportation Command (TRANSCOM) in May of 1995, TRANSCOM managers are responsible for ensuring that they do not spend more than they have.[9] However, they do not know their cash balance. The position the managers are in is similar to an individual writing personal checks without ever knowing his or her checkbook balance. In April 1995, just before cash management responsibility was transferred, TRANSCOM called attention to the difficulties it would have in complying with the Act to DLA, stating that it "does not have an accounting system to properly account for or report cash transactions," and that "during contingency operations, we have no control over cash collections of transportation bills." In response to TRANSCOM's memorandum, the DLA comptroller stated that "the lack of control over cash cited in your memorandum applies equally to all Defense agencies, including DLA."

Further, managers only receive official information once a month on the amount of collections and disbursements that impact the cash balance. These data are not timely since they are not received until 3 to 4 weeks after the end of the month in which transactions took place.[10] For example, the reports for February 1996 will not be available until the end

[8]This amount did not include the Defense Commissary Agency appropriation and the subsidy payment for the Transportation Command because these amounts should have been spent by the end of the fiscal year.

[9]Originally, TRANSCOM came under DLA's purview for cash management purposes. In May 1995, TRANSCOM became the only DOD activity below the DOD component level delegated with the responsibility for complying with the Antideficiency Act limitation. For the remaining portions of the Fund's cash, the responsibility is with the Army, Navy, Air Force, Office of the Secretary of Defense (Comptroller), and DLA for all DOD agencies except TRANSCOM.

[10]In addition to the cash balance data on the official reports, DFAS provides estimated cash balance information to the military services and DOD components on the eighth or ninth day after the end of the month in which the transactions took place.

of March 1996. As a result, the Fund's cash can only be managed on a reactive rather than proactive basis.

The lack of timely data was raised as a serious problem by the Joint Logistics Commanders who are senior-level general officers. In a June 1995 memorandum to the Under Secretary of Defense (Comptroller), the Joint Logistics Commanders stated that "the current twenty-five day compilation period is not acceptable for cash management purposes" and that a "reduction in cycle times for recording and reporting transactions impacting cash balances is required." They also stated that "cycle time reduction is of critical importance to facilitate major programmatic decision[s] which may be driven largely by cash balance considerations, particularly those made late in the fiscal year."

DFAS officials recognize that the current reports are not adequate or timely. A DFAS official told us that DFAS is currently developing reporting procedures so that the military services and DOD components can identify the monthly cash balance for each Fund business area, such as the Navy shipyard business area or the Air Force depot maintenance business area. With respect to the timeliness of the reports, DOD's Financial Management Regulation on the Fund establishes a goal to improve cash reporting by providing real-time cash balances on the Fund's business areas. However, until the Fund's financial systems and processes are improved, the ability to provide the collection and disbursement data more promptly will not be achieved.

Further, given that these system improvement efforts will be a long-term venture, it is important for DOD to concurrently pursue efforts to improve the quality of the financial information in the systems today. In previous reports on the Fund, we have stressed the need for DOD to improve existing operations and to not wait for implementation of the new systems to improve the quality of information. Operating improvements can be realized under the present systems through better adherence to existing policies and procedures and manual correction of existing erroneous data. In fact, if the reliability of the information is not improved dramatically, any new systems will provide the same erroneous data and perpetuate the operational problems that result from managers not receiving accurate information.

Financial Reports Do Not Disclose Impact of Undistributed Disbursements and Collections on Accounts Receivables and Payables

The Fund's financial reports, as of September 1995, showed that the Fund had $4.5 billion and $920 million of undistributed disbursements and collections, respectively. In preparing the Fund's monthly financial reports, DOD did not fully disclose that billions of dollars of adjustments were made to its accounts receivable and payable balances for undistributed disbursements and collections.

In order to more accurately reflect the true accounts receivable and payable balance on financial reports, DOD's guidance—Financial Management Regulation, Volume 11B, Chapter 54—provides that accounts receivables and payables should be adjusted by the amount of undistributed collections and disbursements, respectively. Conceptually, undistributed collections and disbursements are collections and disbursements that have been made and reported to the Treasury but not posted to DOD's records. Therefore DOD adjusts the (1) accounts payable balance based on the difference between the disbursements recorded in the accounting system's general ledger and the disbursements reported to the Treasury and (2) accounts receivable balance based on the difference between the collections recorded in the accounting system's general ledger and the collections reported to the Treasury. Normally, adjustments should reduce receivable and payable balances.

However, our analysis of the Fund's financial reports and supporting documentation showed that DOD had negative undistributed disbursements and collections in some business areas which increased, instead of decreased, the amounts of accounts payable and receivable. These negative amounts can occur for numerous reasons, such as transactions being reported on the activity records but not on Treasury records and/or double recording of transactions by the activities. For example, as of the end of September 1995, accounts receivable for the Navy shipyards and the DLA distribution depots were increased by $542 million and $364 million, respectively, as a result of negative undistributed collections. Similarly, accounts payable for the Military Sealift portion of TRANSCOM increased by $205 million as a result of negative undistributed disbursements.

Fully disclosing adjustments on the Fund's monthly reports would serve to highlight reporting problems, such as negative undistributed collections and disbursements. Such negative amounts cast serious doubts on the accuracy and reliability of the reported account balances. If they were fully disclosed on financial reports, they would serve as "red flags" for management, calling attention to the fact that the information being

reported could be inaccurate and warrants further analysis, and that corrective action may be needed.

Advance Billings Continue Despite Large Amounts of Accounts Receivables

During fiscal year 1995, DOD continued the practice of advance billing customers for work it had not yet performed to ensure that sufficient funds were available to meet day-to-day operating expenses. At the end of September 1995, the military services had advance billings outstanding of $2.6 billion. Of this amount, the Navy had about $2 billion or 77 percent of the total. At the same point in time, DOD had outstanding accounts receivables of $1.4 billion that were over 60 days old. If DOD was more aggressive in collecting these receivables, it could help reduce the Fund's cash shortage and the need to advance bill customers.

Advance Billing Used to Alleviate Cash Shortage

Recognizing that the Fund's operations would not generate adequate cash to complete the transfers of $5.5 billion as required by the National Defense Authorization Act for Fiscal Year 1993, the DOD Principal Deputy Comptroller directed in June 1993 that all depot maintenance and selected Naval research and development activities advance bill customers for goods and services to be provided. In July 1994, the Comptroller of Defense stopped the advance billing at all activities except the Naval shipyards and research and development activities. Although these remaining activities had been tentatively scheduled to stop advance billing in January 1995, this did not occur. In discussing a draft of this report with DOD officials, they stated that when the responsibility for Fund cash was returned to the DOD components, along with the associated Antideficiency Act responsibilities, in February 1995, the amount of cash returned to the Army, Navy, and Air Force was not sufficient to cover outstanding Fund liabilities. The Fund's financial reports indicate that this was the case, with each of the military services facing cash shortages. Therefore, according to DOD, it was necessary for the military services to continue to advance bill customers so that their cash portion of the Fund would not go negative.

The following table provides information on the actual amount of outstanding advance billings and the reported cash balance for the military services and the Defense agencies at the end of September 30, 1995.

Table 1: Advance Billings and Reported Cash Balances at September 30, 1995

Dollars in millions

DOD component	Reported cash balance	Outstanding advance billing	Cash balance without advance billing
Navy	$1,609	$1,981	$(372)
Air Force	545	388	157
Army	560	245	315
Defense agencies	1,602	0	1,602
Office of the Secretary of Defense	124	0	124
Total	**$4,440**	**$2,614**	**$1,826**

The above table shows that if the Navy had not advance billed its customers, the Navy Fund cash balance would have been a negative $372 million as of September 30, 1995. In fact, the Navy advance billed its customers about $1.2 billion during September 1995 to ensure that the Navy Fund cash balance remained positive—at the end of August 1995, the Navy Fund cash balance was about $40 million. By comparison, even without advance billing, the table shows that the Army and Air Force portion of the Fund had positive balances of $315 million and $157 million, respectively.

In updating the Fund's cash balance information as of the end of December 1995, we found that the reported cash balance had significantly decreased since September 1995. Over that 3-month period, the Fund's overall cash balance had decreased from $4.4 billion to $2.1 billion—over a 50-percent reduction. Navy had the greatest share of the cash reduction; its balance decreased from about $1.6 billion to $83 million. In discussing a draft of this report with DOD officials, they stated that the Fund would not advance bill customers during fiscal years 1996 and 1997. They also stated that the Army and Air Force would eliminate their outstanding advance billing balances by the end of fiscal year 1996 and that the Navy would eliminate its outstanding advance billing balance by the end of fiscal year 1997. As part of our ongoing work, we will continue to monitor the Fund's effort to eliminate the outstanding advance billing balances.

The Fund Has Large Amounts of Accounts Receivables on Its Books

One way to help reduce the cash shortage problem is for the Fund to promptly collect accounts receivables. Since the Fund is a $75 billion operation and it bills customers at least monthly, it is normal to have 1 or 2 months of accounts receivables on the books. As of September 1995, DFAS reported that the Fund had $6 billion in accounts receivables for Fund

business areas with receivables exceeding $50 million. However, about 24 percent of the Fund's receivables, or $1.4 billion, have been outstanding for over 60 days with almost $1 billion of this amount outstanding for over 120 days. The following table provides aging information on the Fund's accounts receivables that are over 60 days old.

Table 2: Accounts Receivables More Than 60 Days Old at September 30, 1995

Dollars in millions

	Number of days old			
Business area	**61-90**	**91-120**	**> 120**	**Total**
Supply Management—Navy	$24	$31	$255	$310
TRANSCOM—Defense	45	31	130	206
Supply Management—Defense	78	8	114	200
Logistics Support—Navy	13	9	93	115
Communications Information Services—Defense	39	25	46	110
Distribution Depots—Navy	12	9	86	107
Subtotal	211	113	724	1,048
All Other Business Areas	53	65	260	378
Total	**$264**	**$178**	**$984**	**$1,426**

The DOD Financial Management Regulation, Volume 4, provides that "procedures shall be established for the routine aging of all amounts overdue so that appropriate actions can be taken to effect their collection. The aggressive and efficient management of receivables in the Department of Defense is an important element of DOD stewardship over public funds." However, as the above table shows, DOD has not collected the accounts receivables in a timely manner. Some examples of why the Fund has not been collecting receivables in a timely manner are highlighted below and are discussed in further detail in appendix I.

- DFAS was not reimbursed $57 million by the Army and $34 million by the Navy in a timely manner for work performed in fiscal years 1993 and 1994. DFAS was paid 6 months to 2 years after it performed this work. Further, as of February 2, 1996, the Navy still has not reimbursed DFAS $7 million for work performed during fiscal years 1993 or 1994. DFAS was not paid primarily because it was performing work before receiving a funding document from its customers as generally required by the DOD Financial Management Regulation.
- As of September 30, 1995, DFAS' accounts receivable report showed that TRANSCOM had $697 million of accounts receivable. Of that amount,

$437 million had not been billed to customers. For example, during fiscal years 1993 and 1994, TRANSCOM performed about $104.5 million of transportation services but had not received reimbursement as of February 16, 1996—1 to 3 years after the work was performed. TRANSCOM has not been reimbursed primarily because the billing documentation did not identify the specific activities to be billed.

In discussing a draft of this report with DOD officials, while agreeing to pursue collection of the receivables, they stated that accounts receivable data provide misleading information to DOD managers since some of these receivables will not be collected. They said they needed to determine the collectibility of the receivables and write-off amounts determined to be uncollectible. However, since most of the receivables are from DOD activities, if they were valid receivables, it would seem they should be collectible. Therefore, DOD needs to aggressively pursue collecting the receivables and fully document why any receivables would not be collectible. Because the Fund is a revolving fund, promptly being reimbursed for work performed is essential to its financial stability since this is the principal means through which it receives moneys needed to cover operating expenses. Further, the lack of timely reimbursements may result in cash fluctuations throughout the fiscal year and therefore lead to possible additional advance billing of customers.

Navy Cash Management Problems Are the Most Severe

Although problems discussed in this report transcend the entire Department, they were most prevalent with the Navy and DFAS activities providing accounting services to the Navy. The difficulties in accurately accounting for and reporting on the Navy's portion of the Fund's cash are highlighted below and discussed in more detail in appendix II.

- Processing of interfund transactions, which occur when one DOD activity sells or buys goods and/or services from another DOD activity, resulted in the overstatement of business area cash—collections less disbursements—on the departmental level financial reports. Although this problem impacts several business areas, it is the most severe in the Naval Aviation Depots. Within the aviation depots alone, Navy officials acknowledged that cash may be overstated anywhere from $800 million to $1 billion.
- As discussed earlier, recording of undistributed transactions distorted the amount of collections and disbursements reported on the Fund business areas' financial reports. The Navy/DFAS routinely recorded undistributed collections and disbursements in the Research and Development business

area financial reports, rather than allocating the amounts to the appropriate business areas. This resulted in an understatement of cash in the Research and Development business area and a corresponding overstatement of cash in the other business areas. As a result, management did not have an accurate picture of the business areas' collections, disbursements, and cash for use in the decision-making process.

- Large unreconciled cash differences exist at the Naval Aviation Depots. As of September 30, 1995, the unreconciled cash differences at the aviation depots ranged from a negative $15 million to a positive $375 million. A comptroller official with the Naval Air Systems Command (NAVAIR) stated that visibility over cash within NAVAIR had been lost.

Since the Navy constitutes approximately $23 billion or 31 percent of the Fund's estimated fiscal year 1996 revenue of $75 billion, until the problems with the Navy cash balances are resolved, the accuracy of the financial information on the Fund's operations will continue to be highly questionable. We have discussed these matters with cognizant Navy and DFAS officials, and, based on these discussions, they have initiated actions that, if properly implemented, should help resolve the problems. For example, DFAS and the Navy have developed specific funding codes to help resolve problems related to processing interfund transactions.

Fund Financial Statements Audits Also Identified Cash Management Problems

Since the inception of the Fund, the DOD IG and the military service audit agencies have audited the Fund's financial statements, prepared pursuant to the requirements of the CFO Act. These audits have continually identified serious problems in the Fund's financial statements which relate to the Fund's cash management practices. The DOD IG was not able to render an opinion on the Consolidated Statement of Financial Position of the Fund as of September 30, 1994,[11] because of the lack of a sound internal control structure for the Fund and significant instances of noncompliance with regulations. Some problems related to the Fund's cash, accounts receivable, and accounts payable identified in DOD IG and military service audit agency reports are highlighted below.

[11]This was the last fiscal year for which audited financial statements were available at the time of our review.

- Unsupported and unverified transactions recorded in DLA's distribution depot and the Air Force depot maintenance business areas caused accounts receivable to be misstated by $511.8 million.[12]
- The Naval Audit Service reported that the accounts payable for the Navy portion of the Fund was overstated by a net estimated amount of $52.4 million. Overstatements were caused by activities paying recorded payables in fiscal year 1994 without adjusting accounts payable, insufficient supporting documents, and bookkeeping and input errors.[13]
- The Air Force Audit Agency reported that the Financial Inventory Accounting and Billing System (FIABS) did not record accounts payable for $2.4 billion disbursed for reparable item purchases and repairs. Additionally, FIABS did not maintain subsidiary records to support $96.9 million owed to vendors for purchased consumable items. As a result, users of the financial information did not have accurate accounts payable balances to project future cash outlays.[14]

Although established as a business operation, the Fund has yet to pass the test of an annual financial statement audit—for fiscal years 1993 and 1994, the DOD IG could not render an audit opinion on the Fund's consolidated financial statements.

Conclusions

The cash management problems we identified in this report are only a facet of the broader financial management weaknesses confronting the Fund and DOD overall. Successful implementation of the CFO Act will be key to solving DOD's long-standing financial management weaknesses. In the interim, by correcting the Fund's cash management problems, DOD can provide better tools than currently available to the Fund's business area managers for use in the decision-making process. While the Fund's cash balance is managed at the military service and DOD component level, most decisions that impact cash, such as buying inventory items from vendors, are made at the business area or activity level. However, the poor state of cash-related information DOD managers have to work with severely inhibits their ability to manage the Fund's cash. This is evident by the fact that DOD relies on advance billing of customers for work not yet performed to ensure that the Fund has sufficient funds available to meet its day-to-day

[12]Defense Business Operations Fund Consolidated Statement of Financial Position for Fiscal Year 1994 (DOD IG Report No. 95-267, June 30, 1995).

[13]Fiscal Year 1994 Consolidating Financial Statements of the Department of the Navy Defense Business Operations Fund (Naval Audit Service Report 044-95, May 30, 1995).

[14]Review of Selected Accounts, Supply Management Business Area, Fiscal Year 1994 (Air Force Audit Agency Project 94068041, June 27, 1995).

operating expenses. Covering cash shortages in this manner does not provide the necessary incentives to effectively manage certain business processes of the Fund that are related to cash such as collecting accounts receivables in a timely manner. Unless a high priority is placed on correcting these problems, the status quo will be perpetuated, and the Fund will continue to be limited in its ability to carry out its original objective of enhancing readiness capability through business operation efficiencies.

Recommendations

We recommend that the Under Secretary of Defense (Comptroller)

- identify the cash balance for each business area in the Fund's monthly 1307 financial report,
- fully disclose in the monthly 1176 and 1307 reports the amount of the adjustments made to the accounts receivable and payable balances for undistributed collections and disbursements,
- validate and aggressively pursue the collection of accounts receivables especially those over 60 days old, and
- direct DOD activities to follow existing DOD Financial Management Regulation and provide funding documents to the Fund prior to the Fund beginning work.

Agency Comments

On March 20, 1996, we discussed a draft of this report with officials of the Secretary of Defense (Comptroller), Army, Navy, Air Force, DFAS, and DLA, who are responsible for the Fund's cash management. In general, these officials agreed with the report's findings, conclusions, and recommendations. Regarding the accounts receivable information and DOD's view that some of the receivables may not be collectible as noted earlier in this report, we modified the proposal contained in our draft report to recommend that DOD validate the Fund's accounts receivable balances.

We are sending copies of this report to the Secretary of Defense; the Director of the Office of Management and Budget; the Chairmen and Ranking Minority Members of the Senate Committee on Armed Services; the Senate Committee on Governmental Affairs; the House Committee on Government Reform and Oversight; the Subcommittee on Government Management, Information, and Technology, House Committee on Government Reform and Oversight; and the House and Senate Committees

on Appropriations; and other interested parties. Copies will be made available to others upon request.

Please contact me at (202) 512-6240 if you or your staffs have any questions concerning this report. Other major contributors to this report are listed in appendix III.

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Abbreviations

CERPS	Centralized Expenditure Reimbursement Processing System
CFO	Chief Financial Officer
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DOD	Department of Defense
EDI	Electronic Data Interchange
FIABS	Financial Inventory Accounting and Billing System
FMFIA	Federal Managers' Financial Integrity Act
IG	Inspector General
MIPR	Military Interdepartmental Purchase Request
NADEP	Naval Aviation Depot
NAVAIR	Naval Air Systems Command
R&D	Research and Development
TRANSCOM	Transportation Command

The Fund Is Experiencing Difficulty Being Reimbursed for Services Provided

Since the Fund is a revolving fund, being promptly reimbursed for work performed is essential to its financial stability. As the Fund performs work and incurs costs, it bills customers on the basis of predetermined prices—commonly referred to as "stabilized" or "standard" prices. These payments are then used to finance subsequent operations, much as sales revenues are used in commercial enterprises. As stated in this report, we identified numerous instances in which the Fund was not being reimbursed in a timely manner for services performed. As of September 1995, 24 percent of the Fund's receivables, or $1.4 billion, had been outstanding for more than 60 days. This constricts management's ability to manage cash efficiently, and it could increase the requirements of the Fund to cover the cash fluctuations throughout the fiscal year. The following details the instances we identified in which customers did not reimburse the Fund in a timely manner.

DFAS Not Promptly Reimbursed for Services Provided

Each year, DFAS performs about $1.5 billion of accounting and finance work, such as paying civilian and military personnel for the military services and Defense agencies. However, DFAS was not reimbursed $57 million by the Army and $34 million by the Navy in a timely manner for work performed in fiscal years 1993 and 1994. In addition, DFAS still has not been reimbursed $7 million for Navy work performed in fiscal years 1993 or 1994. In this case, the Navy did not send DFAS a funding document to cover routine DFAS accounting services. DFAS and the Navy have been working on resolving this problem, and DFAS recently requested that the Navy provide a funding document—called a Military Interdepartmental Purchase Request (MIPR)—for $7 million to cover DFAS services performed in fiscal years 1993 and 1994.

Chapter 61 of the DOD Financial Management Regulation on the Fund provides that "as a general rule, no work or services should be performed by a Defense Business Operations Fund activity except on the basis of reimbursable orders received and accepted that constitute obligations of Federal Government ordering activities or advances from non Federal Government entities."

The following details cases we identified in which the Army and Navy did not promptly reimburse DFAS.

- DFAS performed $17 million of work in fiscal year 1993 and $40 million of work in fiscal year 1994 that the Army did not pay for until the following fiscal year. To finance the fiscal year 1993 work, the Army issued MIPRs to

DFAS. The Army issued 38 MIPRs, dated between April 1994 and October 1994, to DFAS—at least 6 months after the end of fiscal year 1993. To finance the fiscal year 1994 work, the Army issued 9 MIPRs, dated between June 1995 and September 1995 to DFAS—at least 8 months after the end of fiscal year 1994.

- DFAS performed $41 million of Navy work in fiscal years 1993 or 1994 for which it did not receive payment in a timely manner. In October 1995, the Navy paid DFAS $34 million for this work—1 to 2 years after the work was done. As of February 2, 1996, the Navy still had not reimbursed DFAS for $7 million for the work performed during this time period.

Army and Navy officials informed us that they did not pay bills promptly because they did not always receive sufficient details from DFAS on the bills, including information on how much money was owed by the different activities within a service. DFAS officials told us that, since the Army and Navy raised the concern on the billing detail, DFAS has begun to include in its bills to the services more detailed information, such as (1) the identification of the specific customer that will pay the bill and (2) the type of work performed such as maintaining pay accounts.

DFAS officials also told us that they were performing work for the military services and DOD components without always having received a funding document from the military services or DOD components. They told us that (1) this has been a continual problem since DFAS became part of the Fund in fiscal year 1992 and (2) the military services and DOD components knew that DFAS was going to perform some accounting services even without receiving a funding document. To resolve the DFAS funding problem, the Under Secretary of Defense (Comptroller) issued memorandums to the military services and DLA in August 1995 requiring them to fund the full fiscal year 1996 DFAS amount no later than 10 working days after the apportionment reflecting the fiscal year 1996 Appropriations Act.

Distribution Depots Are Also Experiencing Timeliness Problem in Being Reimbursed

Similar to DFAS, DLA distribution depots, which are responsible for receipt, storage, and issue of inventory items, are not promptly reimbursed for the work they have performed. This is occurring chiefly because the distribution depots also are performing work before receiving a funding document from their customers.

To illustrate, on November 6, 1995, or 1 month after the beginning of fiscal year 1996, we requested from DLA a listing of those activities that had provided the distribution depots with fiscal year 1996 funding documents

and those activities that had not provided them funding documents. We found that, at the time, 19 activities had provided the distribution depots funding documents totaling about $78 million. However, 18 activities had not provided the distribution depots with funding documents. After we requested the information, the 18 activities eventually provided the distribution depots with funding documents totaling $174 million. Of that amount, about $167 million was received in December 1995. Because the distribution depots did not receive funding documents in time, they could not bill some customers for work performed in October and November 1995 until December 1995.

In addition to the funding document problem, the distribution depot billing process is manual, which precipitates other problems because it is time-consuming and can cause clerical errors. For example, clerical errors resulted in $234 million of collections being improperly recorded in March 1995. As a result, large fluctuations were shown on the distribution depot business area's monthly reports on budget execution (1176 report) as the errors were corrected. Specifically, the cumulative collection balances for February, March, and April 1995 were $404 million, $769 million, and $570 million, respectively. Since the monthly reports provide cumulative balances, the collection amount should be increasing each month. However, the April balance is almost $200 million less than the March balance.

DFAS-Columbus, which provides accounting services for the distribution depots, recognizes that it needs to automate the manual billing process. In fiscal year 1993, a system change request was made to automate the billing process. Current DFAS plans show that automating the billing process will be done in three segments with the initial segment being implemented in June 1996. The first segment is to include such features as establishing a new subsidiary ledger, identifying customers, and capturing funding document information. The second and third segments, which are expected to be implemented in January 1997 and January 1998, respectively, are to add such features as the issuance and acceptance of funding documents by electronic data interchange (EDI), automatic updates to general ledger accounts, EDI transfer of funds capability, status of funds reports to customers, and an interface of billing data to the disbursing and collection system.

TRANSCOM Has Not Been Reimbursed for Transportation Services

As of September 1995, DFAS' accounts receivable aging report showed that TRANSCOM had $697 million of accounts receivable. Of that amount, $437 million, or 63 percent, of accounts receivable had not been billed. Because of the severity of the accounts receivable problem, on November 20, 1995, the Under Secretary of Defense (Comptroller) issued a memorandum to TRANSCOM pointing out that (1) "TRANSCOM appears to have the highest percentage of total accounts receivable, as well as unbillable receivables, within DBOF" and (2) "since reducing aged receivables remains an important financial goal as well as integral to sound cash management, TRANSCOM needs to again focus on solutions to this problem."

According to TRANSCOM and DFAS officials, in some cases TRANSCOM has not billed customers because it does not know who to bill due to invalid billing codes. TRANSCOM estimates that this problem accounts for more than $125 million of its unbilled amount. Another $100 million is unbilled because customers rejected bills—a problem that also may be related to invalid billing codes. For example, during fiscal years 1993 and 1994, the Air Mobility Command of TRANSCOM performed about $104.5 million of transportation services for the Army and/or DLA but has not received reimbursement as of February 16, 1996. Of the $104.5 million, TRANSCOM performed $61.1 million and $43.4 million of transportation services in fiscal years 1993 and 1994, respectively. TRANSCOM has not received reimbursement primarily because the billing documentation did not identify the activities to be billed. According to TRANSCOM and DFAS officials, $91 million of the $105 million relates to the use of invalid billing codes. They are now researching each shipment 1 to 3 years old to identify a valid code and which activity should pay the bill.

To resolve the accounts receivable problem, DOD established a joint working group comprised of TRANSCOM, Transportation Component Commands, and DFAS functional experts in June 1995. Many factors contributing to the accounts receivable problem originate in the transportation operation systems and processes that provide the accounting system data which DFAS uses to bill and collect customer dollars. The joint working group is currently discussing changes that need to be made to the systems to correct the problem.

Military Sealift Command's Collections Not Recorded Promptly

During fiscal year 1995, collections for the Military Sealift Command portion of TRANSCOM were not processed by DFAS for the months of April and June 1995. According to Military Sealift Command officials, the collections for these 2 months were not processed because DFAS did not input the data into the disbursement/collection system. This resulted in large fluctuations in net outlays (the difference between disbursements and collections) from month to month. Officials informed us that the collection cycles were processed in subsequent months.

The actual Military Sealift Command's collections processed from March through July are shown in the following table.

Table I.1: Military Sealift Command Collections Recorded From March Through July 1995

Dollars in thousands

Month	Amount
March 1995	$106,878
April 1995	0
May 1995	182,188
June 1995	0
July 1995	207,994

As table I.1 shows, there is an irregular pattern in reporting collections by the Military Sealift Command. Since the Military Sealift Command is part of TRANSCOM, not processing collections makes TRANSCOM's cash management responsibilities difficult to perform. Chapter 61 of the DOD Financial Management Regulation, Volume 11B, on the Fund provides that billings and collections shall be accomplished at least monthly and include applicable labor, material, overhead, and surcharges. Processing the collection data each month is critical because this is the mechanism through which the Fund obtains the funds necessary to help finance its day-to-day operations. As previously discussed, DOD recognizes that the transportation business area has financial problems and has established a joint working group to resolve these problems.

Navy Faces Formidable Challenge in Managing Fund Cash

The Navy—and DFAS activities providing accounting services to the Navy—had the most problems accurately accounting for and reporting on the Fund's cash. Specifically, we found problems with the (1) processing of interfund bills that overstated business area cash on the departmental level financial reports, (2) reporting of collection data that overstated Treasury cash, (3) treatment of undistributed transactions on financial reports that distorted business area collections and disbursements information on financial reports, and (4) accountability over cash at the Navy Aviation Depots (NADEPS). Effective cash management is directly dependent on the availability of accurate and timely data on cash levels. These problems could (1) result in an increase in the Fund's cash requirement to cover the day-to-day fluctuations in the Fund's cash balance and (2) impact major programmatic decisions, which may be driven largely by cash balance considerations.

Interfund Billing Overstates Business Area Cash

Interfund billing transaction processing problems at DFAS-Cleveland have resulted in Navy business area disbursements being misstated on the Fund's monthly 1176 financial report. Navy and DFAS officials informed us that this problem has resulted in misstated reported disbursements for several Navy business areas, such as the NADEP, Shipyard, Ordnance, and Research and Development business areas. They also stated that the NADEPS have the biggest disbursement reporting problem. The officials estimated that the interfund problem has resulted in an overstatement of NADEPS' cash anywhere from $800 million to over $1 billion. This reflects a breakdown in controls in DOD's disbursement process and creates problems in reconciling the departmental and activity-level books.

Interfund transactions occur when one DOD activity sells or buys goods and/or services from another DOD activity. The Navy's interfund processing problem primarily occurs when the Army, Air Force, or DLA sells material to Navy depot maintenance activities and uses nonspecific codes to identify the Navy buying activity. This results in interfund disbursement transactions not being charged to the Navy activity buying the material in Navy's departmental level accounting records. DFAS and Navy officials told us that this is not a new problem. Various documents disclosed that the Navy has had problems with processing interfund transactions since the early 1980s.

We discussed the interfund transaction processing problem with DFAS headquarters officials, and, as a result, DFAS has developed a listing of specific activity fund codes for use by the military services and DLA. The

Navy and DFAS are currently developing implementing procedures for the DOD activities to use these fund codes.

Estimation of Collections Results in Overstatement of Cash Balance

In May 1995, the Naval Audit Service reported[1] that the Navy Fund supply management business area inappropriately reported estimated collections resulting from sales rather than actual collections. While estimating collections based on sales has been a long-standing Navy practice since ships and other activities are sometimes late in reporting actual collections, current DOD and DFAS guidance states that collections from sales are to be based on actual collection transactions and not estimates. Because this guidance was not followed, the Navy's (Aviation Supply Office) cash was overstated by $670 million on DOD's and the Treasury's accounting records. DOD agreed with the Naval Audit Service's finding that the Navy/DFAS should not be estimating collections for the Navy Aviation Supply Office.

The overstatement of cash occurred when the Navy and DFAS implemented an accounting system change. Because of the change, duplicate collections were reported when DFAS paying offices estimated collections for the Naval Aviation Supply Office in one financial transaction register while actual collections were being reported in another register. To correct this problem and accurately report actual collections for the Aviation Supply Office, DFAS made a $670 million net adjustment (collections less disbursements) to the accounting records in May 1995, which reduced the Navy Fund cash balance on DOD's and the Treasury's books. However, we found that the Navy/DFAS is still estimating collections for 87 other Navy activities. As of September 1995, the Navy/DFAS had estimated collections of $150 million resulting from sales.

To curtail this practice, DFAS headquarters sent a memorandum, dated December 29, 1995, to its activities instructing them that "effective immediately, the practice of estimating collections and disbursements is prohibited." The memorandum further instructs DFAS to contact the activities not reporting actual collections in time to meet the Treasury reporting cut off date and obtain the actual amounts in lieu of using estimates. If attempts to get the actual collection amounts fail, the financial reports prepared by DFAS are to be footnoted to disclose the activities missing from the reports. The Navy agrees with DFAS that the use of estimates is inappropriate for financial reporting. However, the Navy

[1]Fiscal Year 1994 Consolidating Financial Statements of the Department of the Navy Defense Business Operations Fund (Naval Audit Service-44-95, May 30, 1995).

informed DFAS that eliminating this practice is subject to the development of procedures that provide for the processing of actual collection data for activities not able to meet the Treasury reporting cut off date.

Undistributed Transactions Distort Business Area Cash

Navy/DFAS treatment of undistributed transactions resulted in significant misstatements of cash for Navy business areas. Specifically, Navy's Research and Development (R&D) business area—rather than the appropriate business areas—were allocated undistributed amounts at the request of the Navy. This treatment of undistributed transactions misleads report users by distorting business area disbursements and collections, resulting in an understatement of R&D cash and an overstatement of the other Navy business areas' cash. The following table shows the amount of undistributed disbursements and collections that were recorded in R&D for fiscal years 1993 and 1994.

Table II.1: Undistributed Transactions Recorded in the Navy's Research and Development Business Area During Fiscal Years 1993 and 1994

Dollars in millions

Fiscal year	Undistributed disbursement	Undistributed collections	Net amount in R&D
1994	$167.9	$ 0.9	$167.0
1993	439.4	36.1	403.3

We have discussed the treatment of undistributed disbursements and collections for financial reporting purposes with both DFAS and Navy Comptroller officials. Subsequently, a DFAS official told us that the undistributed disbursements and collections were allocated to the appropriate business area in the Fund's monthly financial reports beginning in September 1995.

Unreconcilable Cash Differences Exist at Navy Aviation Depots

We also found that there are significant differences in cash amounts between the NADEPs' accounting records and the department-level records contained in the Centralized Expenditure Reimbursement Processing System (CERPS) that cannot be reconciled. This situation has caused considerable concern within Naval Air Systems Command (NAVAIR), which has overall responsibility for NADEP operations. A NAVAIR comptroller official told us that visibility over Fund cash within NAVAIR has been lost and that nobody knows what the cash balance is or should be. As a result, NAVAIR's ability to adequately manage the Fund's cash is severely inhibited. As of September 30, 1995, unreconcilable cash differences at the NADEPs

ranged from a negative $15 million to a positive $375 million. The following table shows these unreconcilable amounts by individual NADEP.

Table II.2: Unreconcilable Cash for the Naval Aviation Depots as of September 30, 1995

Dollars in millions

NADEPs	CERPS cash	Treasury cash	Unreconcilable amount
Jacksonville	$83	$99	($16)
Cherry Point	84	93	(9)
Pensacola	33	(19)	52
Alameda	206	(78)	284
North Island	446	71	375
Norfolk	(67)	(69)	2

Because of the current process used to account for and report disbursement and collection data, there are three different cash balances for the individual NADEPs depending on the accounting records from which the balances are obtained: (1) an amount recorded on the NADEPs' activity accounting records, (2) an amount reported by CERPS, and (3) an amount reported as the Navy Comptroller Treasury balance. In theory, the amount reported by CERPS and the amount reported as the Navy Comptroller Treasury balance should be the same because they are derived from the same disbursement and collection transactions. However, this is not the case. The Navy Comptroller Treasury amount contains disbursement and collection information from various financial registers that are not made available to the NADEPs. As a result, the CERPS and Navy Comptroller Treasury amounts do not agree.

When the NADEPs perform cash reconciliations between their activity records and departmental records, they can usually reconcile the differences between the activity and CERPS amounts being reported, for example, differences that occur in the timing of when transactions are recorded in the activities records versus when the transactions are reported to the Treasury. However, they cannot reconcile the differences between CERPS and the Navy Comptroller Treasury balance because of the missing financial register information. Even if the NADEPs had the missing information, they would still have trouble reconciling the amounts because the interfund processing problem discussed above is contributing to some of the unreconcilable amounts. Because of the (1) different cash balances the NADEPs must use when reconciling cash and (2) missing financial registers, the NADEPs include qualifying language in their fiscal year-end certification of the financial statements that references the three

different cash balances as well as the missing financial information. In discussing a draft of this report with DOD officials, they acknowledged that having three cash balances is a problem and that they are taking actions to eliminate one of the cash balances by providing the NADEPs the missing financial register information.

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Related GAO Products

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