

GAO

Testimony

Before the Governmental Affairs Committee  
United States Senate

For Release on Delivery  
Expected at  
10:00 a.m. EST  
Wednesday  
February 19, 1992

FINANCIAL AUDIT

Aggressive Actions Needed  
for Air Force to Meet  
Objectives of the CFO Act

Statement of Charles A. Bowsher  
Comptroller General of the United States



Mr. Chairman and Members of the Committee:

We are pleased to be here to discuss our latest evaluation of the Air Force's financial management operations. As you may recall, 2 years ago we testified before this Committee on the results of our first financial audit of the Air Force. We were extremely critical of its financial management operations, having found that over 70 percent of its non-cash assets were unauditable. Since then, we have continued our work and issued 12 additional reports which discuss, in more depth, problems with Air Force financial management systems that impair its ability to achieve sound financial management. The report we are issuing today<sup>1</sup> largely summarizes the information and recommendations for corrective actions presented in those 12 reports.

Today, we regret to report that, overall, the serious financial management problems we reported still remain. The Department of Defense (DOD), almost without exception, has agreed with our findings and recommendations and has expressed a strong commitment to implementing corrective actions. But the implementation of many such actions has been relatively slow. Our current audits involving Air Force Financial systems confirm that initiatives planned or started at higher levels have not yet had a great deal of impact at the working level, where transactions are made and data is generated.

I would not want to understate the magnitude and difficulty of the task DOD faces in bringing sound and effective financial management to the Air Force. Current DOD and Air Force management inherited obsolete, fragmented, and poorly coordinated financial systems containing data which is often suspect, and in many cases just plain incorrect. Air Force financial managers who are now tasked with bringing about major changes face an environment where, traditionally, financial management has not been a high priority of the top leadership. Instead, the focus has predominately been budget oriented--how much can I spend this year, and how much will I receive next year? Clearly, a great deal of sustained effort led and reinforced by top management will be required to achieve first-class financial management. The task may be made even more difficult because of the cut backs, reorganizations, and downsizing the Defense establishment is currently experiencing.

To its credit, DOD top management has undertaken major long-range initiatives to bring about fundamental changes to the way it manages its financial resources, including organizational changes to strengthen financial management leadership. We agree in concept with most of the initiatives and have work underway to monitor

---

<sup>1</sup>Financial Audit: Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act (GAO/AFMD-92-12).

their execution. However, we believe that more can and needs to be done in the short term both to bring better accountability to current operations and to ensure the success of the long-term initiatives.

Specifically, aggressive actions, particularly short-term repairs to existing systems and practices, are needed to

- improve reliability of basic financial data;
- permit the preparation of credible financial reports;
- improve the functioning of inventory control systems; and
- strengthen internal controls to prevent fraud, waste, and abuse.

Unless these short-term repairs are made promptly, we would anticipate the following.

- The DOD Inspector General's audit of the Air Force's fiscal year 1992 financial statements required by the Chief Financial Officers (CFO) Act, may, like our audit of 1988, conclude that the financial data is not reliable.
- Important DOD management initiatives, like the Corporate Information Management effort, and financial management initiatives like the Defense Business Operations Fund, will be delayed and their success jeopardized.
- DOD's attempts to reduce the acquisition of unrequired inventory will be delayed, and to some extent, frustrated due to the lack of relevant and meaningful information.
- Accounting and control-based problems, like those disclosed in the recent "M account" report by the DOD Inspector General, will keep occurring.

The Air Force's deficient accounting and internal control systems could result in even more adverse consequences as DOD and the Air Force engage in the difficult task of downsizing the military structure. Force reductions and other actions which are undertaken will need to consider cost implications. Unfortunately, reliable cost information is just not available from the Air Force's accounting systems. Thus, the necessary trade-offs between readiness and costs will be hampered by the lack of good information.

Now, I would like to discuss some of the findings contained in the report we are releasing today. These will illustrate the kinds of financial management problems that the Air Force faces.

BILLIONS OF DOLLARS OF ERRORS  
FOUND IN ANNUAL FINANCIAL REPORTS

In auditing the Air Force's 1989 Treasury financial reports, we identified billions of dollars of adjustments needed to improve the accuracy of the reports and the underlying records. After we informed the Air Force and the Treasury of the magnitude of the errors, Air Force officials recalled the reports and made approximately \$62 billion in adjustments. These were needed to correct errors in account balances, eliminate amounts that were included in balances twice, record amounts that had not been posted to accounts, and reclassify certain balances to the proper accounts. Hopefully, the magnitude of errors in more recent Treasury reports has been reduced by the effort of the new Defense Finance and Accounting Service finance center.

AIR LOGISTICS CENTERS' INVENTORIES ARE  
INACCURATE AND CONTROLS ARE WEAK

Our physical counts of high-dollar inventory items at four Air Logistics Centers found that an estimated 18.3 percent of the perpetual records differed from quantities actually in storage. We estimated that such inventories, valued at \$14.8 billion, contained \$2.3 billion of errors--overstatements of \$1.5 billion in certain accounts and understatements of \$.8 billion in others.

In addition to their importance in maintaining control, accurate inventory records are critical to making sound purchasing and budgeting decisions. Understatement of amounts on hand or lack of completeness in the records leads to unnecessary purchases.

The following examples illustrate some of the problems we found.

- The Logistics Centers' research and our review found transactions that were either inaccurately or incompletely recorded in the perpetual inventory system. The Centers' research found examples where shipments of material had been made without reducing the perpetual inventory records and where receipts of material had been received but no entries were posted to the perpetual records, or the amounts posted were incorrect.
- Our work identified duplicate reporting of \$2.6 billion of inventory as of September 30, 1989, due to programming errors in a new inventory system.
- Some large inventory errors went uncorrected because physical inventory results were ignored and necessary adjustments never made. We learned from the Logistics Centers' staff that errors were not corrected sometimes to avoid having to report high-dollar inventory adjustments to management.

- Audit tests showed that 62.3 percent of acknowledged inventory errors over \$500,000 were not corrected within 21 days--the Air Force Logistics Command's time limit for correcting such errors.
- Air Force personnel did not always comply with inventory guidelines to make recounts when initial counts disclosed differences with the perpetual records, thus circumventing a key control designed to ensure accurate quantity information.
- All five Centers made billions of dollars in automated inventory adjustments to arbitrarily force general ledger accounts into balance with perpetual inventory records. Failure to investigate the causes of differences between such records increases the risk of entering erroneous transactions into the general ledgers.

In our view, many of the problems we found at the Centers resulted from noncompliance with existing control and operating procedures. The causes for this appear to relate to inadequate supervision and staffing problems.

#### STOCK FUND INVENTORY PROBLEMS

Up to now, I have been talking about high-value inventory items. Weaknesses are at least as serious for the lower-cost stock fund items of the Systems Support Division, Air Force Stock Fund. We identified deficiencies that have prevented good inventory management and contributed to sharply increased prices to military units that purchase these items from the stock fund. We found that billing system problems resulted because systems controls were not adequate to ensure that transactions were properly recorded.

We also found that inventory was extremely large in relation to sales at all five Air Logistics Centers. For example, we found that the years of inventory on hand ranged from 5.9 at the San Antonio Center to 8.6 at the Ogden Center. The weighted average years of inventory at all five Centers was 7 years.

Systems Support Division items are procured based on individual item requirements computations with controls in place to ensure valid requirements. But, 7 years of inventory suggests that those controls may be ineffective and that management may have been delinquent in allowing such a build-up to happen. Excess quantities are expensive. For example, the loss from disposal of excess and obsolete inventories was equivalent to about 16 percent of fiscal year 1989 sales to customers, and was a cause for increasing the prices of items by \$180 million in fiscal year 1990. In addition to these direct losses, excess quantities cost money to store and maintain.

From fiscal year 1987 through 1990, surcharge rates charged Systems Support Division customers were increased from 13.4 percent to 25.7 percent. We believe that this sharp increase in surcharges was partly caused by the Air Force's need to cover losses due to billing problems, as well as the writeoffs resulting from the disposal of excess and obsolete items.

Weaknesses in inventory management and controls result in substantial unnecessary and avoidable costs to the Air Force. The accounting, control, and management deficiencies we have reported undoubtedly contributed to the \$11 billion of unrequired inventory the Air Force reported as of September 30, 1990. Because of the weak accounting systems, there is no way to quantify the huge costs which have occurred over time.

OTHER INTERNAL CONTROL WEAKNESSES  
MERIT MANAGEMENT'S ATTENTION

Our work showed that the Air Force cannot rely on its internal control systems to ensure that all assets are safeguarded, or that its account balances are reliable and accurate. Some examples of internal control weaknesses drawn from our report follow:

- Numerous accounts reported by Air Force organizations contained abnormal balances, such as assets with negative values. Within the United States Air Forces in Europe, trial balances for September 30, 1989, contained negative balances in inventory (\$52.4 million), real property (\$1.4 million), and construction in progress (\$7.8 million). The existence of such illogical balances is a sure indicator that errors have occurred in the recording or processing of transactions. There should have been follow-up investigations to deal with these problems and prevent them from happening in the future.
- Organizations did not consistently investigate unreasonable amounts and large variances in account balances. For example, we found four bases in one command which reported zero balances for construction in progress, even though all four had ongoing construction projects.
- Reconciliations between subsidiary and control accounts were not always performed to ensure the accuracy and propriety of recorded account balances. For example, bases in the United States Air Forces in Europe reported control accounts for certain assets, totaling \$1.1 billion, which were not supported by subsidiary records. The balance of the subsidiary accounts totaled \$965 million, a difference of about \$163 million from the control accounts. The headquarters' staff accepted the control account balances as being accurate and arbitrarily "plugged" the subsidiary accounts to force them to agree with the control accounts.

-- Controls over \$592 million of direct materials at the Air Force Industrial Fund's depot maintenance centers did not ensure that materials were charged to the correct jobs, or that they were limited to actual job requirements.

Since 1984, the Air Force has annually disclosed in its reports to DOD prepared pursuant to the Federal Managers' Financial Integrity Act of 1982 (section 4) that its general funds accounting system fails to conform with relevant federal principles and standards. However, section 2 of the act also requires the Air Force to annually evaluate its systems of internal control and report to the President and the Congress whether its systems comply with internal control standards prescribed by the Comptroller General. For the most part, the weaknesses we identified in our audits have not been reported. We informed the Air Force about some of these problems more than 2 years ago. However, the Air Force has not reported these problems to DOD during the annual Defense-wide internal control reviews required by the Federal Managers' Financial Integrity Act of 1982. This suggests that the Air Force does not give sufficient attention to the act's objectives. It is our conclusion that the Air Force's system of internal controls does not comply with applicable standards and that the Air Force should report that it does not.

#### SERIOUS DEFICIENCIES IN THE AIR FORCE'S GENERAL LEDGER

The Air Force emphasizes budgetary fund control to ensure that obligations and expenditures do not exceed appropriation limits set by the Congress. However, it does not sufficiently emphasize accounting to ensure that its resources are properly controlled, managed, and reported to DOD, the Congress, and the public. The Air Force's general ledger was not designed and implemented in a manner that supports accounting requirements and policies published in the DOD Accounting Manual.

The Air Force's accounting and financial management systems are not integrated under a departmentwide, transaction-driven general ledger. One result is that the system lacks true double-entry recording of transactions, a control feature routinely included in accounting systems for many years. Because of these limitations, the Air Force's general ledger--which should serve as the basis for financial reports--generates inaccurate financial information that is of limited value for managing resources, monitoring operations, and producing internal and external reports.

#### Asset Accounts Not Properly Updated

In fiscal year 1989, the Air Force expended approximately \$100 billion in appropriated funds and received about \$5 billion in reimbursements. Of the \$95 billion in net cash outlays, \$3 billion was used to liquidate liabilities, \$62 billion was for everyday

costs of operations, and about \$30 billion was expended on capital assets, such as buildings, facilities, and weapons systems. We estimated that for the year, about \$20 billion of budgetary expenditures for capital assets was not accurately recorded in, or could not be traced to, the related asset accounts in the general ledger.

The Air Force provided explanations for about \$15.7 billion of the amount, including classified assets not being recorded in the accounting records for security reasons and correction of errors in the previous years' balances. However, the remainder--an amount equal to about 14 percent of 1989 capital outlays--was unexplained and in our view attributable simply to weaknesses and deficiencies in accounting policies, procedures, and systems. The public should not be expected to tolerate the fact that billions of dollars of Air Force resources are not under proper accounting control.

#### General Ledger Accounts Not Adequate

The general ledger lacks accounts needed for such things as cash/funds with Treasury, allowances for doubtful accounts, unexpended appropriations, and invested capital. Generally, balances for these accounts are compiled from budgetary reports or arbitrarily computed. In other cases, the general ledger does contain needed accounts, but their balances are often so unreliable that they are not used to prepare financial reports. For example, the Air Force does not use the general ledger balances for revenues, expenses, accounts receivable, and accounts payable to prepare its financial reports. Instead, it obtains the needed data from budgetary data bases. We noted that the general ledger balances for such accounts often differed by hundreds of millions of dollars from the more reliable balances obtained from budgetary sources.

Systematically compiling data in a general ledger is a large, but not overly difficult, task. We recognize that the systematic accumulation and "roll-up" of financial information from over 100 accounting offices and over a dozen Air Force commands requires financial discipline at all organizational levels. But, it can be done and, in our view, should be one of the high priority, short-term repairs the Air Force makes to its financial management systems and practices. Unless it is done, producing auditable financial statements--a goal of the CFO Act--will be difficult, if not impossible, to achieve.

## OTHER DEFENSE ORGANIZATIONS HAVE SIMILAR FINANCIAL PROBLEMS

A perspective to keep in mind is that the kinds of financial management and control problems we have reported are by no means limited to the Air Force. After we issued our February 1990 report on the Air Force, the Secretary of the Army reported similar problems in his Department. Specifically, the Secretary reported that 7 of the Army's 37 existing accounting systems did not comply with Comptroller General standards; billions of dollars of property were not under financial accountability or general ledger control; and finance and accounting operations were not accomplished as efficiently and effectively as would be possible if certain functions were centralized. In our financial audit of the Army for fiscal year 1991, we are comprehensively evaluating its financial management operations and will report the results later this year.

With respect to the Navy, DOD reported in May 1990 that 6 of its 13 primary accounting systems had one or more material internal control weaknesses. The report noted that the Navy did not have financial systems to accumulate, record, and report the actual costs of acquisitions and modifications of equipment and, in essence, acknowledged that the Navy lacks an integrated general ledger accounting system.

The DOD report further stated that one of the Defense Logistics Agency's primary accounting systems had a number of material weaknesses, including lack of general ledger control and system documentation, and inadequate systems interfaces, hardware, and software. The report disclosed that the Army does not always rely on its general ledger accounts for financial reporting. Instead, it obtains data from program systems to report on certain accounts, such as property.

## IMPLICATIONS OF FINANCIAL MANAGEMENT PROBLEMS FOR AUDITABLE FINANCIAL STATEMENTS

The Chief Financial Officers Act of 1990 requires the Air Force to prepare agencywide financial statements for fiscal year 1992 and have them audited. In January 1991, we conducted follow-up work on the status of Air Force corrective actions in response to our February 1990 report. At that time, the Air Force and DOD had made only limited progress in correcting the problems we previously disclosed and implementing our recommendations.

In view of the problems we found during our fiscal years 1988 and 1989 reviews of the Air Force's financial operations, the question arises whether Air Force can now prepare reliable financial statements that can withstand the rigor of a comprehensive audit. In our view, the Air Force and DOD can certainly prepare much more reliable financial reports and statements than those of past years. By implementing our recommendations and suggestions, and

scrupulously adhering to established internal control procedures and processes, the Air Force can significantly improve its financial management operations and reporting for fiscal year 1992 and future years. However, such improvements will require a substantial commitment by management.

IMPLICATIONS OF FINANCIAL MANAGEMENT  
PROBLEMS FOR THE DEFENSE BUSINESS OPERATIONS FUND

Four months ago, DOD established the Defense Business Operations Fund, a fund intended to eventually finance and control virtually all of the Department's support activities. As established, the fund is a version of a proposal included in DOD's fiscal year 1992 budget submission with some additional controls over operations of the fund. It includes the nine existing stock and industrial funds operated by the military services and four other DOD activities-- Defense Finance and Accounting Service, Defense Industrial Plant Equipment Services, Defense Reutilization and Marketing Service, and the Defense Technical Information Service. For fiscal year 1992, the Fund is expected to generate revenues of at least \$75 billion. On April 30, 1991, we discussed the advantages of the original proposed fund's operating arrangements in testimony<sup>2</sup> before the Subcommittee on Readiness of the House Armed Services Committee. However, we also cautioned against implementing DOD's full plans for the fund until a number of concerns were addressed.

The National Defense Authorization Act for Fiscal Years 1992 and 1993 authorized the fund through April 15, 1993. However, in order to allow the Congress an opportunity to evaluate its execution, the act prohibited DOD from including any new activities in the fund. Also, the conference report accompanying the act directed DOD to provide the Congress and GAO with an implementation plan for the fund by January 1, 1992.

We have reviewed the implementation plan and have discussed it with DOD officials. A number of the concerns we pointed out in our April 30, 1991, testimony still remain unresolved. Many actions underway still need to be completed. In addition, many significant issues need to be resolved, such as policies governing the pricing of goods and services, and the transfer of funds between the Defense Business Operations Fund and its customers.

We believe that DOD is motivated to overcome the plan's present deficiencies in the next few months. However, there are basic accounting and control deficiencies illustrated by the Air Force inventory problems which, if not corrected, threaten the fund's ultimate success. To improve the efficiency and effectiveness of

---

<sup>2</sup>Defense's Planned Implementation of the \$77 Billion Defense Business Operations Fund (GAO/T-AFMD-91-5, April 30, 1991)

support operations, DOD is relying on the fund to raise the cost consciousness of the military customers of the stock and industrial funds, as well as the managers of those funds. However, if costs generated under the fund's systems are not credible--that is, if the fund has inordinately high prices that bear no relationship to reality--DOD will not raise the cost consciousness of the military nor make operations more efficient.

IMPLICATIONS OF FINANCIAL MANAGEMENT PROBLEMS FOR  
DOD'S CORPORATE INFORMATION MANAGEMENT INITIATIVE

In our view, the thrust of many aspects of the Corporate Information Management initiative, like the Defense Business Operations Fund initiative, is in the right direction if properly implemented. When fully implemented, the initiative could help put the operations of the activities of the Air Force and the other services on a much more businesslike basis. An objective of the Corporate Information Management effort is to provide system standardization, improve the quality and consistency of data in DOD's information systems, and reduce the large number of redundant systems now existing. DOD is relying on the initiative to provide long-term solutions to many of the financial management problems we have reported. As an interim step for financial management systems, the Corporate Information Management project is also selecting the best of the existing military services' systems to serve as interim systems until DOD develops and implements standard systems.

The process that DOD has chosen to upgrade its financial systems--use of the "best of breed" systems--is reasonable in many respects. "Best of breed" systems are those which have been found to represent the best of a specific type of system--such as a payroll system--that exists within the military services or other DOD components. That "best" system would then be adopted by all the other DOD organizations, thus reducing the number of systems, upgrading them, and paving the way for DOD-wide systems integration.

While we believe the "best of breed" concept is reasonable for eliminating duplicate systems in the short term, we tend to depart from DOD on how it should be carried out. We believe that more emphasis needs to be placed on short-term repairs to existing systems, and on improving the linkage of existing systems through a general ledger. DOD and Air Force management should not rely solely on the Corporate Information Management initiative to correct the basic and fundamental problems noted in our reviews.

We are concerned that at this time there could be over-reliance on technology to resolve Air Force's financial problems. Air Force management should ensure that proper policies, procedures, and controls are followed under existing systems. They should also ensure that reconciliations are performed and appropriate

documentation is maintained. They should integrate existing systems with a general ledger. DOD should acknowledge the need to repair its "best of breed" systems before they are transferred to the Air Force. Also, training the people who operate the systems to provide systems input and use system output should be stressed. Unless personnel are well-trained and disciplined in the performance of their duties, even the best designed systems will fail. For the long term, we believe that management should follow a process of "simplification-automation-integration." Simplification comes first. Simplification means reengineering the processes to correct the existing problems and improving the procedures and processes personnel follow in performing their work. If these fundamentals are properly addressed, automation and, ultimately, integration of new DOD-wide automated systems would have a much better chance to succeed.

Our Air Force audits illustrate that basic accounting and control procedures--some of which are required by present DOD policies while others are not--are not being carried out in a professional manner. Under these circumstances, the success of new DOD initiatives and the financial management objectives of the CFO Act will be limited. The overall message of our Air Force recommendations is that short-term actions need to be emphasized.

Mr. Chairman, this concludes my prepared statement. I will be pleased to answer any questions from you and the Committee members.

GAO REPORTS ISSUED AS A RESULT  
OF THE FISCAL YEAR 1989  
AIR FORCE AUDIT

<u>Report number</u>	<u>Title</u>	<u>Date issued</u>
GAO/AFMD-91-22	<u>Financial Audit: Financial Reporting Reporting and Internal Controls at the Air Force Systems Command</u>	January 23, 1991
GAO/AFMD-91-26	<u>Financial Audit: Air Force's Base-Level Financial Systems Do Not Provide Reliable Information</u>	January 31, 1991
GAO/AFMD-91-34	<u>Financial Audit: Financial Reporting and Internal Controls at the Air Logistics Centers</u>	April 5, 1991
GAO/AFMD-91-55	<u>Financial Audit: Status of Air Force Actions to Correct Deficiencies in Financial Management Systems</u>	May 16, 1991
GAO/AFMD-90-74ML	Management Letter to Commander, Offutt Air Force Base, Nebraska	May 23, 1990
GAO/AFMD-90-96ML	Management Letter to Commander, Air Force District of Washington, Bolling Air Force Base	July 24, 1990
GAO/AFMD-90-103ML	Management Letter to Deputy Chief of Staff (Comptroller) Headquarters, United States Air Forces In Europe	October 22, 1990
GAO/AFMD-90-104ML	Management Letter to the Commander 20th Tactical Fighter Wing, Upper Heyford, United Kingdom	September 7, 1990

ATTACHMENT

ATTACHMENT

<u>Report number</u>	<u>Title</u>	<u>Date issued</u>
GAO/AFMD-90-106ML	Management Letter to the Commander 316th Air Division, Ramstein Air Base, Republic of Germany	September 7, 1990
GAO/AFMD-90-109ML	Management Letter to the Commander, Air Force Accounting and Finance Center	July 20, 1990
GAO/AFMD-91-33ML	Management Letter to the Commander, Air Force Logistics Command	February 26, 1991
GAO/AFMD-92-5ML	Management Letter to the Comptroller, Department of Defense	October 22, 1991