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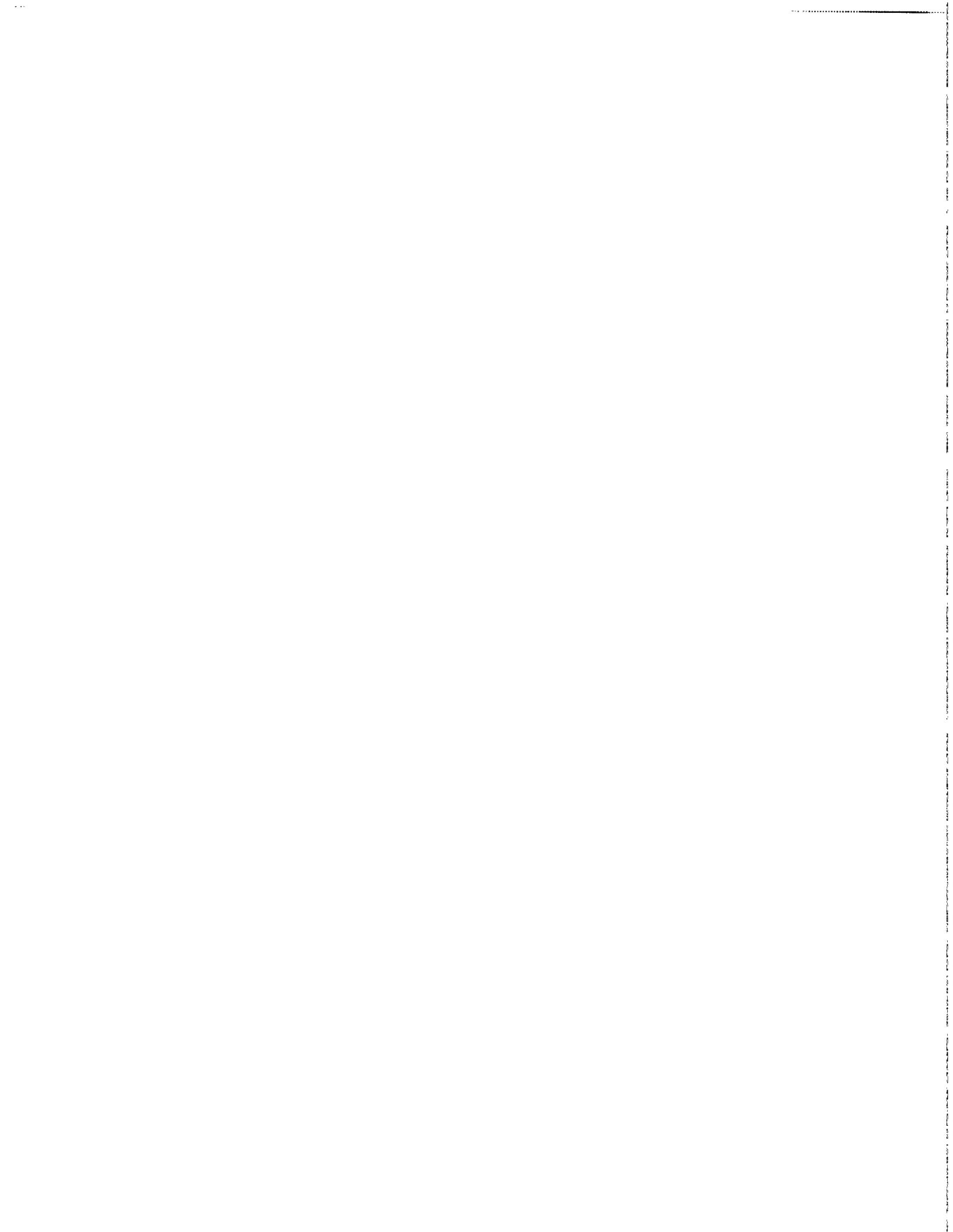
**Report to the Congress**

**August 1992**

# **FINANCIAL MANAGEMENT**

## **Immediate Actions Needed to Improve Army Financial Operations and Controls**







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

147253

Comptroller General  
of the United States

B-249197

August 7, 1992

To the President of the Senate and the  
Speaker of the House of Representatives

This report presents the results of our review of the Department of the Army's financial management operations for fiscal year 1991. The review was part of our audit of the Army's fiscal year 1991 financial statements, conducted under the Chief Financial Officers Act of 1990 (Public Law 101-576). This represents the Army's first attempt to develop auditable financial statements.

Army managers were accountable for a reported \$346 billion in weapon systems, inventories, and other assets and for about \$92 billion in budget authority for fiscal year 1991. However, as expected with a first-time audit, we noted that the Army's financial management systems and internal controls are not sufficient to provide reliable and adequate financial information to effectively manage the Army's diverse and complex operations. Our report discusses these problems and contains recommendations for corrective actions. The Secretary of the Army has expressed a strong commitment to dealing with the issues surfaced by the audit.

The Army plans to dramatically reduce the size of its military and civilian work force by 1997, while maintaining a high level of military capability. Correcting the weaknesses we found could help the Army to efficiently and effectively achieve its downsizing goals while maintaining military capability.

We are sending copies of this report to the Secretaries of Defense and the Army, the Director of the Office of Management and Budget, interested congressional committees, and other interested parties. Copies will be made available to others on request.

Charles A. Bowsher  
Comptroller General  
of the United States

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# Executive Summary

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## Purpose

The Department of the Army, along with the rest of the national defense establishment, is at a major crossroads after the nation's greatest peacetime defense buildup. With the collapse of the Soviet Union, budgets are being reduced and managers are striving to downsize forces with the least loss of readiness and make the best use of more limited resources.

With a reported \$346 billion in assets and fiscal year 1991 budget authority of about \$92 billion, the Army represents one of the largest management challenges within the federal government. To understand the cost implications of drawdown decisions and to control and apply its limited resources effectively, the Army needs adequate financial information, operations, and systems. This report provides the results of GAO's review of the financial management systems used to account for, control, and report on the Army's financial operations. This assessment was part of GAO's audit of the Army's fiscal year 1991 financial statements, conducted under the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576). GAO assessed (1) the adequacy of the Army's financial management systems and operations, (2) the effectiveness of the Army's implementation of the Federal Managers' Financial Integrity Act (FMFIA) of 1982, and (3) the adequacy of Department of Defense (DOD) initiatives to improve Army's financial systems and operations.

GAO's audit covered Army's financial statements and operations for fiscal year 1991. During that year, the Army carried out its unprecedented deployment and combat activities under operations Desert Shield and Desert Storm. About a third of the total active Army participated in these operations, and virtually all Army activities were at least indirectly affected. In GAO's judgment, the deployment did not affect the audit's overall outcome because the many problems noted were longstanding in nature. However, it is possible that the severity of the problems was increased by the deployment.

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## Background

During peacetime, the Army is organized by major commands and activities responsible for such tasks as developing war-fighting doctrine; training personnel; procuring and storing inventory; and researching, developing, and acquiring weapon systems and support equipment. The Army received \$78 billion in budget authority for fiscal year 1990 and current plans call for funding to drop to \$58 billion by fiscal year 1997. As shown in table 1, the Army's projected downsizing plans, if carried out, will dramatically change the size of its military and civilian workforce between fiscal years 1990 and 1997.

**Table 1: Army Workforce Estimates for Fiscal Years 1990 and 1997**

Personnel category	1990	1997	Projected decrease
Active	751,000	536,000	215,000
Reserve	736,000	567,400	168,600
Civilian	380,000	294,644	85,356

To efficiently and economically meet the Army's downsizing goals, decisionmakers should have reliable information on the cost of operations under alternative force and organizational structures.

DOD-wide organizational and administrative changes currently underway will significantly affect Army financial systems and operations. First, in fiscal year 1991, DOD started to consolidate the military services' accounting functions under the Defense Finance and Accounting Service, which prepared the Army's fiscal year 1991 financial statements based on information provided by hundreds of Army activities. Second, responsibility for DOD-wide improvements to existing accounting systems, including the Army's, was placed under DOD's Corporate Information Management Initiative in 1989. Third, in October 1991, DOD implemented the Defense Business Operations Fund, which consolidated nine existing industrial and stock funds operated by the military services and DOD as well as the Defense Finance and Accounting Service and other DOD support activities. For fiscal year 1993, DOD estimates that the Fund will have sales of about \$81 billion. Taken together, these actions place significant financial operations and improvement activities for the military services under DOD. But the Army retains a very important role for financial operations.

## Results in Brief

The Army recognizes that it has widespread and serious weaknesses in the systems that account for and control its reported \$346 billion in assets. These weaknesses leave the Army without adequate assurance that many of its assets are safeguarded against waste, inefficiencies, and losses. Correcting these weaknesses could help the Army achieve its downsizing goals efficiently and effectively.

Specifically GAO found the following:

- Although the Army has been working on accounting systems improvements since at least 1983, current operations and systems still do not provide reliable financial data. For example, because the Defense Finance and Accounting Service could not rely on data provided by Army

accounting activities, it initiated and processed about \$250 billion in adjustments to the data before it could prepare the Army's fiscal year 1991 financial statements. These adjustments were generally made without adequate documentary support or supervisory review. In addition, existing accounting policies and procedures are not always followed, thus raising questions about the accuracy of reported asset values. For example, GAO could not verify the accuracy of equipment accounts reported to be \$151 billion because accounting policies on valuing items were not consistently followed. Further, the financial statements did not disclose billions of dollars in future liabilities. As a result of these and other uncertainties regarding account balances, GAO stated<sup>1</sup> that it was unable to express an overall opinion on the Army's fiscal year 1991 financial statements. GAO cautions users that these statements have limited reliability.

Widespread weaknesses in controls over billions of dollars in resources have significantly increased the risk of undetected waste, loss, or theft of equipment, spare and repair parts, and other property. These conditions were most serious as they relate to control over inventories of supplies and spare parts where GAO found that

- about 35 percent of the recorded quantities were inaccurate by 10 percent or more for the \$12.5 billion inventory controlled by Army depots;
- controls over the \$7.4 billion in government material and equipment furnished to contractors were inadequate;
- about \$18.4 billion of ammunition inventory held in central storage areas at installations was not recorded in accounting records that support financial statement values and there were no accounting or logistics records for about \$0.8 billion of ammunition inventories either in transit or in production;
- about \$0.9 billion in inventories held by combat and support divisions were not recorded in accounting records that support financial statement values;
- the Army has reported unrequired inventories of \$2 billion, or 12 percent of its reported inventory value, and additional inventory originally valued at about \$2 billion is in the process of being disposed of;
- obvious errors in inventory reports and records, such as negative inventory account balances, were not being investigated; and

<sup>1</sup>Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991 (GAO/AFMD-92-83, August 7, 1992).

- large amounts of inventories waiting for repair and stored at depots were not always effectively secured to prevent theft or loss or adequately protected to prevent weather damage.

As part of DOD's internal control reporting under the Federal Managers' Financial Integrity Act of 1982, the Secretary of the Army has annually stated since 1983 that Army control systems provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. However, given the known control system weaknesses and the additional weaknesses GAO's review identified, GAO does not believe that the Army has effective control over and accountability for many of its assets.

GAO's findings are not unexpected for a first time audit. Unlike most of the private sector, until recently the government has not required its own agencies to produce auditable financial statements. Therefore, the kinds of financial discipline, procedures, training, and systems that are needed have not existed in government. As the agencies cope with weaknesses disclosed by audits mandated by the CFO Act, overall improvement in the financial management activities, as well as savings and benefits from reduced costs and efficiency improvements can be anticipated. GAO believes the weaknesses can be overcome relatively quickly, but doing so will require financial support to strengthen the systems and processes, and most importantly, strong, sustained commitment from top leadership.

Although some of the problems pointed out in this report are long-standing and have been acknowledged by DOD, the full extent of these problems was not known to top management until GAO completed its audit. DOD initiatives are addressing many of the problems GAO identified. GAO is encouraged that the Army recently established a special action group to address financial management problems and believes the group could provide the top level leadership needed to deal expeditiously with the most serious problems. The CFO Act provides a framework for the Army and DOD to address many financial management problems by improving such things as financial leadership, systems development, and personnel resources. Under initiatives such as the Corporate Information Management project, DOD offers long-term improvements. But GAO believes that much can be done with existing operations, systems, and personnel to make much needed short-term improvements. Further, many of the short-term improvements are necessary if the longer-term initiatives are to work.

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## Principal Findings

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### Financial Data Are Not Reliable

The Army's financial operations and systems do not provide accurate accounting and operational cost information because (1) they are designed largely to track obligations—legally binding requirements to pay out funds for an activity—rather than actual costs of performing that activity and (2) existing policies and procedures are not consistently followed. The existing accounting system structure, which was initially developed during the mid-1970s, is comprised of 43 separate accounting systems. The logistics, payroll, and budget systems often used to initially record events and transactions were frequently unreliable, thus compounding the accuracy problems of the accounting systems. As a result, data used to produce financial and operational reports are often inaccurate and cannot be relied on for decision-making.

As part of a pilot effort under the CFO Act, the Army prepared financial statements—for the first time—for fiscal year 1991. Army top management predicted that many of the problems found in GAO's financial audit of the Air Force would also be found in the first-time audit of the Army statements. GAO found substantial problems which were similar in nature to the problems noted earlier with the Air Force;<sup>2</sup> as a result, GAO could not report on the fairness and overall reliability of the Army's fiscal year 1991 statements. Specifically, GAO found the following:

- To correct inaccurate data provided by the Army's widespread operations and systems, the Defense Finance and Accounting Service initiated about \$250 billion in adjustments to that data before it could develop the Army's financial statements. In addition, GAO's audit identified another \$95 billion in adjustments needed to correct errors in reported financial data, including the failure to record certain assets—such as \$11.3 billion in government furnished property—and the incorrect categorization of assets. The underlying causes of these problems were (1) the operation of independent Army accounting systems without the central control that a properly functioning general ledger would provide and (2) the failure to follow existing accounting policies and procedures. As a result, the Army has no assurance that the many ad hoc procedures used to produce its reported asset values were performed accurately.
- The value of the Army's reported \$151 billion investment in equipment, such as tanks and helicopters, could not be verified. The actual cost of

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<sup>2</sup>Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990).

these assets could not be determined because the Army does not follow DOD's accounting policies for recording the actual cost of weapon systems.

- The financial statements did not fully disclose contingent liabilities, totaling at least \$18 billion, including the costs of chemical weapons destruction, hazardous wastes, and other environmental cleanup. Decisionmakers need better information on these liabilities to assess future funding needs and priorities.

Army and DOD officials have acknowledged weaknesses in their financial management systems and have long-term initiatives to correct them. However, these initiatives do not include sufficient short-term measures to correct problems with existing systems.

### Accountability and Control Over Billions in Assets Can Be Substantially Improved

Internal controls over billions of dollars in Army assets—particularly spare and repair part inventories, government owned equipment and material held by contractors, and Corps of Engineers property are ineffective. While generally well controlled, opportunities also exist to improve controls over military equipment and sensitive items. As a result, managers do not have adequate assurance that many of Army's resources are being used in the most effective and efficient manner and that any thefts or losses can be easily detected. The control weaknesses and inefficiencies GAO found include the following:

- The Army Materiel Command could not resolve differences with contractor records totaling about \$11.3 billion for property furnished to contractors. According to Army officials at one location, controls were so poor that instead of attempting to reconcile differences between their records and contractor records, they wrote off property that had been recorded in their general ledger for more than 15 months.
- Inventory records for items controlled by Army depots (wholesale inventories) did not provide adequate control over \$12.5 billion in spare and repair parts. A statistically based physical inventory showed that 35 percent of the inventory record quantities were inaccurate by at least 10 percent. GAO found that personnel did not follow established inventory management policies and procedures, such as conducting regular physical inventories. Inaccurate inventory records can contribute to unnecessary procurements. The Army had an estimated \$2 billion in unrequired inventory at fiscal year 1991 year-end and additional items originally valued at \$2 billion were revalued at a disposal value of about \$50 million.
- Army policy does not require the approximately \$900 million of inventory held by divisions to be included in either Army-wide logistics or

accounting systems so that division inventories are visible to responsible item managers. As a result, wholesale level item managers responsible for procuring inventory were not able to consider these additional quantities in determining what purchases were needed, nor were they included in reported inventory values.

- In some cases, Army units were not complying with regulations to continually review equipment authorizations against actual on-hand equipment and to turn in items they are not authorized to have. Other units could use these items to meet authorized levels rather than ordering more.
- Property accountability records for sensitive items, such as M16 rifles, were not always accurate. Failure to maintain accurate records on the quantities and locations of these sensitive items increases their vulnerability to undetected loss and theft.

In many cases, Army officials attributed the cause of breakdowns in controls to resource constraints. GAO acknowledged these concerns but noted the systemic and long-term nature of many problems.

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### Overall Control Systems Are Not Fully Effective

The Army reported to the Secretary of Defense in 1991 that its control systems met the objectives of internal control systems provided in the Federal Managers' Financial Integrity Act of 1982. However, GAO concluded that the controls do not meet those objectives to provide reasonable assurance that resources are being safeguarded. Material weaknesses in the Army's control systems exist in many areas, including supply operations and financial accounting systems. These weaknesses, some of which were identified by the Army, DOD, and GAO, existed across all levels within the Army. The Army Audit Agency also reported significant control weaknesses for about one-third of the controls it reviewed in fiscal year 1991. In GAO's opinion, a primary cause of the control system breakdowns was the lack of sufficient commitment on the part of operational managers to first identifying internal control weaknesses and then ensuring that they were corrected within a reasonable period of time. The Secretary's ability to provide reasonable assurance is dependent upon accurate information and managers' willingness to report their problems candidly.

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### DOD-Wide Initiatives Addressing Problems

In many cases, the problems GAO is reporting on were already recognized by the Army and DOD. DOD has underway several organizational changes and systems improvement projects aimed at helping to correct the known

problems. While the initiatives are promising, GAO believes more needs to be done to ensure their success, particularly in the near term.

For example, the creation of the Defense Finance and Accounting Service consolidated some, but not all, accounting activities and left unclear who is accountable for accounting data accuracy and policy implementation. The Defense Business Operations Fund consolidates business activities in a single operating fund to better focus on the cost of operations, but basic policies, such as those governing the cost accounting systems to be used, have not been set. The Corporate Information Management initiatives set objectives for developing new accounting systems for the long term, but it does not include sufficient measures to address problems in the short term. There has been a focus on long-term solutions without first improving the data accuracy in the existing systems. Further, DOD has not assessed whether the necessary expertise and resources are available to see that the new organizations function properly and systems improvements projects can be accomplished.

The CFO Act provides a framework for addressing many of the Army financial management problems GAO is reporting on. The act was intended to bring about comprehensive and far reaching improvements in financial management leadership, personnel resources, and accounting systems. The act establishes a CFO in DOD who is responsible for overseeing the financial management activities of the military services. To accomplish the act's objectives, the CFO developed an implementation plan in April 1991. However, GAO's review of actions taken to date shows limited progress has been made because many needed changes are tied to the DOD initiatives previously mentioned.

## Recommendations

GAO is making a number of recommendations to improve DOD-wide and Army financial management systems and operations, with an emphasis on the need for short-term actions. Recommendations include (1) clarifying responsibilities for ensuring that financial data and reports are accurate, (2) ensuring that adequate expertise and resources are available to accomplish financial management improvement projects, (3) identifying changes that are needed to improve the accuracy of existing accounting systems, (4) ensuring consistency of accounting policies and practices and their application, and (5) ensuring compliance with existing asset control procedures, such as taking physical inventories.

GAO is recommending that the Secretary of the Army become involved personally to ensure that proper priorities are set and that all levels of the Army are committed. GAO also recommends that the Secretary ensure that the recently formed financial management special action group is properly empowered, directed, and supported to help him discharge Army's responsibility to improve financial management.

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## Agency Comments

DOD's comments on this report are discussed and evaluated in chapters 2 through 5, and appendix III provides DOD's comments where it does not fully concur with GAO's findings and recommendations. Of the report's 30 recommendations, DOD concurred with 19, partially concurred with 9, did not concur with 1, and reported it is still reviewing 1 recommendation that it plans to respond to at a later date. DOD did not concur with GAO's recommendation that Army advise DOD that it was unable to meet the objectives of FMFIA. However, in GAO's view, identified control weaknesses along with the magnitude of adjustments required to produce Army's financial statements suggest strongly that the Army is presently unable to meet FMFIA's objectives.

DOD partially concurred with several recommendations for which GAO said the Army's recently established special action group should oversee action on recommendations. DOD's reluctance stemmed from concern that this group might replace existing management structures. GAO agrees that the special action group should not replace existing management structures. However, the group should play a key role in providing a departmentwide perspective on individual efforts to implement GAO's recommendations. In addition, DOD partially concurred with several GAO recommendations for which it cited corrective actions that were recently completed or planned to be completed in the near future.



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**Abbreviations**

CFO	Chief Financial Officer
CIM	Corporate Information Management
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
FMFLA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
OMB	Office of Management and Budget



# Introduction

In fiscal year 1991, the Department of the Army received about \$92 billion in appropriations and controlled assets reportedly valued at about \$346 billion. The Army employed about 1.5 million active and reserve component military personnel and 336,000 civilian personnel. These personnel operate hundreds of bases and other facilities throughout the world. This report examines the ability of the Department of the Army's financial management systems and operations to assist managers in meeting the Army's goals in today's constrained fiscal environment.

## The Army Is at a Major Crossroads

The collapse of the Soviet Union, a reduced military threat, and the nation's current fiscal condition have brought the Department of Defense (DOD), including the Army, to a major crossroads that will require significant changes. The Army is responsible for organizing, training, and equipping active duty and reserve component forces to accomplish missions consistent with national security objectives. During peacetime, the Army is organized by major commands and activities responsible for accomplishing such missions as developing war-fighting doctrine; training personnel; procuring and storing inventory; and researching, developing, and acquiring weapon systems and support equipment.

Annual funding for the Army and all of DOD has been reduced<sup>1</sup> in real dollars since fiscal year 1985. The reduced Soviet and Warsaw Pact threat and the budget deficit have accelerated pressures to increase the pace and size of those reductions. In fiscal year 1990, DOD announced its spending and force reductions plan—the base force plan—which called for a 30-percent reduction in Army resources by fiscal year 1997. The Army was appropriated \$78 billion for fiscal year 1990 and current plans call for funding to drop to \$58 billion by fiscal year 1997. Beginning in 1990, the Army planned to reduce its active and reserve component force size from a 5-corps,<sup>2</sup> 28-division force to a 4-corps, 20-division force by the mid-1990s. It also plans to reduce its active military personnel from 751,000 to 536,000, its reserve personnel from 736,000 to 567,400, and its civilian work force from 380,400 to 294,644. Although these reductions were temporarily suspended during Operations Desert Shield and Desert Storm, the Army plans to meet its reduction goals.

<sup>1</sup>Except for fiscal year 1991, in which funding actually rose because it included \$15 billion appropriated for the Persian Gulf Regional Defense Fund.

<sup>2</sup>The Army's five active corps command several major tactical units or divisions. Each corps has both tactical and logistical support responsibilities for its subordinate units. Divisions have from 10,000 to 17,000 personnel depending on the type of division.

These reductions present Army managers with many difficult challenges, such as determining how to structure and base the remaining forces and how to best administratively operate and support this new structure. The Secretary of Defense and Army leadership set an overriding goal of accomplishing the downsizing effectively and efficiently while maintaining the Army's high level of military capability. The Army is striving to avoid the mistakes of past Army drawdowns. During past drawdowns, the Army's war-fighting capabilities appeared to be formidable on paper; however, in reality, many units were "hollow armies" lacking sufficient personnel and equipment required to accomplish their missions. The Army leadership's goal for the present drawdown is to ensure that the future Army—although smaller in size—has the personnel, training, and equipment needed to perform its missions.

One of the keys to meeting these goals is making the most effective and efficient use of all available resources—not just the budgetary resources. Financial management systems and operations that account for and control resources are essential management tools that Army leaders will need to help achieve their downsizing goals. Reliable and relevant financial information, along with other management information, will help the Army make trade-off decisions relating to such things as alternative structures and manage its more limited fiscal resources as efficiently and effectively as possible.

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## Chief Financial Officers Act of 1990

The Army is one of the agencies required to prepare financial statements for fiscal year 1991 and have them audited as a pilot project under the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576). The act is the most comprehensive and far-reaching financial management improvement legislation since the Budgeting and Accounting Act of 1950. It requires the President to appoint a chief financial officer for each of 23 major departments and agencies, including the DOD. The act intends to improve financial management by making each chief financial officer responsible for such key areas as (1) overall financial management organization, (2) financial management systems, (3) planning, (4) financial management reports to include audited financial statements, (5) performance measures, (6) credit management, (7) budget and accounting information, and (8) financial management personnel capabilities.

After passage of the CFO Act, DOD's Chief Financial Officer was also designated as the DOD Comptroller. The Army's key financial manager is

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the Assistant Secretary for Financial Management. The specific roles and responsibilities that the CFO and the service assistant secretaries for financial management will have in implementing the CFO Act are still evolving.

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## DOD Financial Management Initiatives

The early 1990s have seen a DOD-wide effort to streamline and improve financial and other management activities. DOD has initiated several important projects that significantly affect financial management for all components of Defense. These actions are the establishment of the Defense Finance and Accounting Service (DFAS), the Corporate Information Management initiatives, and the Defense Business Operations Fund (DBOF). They will not only significantly affect the structure and operations of the Army's financial systems, but also DOD's implementation of the CFO Act.

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## Defense Finance and Accounting Service

DOD has made significant changes in its financial organization and operations and is now moving to centralize control of financial operations, including external financial reporting, previously operated by the military services. In order to standardize accounting systems and eliminate duplicate efforts, DOD has begun to consolidate military services' accounting functions and plans to develop an integrated accounting and financial management system capable of producing auditable consolidated financial statements. On January 20, 1991, DOD established the Defense Finance and Accounting Service to consolidate all finance and accounting activities throughout the Department. This organization is composed of headquarters and various finance and accounting centers previously operated by the three military departments and the Defense Logistics Agency.

The former U.S. Army Finance and Accounting Center, located at Indianapolis, Indiana is now a component of the consolidated accounting service. The accounting centers operate under the direction of the DOD Comptroller and are responsible for complying with statutory and regulatory financial reporting requirements and preparing consolidated financial statements. In 1991, DFAS assumed responsibility for 16 of the Army's 43 accounting systems.

DOD is considering transferring all Army accounting and finance offices as well as Navy and Air Force offices to DFAS. This transfer would give DFAS virtually all responsibility for operating and maintaining Army accounting

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and financial systems. However, the Army would retain responsibility for other systems, such as logistics and supply systems currently used as a source for a portion of Army's financial reporting.

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### Corporate Information Management

In response to the President's February 1989 address to the Congress calling for improved DOD management, DOD initiated a number of comprehensive, long-term projects in July 1989 to streamline its administrative operations. The objectives of one of these projects, known as the Corporate Information Management initiatives, include (1) improving the standardization, quality, and consistency of data from all DOD management information systems, (2) implementing new or improved business methods, and (3) creating more uniform practices for common functions. DOD views this initiative as its primary vehicle to resolve current departmentwide problems in financial operations as well as other areas.

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### Defense Business Operations Fund

Another major project that will significantly affect Army financial management operations is the Defense Business Operations Fund, established in October 1991 to focus management attention on managing the cost of DOD support operations, including the cost of DFAS. DBOF charges the Army and other customers (DOD components) prices for support operations it provides so that it can recover the full cost of goods and services provided, including administrative and operational expenses. By identifying the full costs of providing goods and services through DBOF, DOD managers hope they can make more informed policy decisions that will increase operational efficiencies and lower costs. The financial systems improvements DOD currently has underway under the Corporate Information Management initiatives are critical to achieving DBOF's objectives.

DBOF currently includes the nine existing stock and industrial funds operated by the military services and five other DOD activities—DFAS, the Defense Commissary Agency, the Defense Industrial Plant Equipment Services, the Defense Reutilization and Marketing Service, and the Defense Technical Information Service. At the start of fiscal year 1992, Army stock and industrial funds were incorporated into DBOF.

For fiscal year 1993, DOD estimates that DBOF will have sales of \$81 billion and assets valued at \$126 billion. It will employ 360,000 civilian and military personnel. When compared to the sales reported by Fortune magazine's global 500 industrial corporations, DBOF's sales would make it

the equivalent of the fifth largest corporation in the world—exceeded only by General Motors, Royal Dutch/Shell Group, Exxon, and Ford.

## Evolution of Army's Financial Management Environment

The Army has a history of long-standing financial management problems that prevent it from managing its systems and operations efficiently and effectively. If these problems continue, they will seriously undermine the Army's ability to effectively and economically achieve its downsizing goals and maintain high unit readiness.

Many of Army's financial systems were initially developed during the mid-1970s when system development efforts focused on providing automation for specific applications, such as processing payroll and issuing checks. While greatly reducing the time required for these tasks, the Army has created an environment where many independent systems process data which is essential to the preparation of the financial statements. In addition, as a result of concerns with controlling obligations dating back to the 1970s, many of the systems used to report the results of Army's financial operations were focused primarily on fund control.

In the 1970s, the Army committed serious violations of the Anti-Deficiency Act by obligating more funds than it had been appropriated. In September 1975, we informed Army officials of a potential overobligation of \$40.2 million. By April 1976, the Secretary of Defense reported that overobligations totaled \$205 million in three of the Army's procurement appropriations. As a result of this serious breakdown in Army's accounting and financial management reporting systems, the Army lost control over some appropriations and had insufficient funds in several procurement accounts to pay 900 contractors.<sup>3</sup> To correct these problems, the Army placed a high priority on developing controls to ensure that obligations do not exceed appropriations—funds control.

During the 1980s, the Army initiated actions to improve internal controls and financial accounting systems in accordance with the objectives of the Federal Managers' Financial Integrity Act of 1982. This act and implementing Office of Management and Budget (OMB) guidance require agencies to annually assess controls, identify and report internal control and accounting problems, plan corrective actions, and implement effective remedies. As part of the Defense-wide internal control reviews the Army reported that it has identified and corrected many control weaknesses.

<sup>3</sup>Serious Breakdown in the Army's Financial Management Systems (GAO/FGMSD-76-71, November 5, 1976).

However, the Army also continued to report persistent servicewide control deficiencies in accounting systems, property accountability records, inventories, and procurement.

## Objectives, Scope, and Methodology

This review was conducted as part of our audit of the Army's fiscal year 1991 financial statements, which were prepared as required by the Chief Financial Officers Act of 1990. The overall objectives of our review were to (1) provide a comprehensive analysis of the adequacy of the financial management systems and operations used to account for, control, and report on Army's financial operations, (2) assess the effectiveness of the Army's implementation of the Federal Managers' Financial Integrity Act of 1982, and (3) assess the adequacy of DOD-wide initiatives designed to improve Army's financial systems and operations.

The specific objectives of our fiscal year 1991 Army audit were to

- evaluate the adequacy and effectiveness of significant internal accounting controls;
- test transactions and account balances to substantiate their accuracy, completeness, and propriety;
- evaluate the adequacy of DOD's consolidation and financial reporting procedures; and
- identify opportunities to improve the Army's financial management operations.

In addition to this report, we have separately issued our opinion on the Army's 1991 financial statements (GAO/AFMD-92-83, August 7, 1992) and will be issuing more detailed reports on significant internal control weaknesses for the various Army components, such as the Army Materiel Command and the Conventional Ammunition Working Capital Fund.

In performing our work, we (1) reviewed the Army's and DOD's policies relating to the Army's organization, accountability procedures, and financial management, (2) discussed financial management operations and accountability procedures, functions, and processes with managers throughout the Army and at DFAS, and (3) evaluated and tested significant internal accounting controls and account balances to assess the reliability of reported financial data. We also considered our previous reports, as well as those by the Army Audit Agency, and reports by the Army pursuant to the Federal Managers' Financial Integrity Act of 1982, that were relevant to the areas of our review.

We performed work at the Office of the Secretary of Defense; Defense Finance and Accounting Service, Indianapolis; and Army headquarters, Washington, D.C. In addition, we judgmentally selected for audit 56 locations and organizations whose annual operations and appropriations accounted for a large percentage of Army resources and expenditures. Appendix I presents the primary locations where we performed our fieldwork. At these locations, we judgmentally selected and tested key internal controls to determine if they were operating as intended by the Army. Additionally, we tested the validity, accuracy, and reliability of specific accounting transactions and account balances. To test the accuracy of significant inventory account balances at the Army depots and for Army's inventory stored at Defense Logistics Agency locations, we used variable sampling methodology. The scope of our work did not include the Army National Guard and Reserves, classified programs, or the external disbursement of Army funds.

We conducted our review from April 1990 through June 1992 in accordance with generally accepted government auditing standards, but we limited our scope as noted above. DOD officials provided written comments on a draft of this report. These comments are presented and evaluated in the "Agency Comments and Our Evaluation" sections at the end of chapters 2 through 5. In addition, DOD comments where it did not fully concur with our findings and recommendations are included in appendix III.

# Financial Reporting Is Unreliable

The Army's financial operations and accounting systems do not produce reliable information needed to provide accurate financial statements to external users and its accounting systems are not used to accumulate cost information to (1) assist in managing day-to-day operations, (2) consider the costs of alternative actions, or (3) develop performance measures. As required by the Chief Financial Officers Act of 1990, the Army issued consolidated financial statements for fiscal year 1991. However, as would be expected with a first time attempt to audit an agency's financial statements, we found substantial problems with Army's reported assets, liabilities, costs, and performance measures. Because of uncertainties about the accuracy of accounting data and reported values, we were unable to certify that the information presented in the Army's statements is fairly presented.

The lack of reliable information occurred principally because of inadequate accounting policies and personnel not following established accounting policies and procedures. In addition, the Army's existing financial systems generally emphasize fund control (that is, ensuring that obligations do not exceed available funding authority) and, as currently operated, cannot accumulate and report the costs of the Army's day-to-day operations.

The Army has been aware of deficiencies in its financial management operations and systems for some time. In an April 17, 1990, memorandum to the Secretary of Defense, the Army acknowledged that it had financial management problems similar to those we reported as a result of our financial audit of the Air Force.<sup>1</sup> The Army cited problems in its financial management systems' ability to (1) account for real and personal property, (2) account for and control inventories, (3) monitor property furnished to contractors, (4) account for the full cost of weapon systems, (5) reconcile related accounts, and (6) generate financial data useful in managing day-to-day operations. These problems are similar to those found in many first-time financial statement audits.

Although DOD-wide and Army specific initiatives are underway to correct the Army's acknowledged financial management deficiencies, these initiatives will take a number of years to complete. Consequently, without additional actions in the meantime, the reliability of the Army's reported financial information will continue to be questionable. The interim actions

<sup>1</sup>Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990). The Air Force was the first DOD component to prepare financial statements and have them audited.

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that we believe the Army should take are discussed in this chapter and our assessment of longer term DOD-wide efforts are discussed in chapter 5.

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## Reported Financial Information Has Limited Reliability

To prepare the Army's financial statements, the Defense Finance and Accounting Service (DFAS) initiated and processed about \$250 billion in adjustments to the financial information. In addition, as a result of our work, we proposed another \$95 billion in adjustments to the Army's reported financial information. Even after these substantial adjustments, we were unable to verify the accuracy of many major account balances in the Army's fiscal year 1991 consolidated financial statements. Specifically, we were unable to verify account balances for inventories, military equipment, contractor-held property, other equipment, real property, construction-in-progress, contingent liabilities, and cash on hand. In addition, we are continuing to review two Army components' treatments of obligations and obligational adjustments. These conditions occurred primarily because of the failure of personnel to follow many established policies and procedures.

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## Policies and Procedures Not Followed for Reporting Inventories

The Army reported \$17 billion in wholesale-level and retail-level inventories of supplies and spare parts as of September 30, 1991. However, the Army's inventory records and accounts do not accurately portray either the quantities or the values of the reported \$12.5 billion in wholesale inventories. A statistically projectable physical inventory of the wholesale item inventories showed that almost 35 percent of the perpetual records differed by 10 percent or more from quantities actually in storage. Furthermore, Army policy is to price its inventory based on an item's most recent acquisition cost. Each item, regardless of where it is stored or located, should be valued at the same price. However, this policy was not consistently followed because we found that 7,405 items had more than one price recorded. As a result of these conditions, we were unable to verify the reported value of this inventory.

In addition, at the retail level, an \$18.4 billion adjustment we proposed for ammunition at installations and an \$0.9 billion adjustment for division-level inventories were not recorded. Army officials stated that DOD and Army accounting policy provide that material, supplies, and ammunition are to be expensed when issued to operating units. However, we found that division-level inventories and ammunition which was not yet issued to operating units was not reported in Army's financial statements.

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Army Practices  
Inconsistent With DOD  
Policy for Reporting  
Military Equipment

DOD accounting policy requires that equipment be valued at the actual costs incurred to acquire the equipment and put it into operation. Instead, the Army accounted for its equipment at a standard price intended to reflect the most recent acquisition cost. All items of a particular class, model, or series are accounted for and reported at the same cost, regardless of the actual costs incurred to acquire them. This inconsistency in reporting policy would preclude the eventual development of consolidated financial statements for DOD.

Recently, the Army initiated a project to determine the actual cost for some of its most recently acquired military equipment—specifically, the Abrams tank, the Bradley fighting vehicle, and the Apache and Blackhawk helicopters. As a result of this effort, the Army increased its military equipment account by \$13.7 billion. Continuing this effort and valuing the remaining military equipment, as well as the associated invested capital, in accordance with DOD accounting policy will improve the Army's information on the costs of these assets. Because the Army did not have reliable cost information, we were unable to verify the accuracy of the reported \$151 billion for military equipment.

The Federal Accounting Standards Advisory Board will be addressing appropriate accounting standards for military equipment. We anticipate that it will address a number of questions, including whether such equipment should be carried at historical cost and, if not, the accounting for any differences from historical cost. However, it is clear that accounting for all costs related to military equipment will be required.

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Policies and Procedures  
Not Followed for  
Reporting Contractor-Held  
Property

The Army does not have systems or records to effectively track or monitor about \$11.3 billion of property owned by the Army, but held by contractors. Based on our proposed adjustments, the Army's statements were changed to reflect these values. Specifically, we found that contractor records showed almost \$7.4 billion of contractor-held, but government owned, inventory and equipment, and \$3.9 billion of government furnished real property. These assets were not accounted for or reported by the responsible commodity commands. When a DOD agency determines that delegating control of assets—like government furnished material or equipment—to contractors is a prudent course of action, DOD policy requires that agency to establish accountability and to exercise appropriate oversight and control over assets.

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Existing Policies and Procedures Not Followed for Reporting Other Equipment

Accountable property officers maintain property books as the formal stock records for capital equipment and sensitive items. These property books are also subsidiary records for accounting entries for these properties. However, we found that property books were not periodically updated in all cases or reconciled with general ledger records. For example, at the 10 installations we visited, information in 22 of 123 property books for nontactical units were not reported to the accounting office and the \$134 million of property was, in turn, not included in the Army's financial statements. We also found that Corps of Engineers managers were unable to substantiate the locations or value of the estimated \$1.3 billion of equipment reported in the Corps' financial statements. Property records were not updated for equipment received, and annually required physical inventories and reconciliations of account balances with property records were not performed. Furthermore, we could not determine whether equipment and the related invested capital accounts were complete. These problems resulted from personnel not following existing policies.

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Existing Policies and Procedures for Reporting Real Property Costs Were Not Followed

The Army reported \$61 billion of real property in its September 30, 1991, Report on Financial Position. Of this amount, the Corps of Engineers reported almost \$28 billion in real property to DFAS. However, the Corps does not maintain a required subsidiary ledger for real property or other records that show the cost of real property assets; accordingly, we were unable to verify this balance.

The other \$33 billion is primarily real property at Army installations. This real property is recorded on subsidiary records in the Integrated Facilities System, which should update the installation general ledger. However, we found discrepancies between the amounts reported on the installations' general ledgers and the Integrated Facilities System. For example, the general ledger property accounts at six installations were approximately \$461 million less than the corresponding real property records.

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Existing Policies and Procedures for Reporting Construction-In-Progress Not Followed

Contrary to policy requirements, the Corps of Engineers included completed military and civil works construction projects and associated costs in its construction-in-progress accounts, in some cases for many years. As a result, completed projects could remain in the construction-in-progress accounts indefinitely. As a result of our April 23,

1991, letter to DOD and Army officials<sup>2</sup> discussing this issue, the Corps initiated a detailed analysis and reconciliation of its construction-in-progress accounts. However, the Corps was unable to determine the full extent of the overstatement of the construction-in-progress account or the total account adjustment needed as of September 30, 1991.

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**DOD Policy for Cash on Hand Reporting Not Appropriate**

In addition to the instances in which existing accounting policies and procedures were not followed or were not consistently followed, we also found that the current DOD policy for reporting cash on hand was inappropriate. The Department of the Treasury has authorized the Army to have disbursing officers in the United States and overseas to facilitate payments to the public. As of September 30, 1991, Army disbursing officers had approximately \$400 million of cash on hand. However, DOD accounting policy states that the amount of cash held by disbursing officers is not considered an asset for external statement purposes. Instead, DOD policy requires that a liability account for the cash advanced by Treasury should be maintained. As a result, the Army excluded the cash on hand from its assets in its financial statements for fiscal year 1991. Since the Army is responsible for cash it holds, we believe current DOD policy does not appropriately reflect this stewardship responsibility.

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**DOD Policy Not Followed for Reporting Contingent Liabilities**

DOD accounting policy requires that a loss be reported in the financial statements if it is probable that, (1) as of the date of the financial statements, a liability has been incurred and (2) the amount of the loss/liability can be reasonably estimated. If one or both of these conditions for the accrual of such a loss could not be met, disclosure of the contingent liability in the footnotes to the financial statements is required.

However, the Army did not record almost \$18 billion of potential liabilities for chemical weapons destruction, environmental pollution claims, and cleanup of hazardous waste sites in the financial statements.

In April 1992, the Army estimated that its costs for destroying chemical munitions would total \$7.9 billion. As of September 30, 1991, the Army had incurred about \$1.1 billion in costs related to this program but did not report the future costs of \$6.8 billion in its financial statements. Because

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<sup>2</sup>Management Letter to the Assistant Secretary of the Army for Financial Management; Director, DFAS; and Resource Management Director, Corps of Engineers (GAO/AFMD-91-62MI, April 23, 1991).

this represents a liability to the Army and the cost can be reasonably estimated, it should have been reported in the Army's financial statements.

DOD has identified nearly 300 sites at bases with potential environmental pollution claims and has confirmed pollution resulting from earlier contamination at 113 of these sites. The preliminary cost estimate to settle claims that may arise at the 113 sites is \$111 million and could be much higher. Because the ultimate liability for these and future claims cannot yet be fully estimated, the Army should have disclosed a contingency for its portion of the claims that can be estimated in the footnotes to the financial statements.

In September 1991, DOD estimated that about \$24.5 billion would be needed to cleanup hazardous waste sites. The Army reported in the footnotes to its financial statements a liability for \$11.6 billion of the DOD-wide \$24.5 billion estimate but did not record the liability in the financial statements. Moreover, a number of factors have affected DOD's ability to develop a reliable estimate of the cost to clean up its hazardous waste sites. For example, all sites may not have been identified and studies to identify the extent and nature of contamination at the sites have not been completed. While DOD has drawn on its past experience to develop its estimate, the estimate could be even higher. Therefore, Army should have disclosed, in the footnotes, the possibility that its estimate could increase.

### Unresolved Issues Concerning Recording of Obligations

As part of our review of the reliability of the Army's reported financial information, we tested the Army's compliance with provisions of laws and regulations governing the recording of obligations. We are continuing to address the legal implications of the following two matters.

- The Corps of Engineers awards its Civil Works Revolving Fund equipment contracts if it is estimated that the required payments can be made out of the Fund's projected revenue. However, the Corps does not record these contracts as obligations when the contracts are awarded. This practice raises the issue of whether the Corps is violating the general requirements to record contracts as obligations and ensure that contracts are supported by available budget authority.
- The Aviation Systems Command made unsupported adjustments of its recorded obligations. This action raises the issue of whether the adjustments obscured potential violations of the Anti-Deficiency Act and whether the Command violated an Army regulation that requires reports and follow-up on potential violations.

If necessary, we will report separately on these issues.

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### Lack of Integrated Systems Network Contributes to Problems

In addition to the policy and procedure problems that caused inaccurate financial data, using data from nonintegrated systems also contributed to unreliable Army financial reporting. Both Defense and the Army used many independent systems to record, process, and report data essential to preparing the Army's financial statements. The Army's financial statements did not flow from and were not supported by an integrated Army-wide general ledger system.

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### Integrated Financial Management Structure Requirements

A general ledger, which includes all necessary proprietary accounts, should be the source for all financial statements and other required reporting. In addition, it serves as an essential control mechanism by summarizing all of an activity's financial data for top management decisionmakers. Office of Management and Budget (OMB) Circular A-127, "Financial Management Systems," requires that agencies establish and maintain a single integrated financial management system which may be supplemented by subsidiary systems. Such systems are required to comply with applicable budget and accounting principles and standards and Treasury reporting requirements and to produce complete, accurate, and verifiable financial data.

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### Information Needed for Financial Statements Not Produced by General Ledger-Controlled Accounting Systems

The Army revised accounting policy on September 30, 1987, requiring the implementation of a standard general ledger on October 1, 1988. However, in May 1990, DOD reported<sup>3</sup> that Army accounting systems did not use an integrated general ledger double entry system from which financial statements could be produced. Consequently, the Army's reported financial information did not flow from, and was not supported by, either a general ledger system or subsidiary accounting systems. By fiscal year 1991, we found that financial information reported for two major components—the Stock Fund and Industrial Fund at the Army Materiel Command and the Corps of Engineers—was not yet produced from DOD's standard general ledger. In addition, the Army's general ledger did not have an amount recorded for either military equipment or for Army's fund balance with Treasury.

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<sup>3</sup>Review of the Financial Management Systems of the Military Departments (DOD, May 1990).

DFAS determined that the general ledger information produced for the Army was so unreliable that it used alternative sources, including nonfinancial systems, for many of the Army's reported accounts. For example, according to responsible officials, substantial account balances, such as an estimated \$78 billion for tactical military equipment, were based on sources other than the general ledger. Our audit showed that these various systems cannot be relied on to produce accurate, timely financial information. Table 2.1 contains examples of financial statement accounts developed from sources other than the general ledger.

**Table 2.1: Financial Statement Accounts Developed From Sources Other Than the General Ledger**

Dollars in millions		
Account description	Amount	Source of data
Military equipment (tactical)	\$78,315	Property records
Fund balance with Treasury	48,000	Budget system
Government furnished property	11,273	Contractor records
Accrued payroll and benefits	2,511	Budget, payroll systems
Invested capital	268,275	Calculated
Accounts receivable	2,113	Budget system
Accounts payable	10,659	Budget system

In addition, we found that when the financial systems produced information that was obviously wrong, Army managers reported the incorrect amounts to DFAS without following up to identify and correct the causes of the inaccuracies. Generally, account balances for specific classes of accounts will carry a normal or predictable balance. For example, asset accounts will generally carry a positive (or debit) balance and unliquidated obligations will show that expenditures do not exceed the amount obligated. We found accounts reported by components to major commands and on to DFAS with abnormal balances, such as negative (or credit) balances in asset accounts and hundreds of millions of dollars in negative unliquidated obligations. For example, one location reported over \$191 million as a negative balance for inventory.

DFAS initiated and processed unsupported adjustments it received from the Army, and it also processed adjustments initiated by the Army accounts office located at the DFAS Indianapolis Center. Specifically, adjustments, corrections, and supplemental accounting data valued at over \$350 billion were processed by DFAS after the end of fiscal year 1991. The transactions initiated by DFAS and those initiated by the accounts office were commingled. However, based on available data, we estimated that about

\$100 billion of the adjustments were initiated by the accounts office and \$250 billion by DFAS. For the transactions initiated by DFAS, officials were unable to provide records or documentation to support the reasons for many of the adjustments and, in those cases where documentation did exist, there was not always evidence of required supervisory review or approval. Without adequate controls, adjustments to accounting records increase not only the risk of undetected errors, but also the risk of illegal or improper acts, such as covering up thefts, hiding losses of assets, or masking errors.

Subsequent to the DFAS adjustments, we proposed about \$95 billion of adjustments to improve the accuracy of the Army's consolidated financial statements.<sup>4</sup> About \$55 billion of the adjustments were made to reclassify account balances that were incorrectly reported in other accounts. Another \$20.7 billion of adjustments were proposed to correct account balances, and, as discussed previously, another \$19.3 billion in adjustments were proposed to reflect division-level inventories and ammunition at installations not previously accounted for.

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## Existing Systems Not Used to Accumulate Operational Cost Information

In today's environment where reduced threats are resulting in downsizing Army forces, decisionmakers need information on the cost of performing current operations versus the cost of operations under alternative force and organizational structures. However, decisionmakers do not have reliable cost information available to consider in their deliberations. In the following examples, cost information was needed but was not readily available or was inaccurate.

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## Cost Information for Persian Gulf Operations Was Inaccurate

We believe the Congress should have accurate cost estimates on conducting operations Desert Shield and Desert Storm in order to make decisions on authorizing the transfer of funds from the Defense Cooperation Account and the Persian Gulf Regional Defense Fund. However, our work shows that DOD had considerable difficulty in accumulating this information and that cost estimates were not always accurate.<sup>5</sup>

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<sup>4</sup>Management Letter to the Assistant Secretary of the Army for Financial Management and Director, DFAS (GAO/AFMD-92-68ML, May 19, 1992).

<sup>5</sup>Cost of Operation Desert Shield and Desert Storm and Allied Contributions (GAO/T-NSIAD-91-34, May 15, 1991). Operations Desert Shield/Storm: Cost and Funding Requirements (GAO/NSIAD-91-304, September 24, 1991).

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The Army could not generate data on costs incurred but rather reported obligational data available from its existing systems. Reporting obligations—legally binding requirements to pay funds—does not consider all expenses incurred to support the Persian Gulf operations. For example, the costs of materials on hand that were consumed during the Persian Gulf operations were earlier recorded as obligations. Consequently, these costs would not be included in Persian Gulf costs reported on an obligational basis.

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European Drawdown  
Costs Uncertain

The Army's accounting systems cannot produce information on the costs associated with downsizing forces. This information is critical to making future budget decisions regarding the remaining force needs. We recently reported<sup>6</sup> that 18 months into the European drawdown the Army still had little reliable cost information. Specifically, the European Command's drawdown cost accounts did not fully reflect actual costs for several reasons. First, command officials de-emphasized cost accounting as too difficult given the scope, complexity, and fast pace of the drawdown. Second, tracking costs related to the Gulf War confused drawdown cost accounting. Finally, according to responsible officials, adequately defining drawdown costs proved difficult.

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Activity Operating Costs  
Not Available

The Army's accounting systems do not routinely capture the operating costs of an activity. Such information is necessary to measure and compare the economy and efficiency of similar activities and operations. Our recent report<sup>7</sup> on the accuracy of cost estimates for conducting training activities illustrates the inability of Army accounting systems to routinely generate basic cost information management needs in its decision-making processes. We found that Army cost estimates for operating signal corps training activities at Fort Sill, Oklahoma, and Fort Gordon, Georgia, were unreliable. The cost analysis was performed to determine whether it would be economical to consolidate Fort Sill training activities with those at Fort Gordon. We found that the Army's cost analysis overstated the cost of conducting signal training at Fort Sill principally because it combined artillery and signal training costs. Army officials, however, believe that the statistical methodology used represents a cost-effective approach to estimating the relative costs associated with

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<sup>6</sup>Army Force Structure: Personnel, Equipment, and Cost Issues Related to the European Drawdown (GAO/NSIAD-92-200BR, April 9, 1992).

<sup>7</sup>Army Training: Army Analysis Overstates Signal Training Costs at Fort Sill (GAO/NSIAD-92-168, April 1, 1992).

the planned training. These officials said that, short of undertaking a costly detailed analysis at each installation, it was the only method available to estimate costs.

## Performance Measurement Information Can Be Improved

The Army's fiscal year 1991 reporting under the CFO Act also included its first attempt to link performance measurement information with financial data reflected in its financial statements. Under the CFO Act, agency Chief Financial Officers are responsible for developing and maintaining integrated accounting and financial management systems that allow performance measurement. Our work showed that performance measures in the Army's financial statements related to peripheral functions and do not provide meaningful and accurate information on the Army's success in achieving its principal missions. For the most part, problems in the Army's performance measurement information resulted from not establishing procedures to verify the accuracy of performance measurement data and not assigning accountability for measures preparation and data accuracy. As a result, the measures presented are of little use to managers, the public, or the Congress.

OMB guidelines on developing performance measures for financial statements provide that the measures should (1) present significant results achieved by programs and compare those results to the entity's mission, (2) include data showing the extent to which the program's missions, goals, and objectives were achieved, and (3) represent program goods and services that most reflect legislative intent and that recipients, managers, and the public value.

While we recognize that information included in the Army's fiscal year 1991 financial statements represented its first attempt to assemble such information, Army performance measures presented were not useful in assessing the Army's military capability because they were not always related to the Army's principal mission. Rather, they covered a variety of activities collateral to the Army's principal mission, such as debt management, civil works programs, and foreign military sales. They also did not provide complete information about the activity being measured or demonstrate whether program goals or objectives were being achieved. For example, the medical system measure stated that the mission of the medical system is to improve access to quality and cost-effective health care. However, data included in the measure showed the number of inpatient bed days, number of outpatient visits, and total cost incurred by

medical centers and hospitals rather than an evaluation of the accessibility, quality, or cost-effectiveness of Army health care.

Army officials recognized that the performance measures presented in the Army fiscal year 1991 financial statements were not relevant to the Army's principal mission. According to responsible officials, the performance measurements data included in the Army's fiscal year 1991 financial statements reflected data that was readily available and supportable.

Performance measures could be greatly enhanced by developing a framework that defines the Army's overall mission and the subordinate commands' missions performed in support of that overall mission. Using this framework, the Army could develop performance measures that would address how well those missions are being performed. For example, Forces Command is responsible for ensuring that the Army is organized and modernized to meet wartime requirements. This overall responsibility can be tied to the Army's overall mission of deterring or defeating threats against the United States' interests. We believe the Army can develop measures that would reflect combat readiness goals, the dollars expended to achieve combat ready divisions, and the extent to which combat readiness goals are being achieved.

Our work also showed that Army performance measurement financial information was presented in terms of obligations rather than costs. We also found that the obligation data included in reported performance measurement information was not complete. Officials told us this was because the Army accounting systems are unable to allocate all relevant obligations to the program being measured. For example, the costs of the flying hours program should include relevant contract maintenance, military pay, and administrative costs. However, according to DOD officials, the accounting system cannot distinguish which of those recorded contract maintenance, military pay, or administrative costs relate to the flying hours program as opposed to other programs.

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## Army Has Taken Actions to Address Financial Management Problems

Based on our preliminary discussions and briefings on the results of our audit, the Assistant Secretary of the Army for Financial Management recognized the significance of the problems and the need for immediate corrective action. He established a special action group on May 1, 1992, to oversee corrective action implementation for the issues we identified. The special action group reports to the Assistant Secretary and is composed of representatives from the offices of the (1) Assistant Secretaries for

Financial Management; Installations, Logistics, and Environment; Research, Development, and Acquisition; and Civil Works, (2) Military Traffic Management Command, (3) Deputy Chief of Staff for Logistics, (4) Corps of Engineers, (5) Major Commands, and (6) Defense Finance and Accounting Service. We are encouraged by the proactive approach the Army is taking to oversee correction of its financial management deficiencies. While the special action group represents a good first step, sustained top management commitment and the cooperation of many functional areas within the Army will be required to correct the problems we identified and the conditions the Secretary of the Army recognized in his April 1990 memorandum to the Secretary of Defense. In that memorandum, the Secretary of the Army attributed the continuing existence of financial management problems to Army managers who see little value for financial cost data in a system that is largely driven by appropriations, budgets, and obligation data. In addition, subsequent to the completion of our field work, Army officials informed us that they had established a senior-level steering committee to provide policy direction and oversight to the special action group.

## Conclusions

The Army has acknowledged longstanding problems in its financial systems and operations and has taken the initiative to begin corrective actions. However, the Army still does not have reliable financial data on its reported \$346 billion in resources. The Army's preparation of financial statements for fiscal year 1991 and our attempt to audit these statements highlight the broad scope and serious nature of these problems. Cost information on its day-to-day operations becomes increasingly important since decisionmakers are considering alternative courses of action relating to such things as force structure, force reduction plans, or when decisionmakers attempt to develop useful measures of performance.

While DOD-wide accounting systems improvement projects represent long-term solutions to many of these problems, there are a number of actions that can be taken now to improve Army's financial information. These include (1) emphasizing the importance of following existing policies and procedures, (2) eliminating gaps in accounting policies that reduce the completeness of financial reporting, and (3) expediting actions to bring Army accounting policies in line with DOD policies.

We are encouraged by the proactive approach that Army has taken to establish a financial management improvement special action group. This group's work is an important first step to systematically and

comprehensively address the Army's financial management problems. Given the breadth and significance of the problems, the Secretary of the Army's direct oversight will be needed to cut across functional lines and make needed improvements.

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## Recommendations

We recommend that the Secretary of Defense direct that DOD accounting policy be revised to require (1) all retail-level inventories and ammunition held at installations and spare parts and supplies held at the division level, be recorded as assets and (2) cash held by disbursing officers be recorded as an asset with a corresponding liability.

We recommend that the Secretary of the Army improve the accuracy and reliability of financial data and reporting by establishing Army-wide goals and performance measures directed at ensuring the accomplishment of existing accounting policies and procedures and the use of those measures in evaluating senior managers' overall performance. Specific areas needing attention are ensuring that (1) inventory values for spare and repair parts are priced in a consistent manner, (2) commands have accurate records of the quantities and values of property held by contractors, (3) military equipment is valued at actual cost, (4) real property records are reconciled with the Integrated Facilities System and accounting records, (5) Corps of Engineers deletes completed projects from the construction-in-progress account, (6) contingent liabilities are disclosed in financial statements, (7) the Army Materiel Command and Corps of Engineers use the standard general ledger, (8) all commands promptly investigate any unusual and abnormal account balances, and (9) performance measures presented in financial statements relate to the Army's overall mission and include actual cost data.

We also recommend that the Secretary of the Army ensure that the recently formed special action group will be effective in dealing with the many financial management problems the Army faces. Specifically, the Secretary should consider (1) whether this group has sufficiently broad authority to accomplish needed corrective actions considering the urgency of the problems and the need for full cooperation from direct support operations functions, such as logistics, maintenance, and supply, as well as from accounting activities, (2) what needed improvements have the highest priority and when those high priority improvements should be achieved, and (3) whether there are sufficient resources available to achieve the priority objectives.

Finally, we recommend that the Secretary of the Army approve a plan for improving financial management and demonstrate sufficient commitment and involvement so that all concerned Army functions and activities understand the priorities for improvement and have the special action group report quarterly to him on progress made in achieving milestones set in the improvement plan.

## Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD agreed with the findings in this chapter except that it (1) did not concur with our findings that the Army's wholesale inventory records were inaccurate and that the Army did not attempt to develop financial performance measures to assess military capability and (2) partially concurred with our finding that the Army did not have accurate records of quantities furnished to contractors. DOD concurred with the recommendations in this chapter except for three with which it partially concurred and one—to record retail-level inventories as assets—to which it plans to respond after further review.

DOD did not concur with our finding that its wholesale inventory records were 35 percent inaccurate, stating that we focused on quantities only in determining inventory accuracy. Based on DOD's dollar threshold criteria, which allows a variance of \$800 before an item is considered out of balance, the Army stated that its reported inventories were 93.5 percent accurate. Army officials acknowledged that their estimates were not based on statistically selected items and that they counted a small number of items. We did not attempt to verify the accuracy of the Army's report. However, our statistical sample results show that 35 percent of the perpetual inventory records differed by 10 percent or more from the items actually on hand. In our judgment, the error rate in the quantities clearly indicates a serious problem.

DOD partially concurred with our finding and recommendation calling for improved Army records for the quantities and values of property held by contractors. DOD stated that custodial and financial accountability will be integrated in conjunction with the Corporate Information Management initiatives. However, as discussed in chapter 5 of this report, the systems to be used as a result of the initiatives will not be implemented for a number of years. In the interim, the Army will continue to have incomplete data on property held by contractors and will not have accurate, reliable data for entry into a new system. In view of the fact this has long been an area of material weakness—it was first reported by the Army in 1985—we believe that concerted short-term actions are needed to obtain timely

control of the billions of dollars in government property held by contractors.

DOD did not concur with our finding concerning performance measures, stating that Army performance measures to assess military capability exist and that they are not, nor should they be, financial in nature. As discussed in this chapter, OMB guidance states that including appropriate program and financial performance measures in agency reports is a key element in ensuring the utility of financial statements. Such measures should assist managers in assessing the efficiency and effectiveness of programs and designing actions to correct problems. We agree that the Army's mission relates primarily to military capability. Further, we agree that its performance measures should center on military capability objectives and goals. But financial effects are part of performance assessment and cannot be ignored, particularly at this time of budget constraints. All programs have some form of financial support or resource consumption that can be measured directly or indirectly and considered in judging whether program objectives are being met. While DOD did not agree with our findings related to performance measures, it did concur with our recommendation that performance measures be established to help ensure accomplishment of existing accounting policies and procedures and that these measures be used in evaluating the overall performance of Army's senior managers.

DOD agreed that its policy for reporting cash on hand was inappropriate but only partially concurred with our recommendation that disbursing officer cash be reported as an asset. It stated that such DOD reporting could duplicate Treasury's reporting of cash. However, Treasury is responsible for addressing this potential problem when developing consolidated financial statements for the federal government by adjusting the financial data to eliminate any duplicate reporting. Such adjustments are a normal requirement for any financial statement consolidation process.

DOD also partially concurred with our last recommendation, which called for a plan and concerted efforts to improve Army financial operations. It stated that a special action group and a senior level steering group were recently established, demonstrating the Secretary of the Army's commitment to and involvement in improving Army functions and activities. As discussed in this chapter, the establishment of these groups demonstrates the Secretary's intent to deal with the problems we have pointed out. However, many of the actions needed to correct the problems discussed throughout this report, including the development of an

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improvement plan, have not yet been taken. Implementing these actions comprehensively and expeditiously will require sustained and highly visible commitment and involvement by the Secretary of the Army as well as other members of top management.

# Controls and Accountability Over Billions in Assets Need Substantial Improvement

We found serious breakdowns in the systems used to control the quantity and location of billions of dollars<sup>1</sup> of Army resources at Army depots, installations, and government owned plants. Our work focused on Army logistics and financial systems used to generate asset information recorded in (1) financial records (accountable records) and (2) records maintained by responsible officials, documenting the quantity and location of assets (custodial records). Specifically, we found the following:

- Serious weaknesses exist in internal controls over about \$17 billion in inventories. These weaknesses have contributed to the inefficient use of material and potential for undetected losses and theft.
- While controls were generally effective at the locations we visited, records do not always accurately reflect quantity, values, and location of equipment, particularly government owned equipment held by contractors and Corps of Engineers property.
- Depot storage facilities do not always adequately protect assets from losses caused by weather damage or theft.

These problems have contributed to or increased the potential for unnecessary procurements of inventory, theft of sensitive or readily marketable property, and increased equipment maintenance and scrappage costs. For example, as of September 30, 1991, the Army reported \$2 billion of unrequired inventory, which constitutes 12 percent of its reported total inventory. Of that amount, items with an estimated realizable value of \$50 million are in the disposal process or are offered for sale to other federal agencies in the Foreign Military Sales program. Those items, prior to entering the disposal process, had a reported \$2 billion inventory value.

## Accounting and Control Policies

Several Army and DOD regulations<sup>2</sup> establish the criteria for controlling and reporting on Army property (equipment and inventories). In summary, these regulations require the responsible Army components to comply with the following.

<sup>1</sup>The Army reported an estimated \$168 billion investment in inventories (such as engines and transmissions) and equipment (such as helicopters, tanks, and trucks) at the end of fiscal year 1991.

<sup>2</sup>Applicable regulations include the following: Army Regulation (AR) 37-1, AR 710-1, AR 710-2, AR 710-3, Department of Army Pamphlet (DA PAM) 710-2-1, DA PAM 710-2-2, AR 735-5, AR 71-13, AR 310-49, AR 700-15 and DOD Regulation 4145.19-12-1.

- Army components must establish equipment requirements in accordance with the Department of the Army equipment authorizations.<sup>3</sup>
- Units must routinely compare equipment authorizations to items on hand. These comparisons require property officers to (1) verify that items on hand plus items on order do not exceed authorizations, (2) cancel requisitions that would exceed authorizations, and (3) turn in any on-hand items in excess of authorizations.
- Equipment and supplies on hand must be physically inventoried at least annually and results must be reconciled with custodial records. Small arms and other sensitive items must be inventoried either monthly or quarterly.
- Custodial records must be reconciled with accountable records.
- The quantity, value, and location of all government furnished material requested, issued, received, and used by contractors must be accounted for by the responsible Army component.
- Responsible Army components must maintain records of the quantity, value, and location of all Army property from acquisition through sales to customers or disposal.
- Responsible Army components must protect equipment and inventories from weather damage.

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## Inventory Systems Do Not Provide Accurate Data

The Army has acknowledged for sometime that it has serious widespread problems in managing its spare and repair part inventories. We found at the Army's wholesale-level and retail-level inventory activities that custodial records do not accurately reflect on-hand quantities and that physical inventories are not being conducted as required. As a result of these weaknesses, the potential exists for unnecessary procurements because units with excess supplies are not able to identify excesses and transfer them to units needing them. In addition, the Army was not always able to ensure that (1) inventory was available when needed to meet repair requirements in support of equipment readiness goals and (2) any losses or thefts would be promptly detected. Also, management reports did not give top management a clear picture of the severity of records inaccuracies.

As of the end of fiscal year 1991, Army wholesale-level and retail-level inventories were estimated at \$17 billion. Also, included in these

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<sup>3</sup>Each unit in the Army has its mission, structure, and personnel and equipment requirements and authorizations established in an authorization document. A unit uses this document for authority to requisition personnel and equipment and as a basis for readiness evaluation. There are two types of authorization documents in the Army: Modification Tables of Organization and Equipment and Tables of Distribution and Allowances.

inventories are expendable supplies (items which are consumed during normal usage such as paint, rations, gasoline, and office supplies), larger repairable items (such as engines and transmissions), and components used in the production of a good or service (such as raw materials used in the production of ammunition).

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### Wholesale Inventory Records Are Inaccurate

The Army's wholesale spare part inventory had an estimated 476,100 types of items valued at \$12.5 billion as of the end of fiscal year 1991. The Army reported that its inventory as of the end of fiscal year 1991 was 93.5 percent accurate. However, a statistically based physical inventory,<sup>4</sup> conducted by the Army showed that about 35 percent of the Army's wholesale records differed from amounts on hand by 10 percent or more. The 93.5 percent accuracy was reported on the Army's Report of Inventory Control Effectiveness. This report on inventory statistics presents an unrealistic picture to DOD top management. Thus, top managers are not receiving information that clearly depicts the severity of problems with inventory record inaccuracy.

However, while required by Army regulations for all types of inventory, only sensitive and controlled inventory items—about 5 percent of inventory value—were being inventoried regularly at Army depots. Responsible officials at the Depot Systems Command, the activity responsible for depots and depot activities at the time of our review, stated that they were unable to complete all required physical inventories due to funding constraints.

The Army's statistical physical inventory of its balances as of fiscal year 1991 showed significant differences between the accountable records and actual inventory quantities on hand. Of the 278 items on the accountable records, 99 were overstated, 93 were understated, and 86 were correct. For example, we found that 15 inventory items sampled required an adjustment over \$10 million each to bring accountable records in balance with the physical count. Two types of engines for the UH-1 troop transport helicopter required adjustments of \$222 million and \$120 million, respectively.

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<sup>4</sup>Based on the suggestion we made in our May 31, 1991, management letter to the Assistant Secretary of the Army for Financial Management and the Director of DFAS (GAO/AFMD-91-68ML), the Army performed a statistically based physical inventory to determine its inventory accuracy without physically counting every inventory item. The sample consisted of 278 wholesale-level inventory items, valued at \$2.6 billion, at over 70 locations worldwide.

Inaccuracies in accountable records adversely affect the Army's ability to identify excesses or shortages and to detect losses or theft. When accountable records show inventory quantities that are less than inventory quantities actually on hand, items in storage are vulnerable to undetected loss or theft. Also, this situation may trigger unneeded procurements.

When accountable records show more inventory than is actually on hand, items may have been lost or stolen. In addition, the information in the accountable records may portray an inaccurate picture of the amount of wholesale-level inventories available to support repairs needed for mission essential equipment. The wholesale-level managers use inventory information for determining requirements; buying the items; storing them at depots; and issuing the items to Army posts, camps, and stations.

The Army's lack of controls over its wholesale-level inventories occurred primarily as a result of (1) weaknesses in management oversight over the use and retention of wholesale inventory and (2) the absence of regular physical inventories and reconciliation of inventory results with accountable records.

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### Weak Accountability Over Retail-Level Inventory

Retail-level inventories encompass both inventories maintained in supply activities at Army installations as well as inventories at installation tenant units such as divisions that are stationed at those sites. Army installations and their tenants are responsible for computing requirements, requisitioning items from the wholesale system, storing the items, and issuing the items to users. The Army's installation supply inventories were valued at \$2.3 billion, while division supply inventories, which were not included in Army inventory accounts, were estimated at \$900 million. We visited 10 supply activities and 3 Army divisions and reviewed their systems for maintaining custodial records and, where applicable, accountable records. Item managers at the wholesale level do not have access to the divisional-level inventory records. As a result, they cannot consider division-level inventories in procurement decisions. In January 1990, we reported<sup>5</sup> on the Army's need for wholesale-level managers to have access to information on inventories maintained at divisions.

We found that the custodial records for retail-level inventories were often inaccurate. Some examples of the inaccuracies we noted follow.

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<sup>5</sup>Army Inventory: A Single Supply System Would Enhance Inventory Management and Readiness (GAO/NSIAD-90-53, January 25, 1990).

- Over \$6 million in repair parts for M1A1 tanks and other equipment that was recorded in the inventory records was not on hand at the three divisions we visited. In addition, \$5.5 million of inventory, including engines, transmissions, and other equipment was on hand but was not recorded in the accountable records.
- At 10 supply activities, records showing negative inventory quantities were common. For example, we identified 16 items with negative on-hand balances at one location and 5 at another. This type of error indicates that the unit is unaware of the actual quantity on hand, and the error may lead to unnecessary procurements or allow undetected thefts and losses.

We found the Army's controls at the retail level were ineffective because personnel did not always follow prescribed procedures. Specifically, we found that required annual physical inventories were not always performed. For example, 2 of 10 supply activities had not conducted a physical inventory in fiscal year 1991. Also, 2 of the remaining 8 activities had not reconciled the results with custodial records.

### Conventional Ammunition Inventory Control Weaknesses

The Armament, Munitions, and Chemical Command (Ammunition Command) cannot reliably track or control the movement of an estimated \$3.6 billion of raw materials, work-in-process, and in-transit inventories, of which \$1.9 billion was included in the Army's reported inventory balance. As a component of the Army Materiel Command, the Ammunition Command is responsible for the management of raw material and component part inventories used to produce conventional ammunition.

The Ammunition Command attempts to manage these sensitive and marketable inventories with logistical and financial records maintained in the Commodity Command Standard System. The Ammunition Command controls ammunition production through a revolving fund, the Conventional Ammunition Working Capital Fund. The Ammunition Command uses logistics records to control the requisition, receipt, storage, sale, and disposal of inventory and to generate financial records and reports. The ammunition plants maintain the custodial records for this inventory.

The Ammunition Command, however, did not maintain logistical records for the estimated \$760 million of components in work-in-process and in-transit. Without logistical records to control the movement of ammunition components at government owned plants, the Ammunition Command could not ensure that raw material inventories in the

production process are maintained within prescribed levels and that the loss or theft of government material would be detected.

Even when logistical records were maintained, the Ammunition Command did not or could not perform the required reconciliations between logistical records and custodial records. For example, one ammunition component showed an on-hand balance of zero while the Ammunition Command's logistical records showed that 272,908 items valued at \$68,227 were on hand. In addition, not all of the required physical inventories were conducted.

## Ineffective Controls for Equipment and Material With Contractors

The Army Materiel Command and its subordinate commodity commands did not effectively control and monitor over \$7.4 billion dollars of government equipment and materials furnished to contractors who were producing equipment, ammunition, supplies, and spare parts for the Army. This matter has been a long-standing concern within DOD. In May 1988, we reported<sup>6</sup> that since 1967, the military services, including the Army, have been criticized for not having established property accountability and financial controls over government equipment and material furnished to contractors.

We found that, although required to do so by Army regulations, the commodity commands either did not maintain records of government equipment and material in the hands of contractors or did not reconcile differences between their accountable records and contractor custodial records. As a result, the commodity commands and other top Army officials did not have accurate information on the quantity, location, or value of government equipment and material in the possession of contractors. Some examples follow.

- The Aviation Systems, Missile, and Tank-Automotive Commands' accountable records differed by over \$2 billion from contractor records. Instead of investigating the differences, the Aviation Systems Command wrote off all government furnished property that had been recorded in its general ledger for more than 15 months. Between September 1991, when this practice was instituted, and January 1992, the Command had written off \$1.3 billion.
- The Armament, Munitions, and Chemical Command had no records for government material furnished to its contractors. Contractors responding

<sup>6</sup>Government Property: DOD's Management of the Property It Furnishes to Contractors (GAO/NSIAD-88-151, May 26, 1988).

to a survey we conducted reported holding government furnished material valued over \$100 million as of September 30, 1991. Included was sensitive explosive material.

- The Aviation Systems and Missile Commands did not maintain accountable records for over \$1 billion in government furnished equipment supplied to contractors. While the Tank-Automotive Command had records for this equipment, these records showed an account balance \$128 million less than the contractors' balance.

Overall, Army controls over government equipment and material furnished to contractors were ineffective because they relied primarily on contractors to account for and control the assets without appropriate independent accounting control. Under these conditions, there is no assurance that (1) the Army's sizeable investment has been adequately controlled and accounted for, (2) equipment or materials are not being procured unnecessarily, and (3) losses can be detected.

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## Equipment Accountability Can Be Improved

Our current work shows that while controls were generally effective at the locations visited, we did find cases where units did not have accurate and reliable data on the quantity and location of its equipment. Equipment, such as weapons systems, represents the Army's largest asset investment, with a reported value of \$151 billion. We found that (1) records for equipment on hand in both the accountable and custodial records were not always accurate because of weaknesses in systems used to account for and control equipment, (2) units do not always report and turn in equipment in excess of their tables of allowances, and (3) small arms and other sensitive items, in some cases, were not properly accounted for. Ineffective control and accountability over equipment can increase the vulnerability of these assets to theft or loss, reduce unit readiness through the ineffective distribution of needed equipment, and increase maintenance costs.

Weak controls over the Army's equipment has been a long-standing problem. In 1982, the Army Inspector General informed the Army Chief of Staff that there were extensive internal control deficiencies concerning equipment distribution and documentation over equipment. A 1986 follow-up Inspector General report disclosed that additional actions were still needed to correct the deficiencies reported in 1982. In January 1989,

we reported<sup>7</sup> that weak internal controls led to disparities between the distribution of equipment and units' authorized levels.

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### Military Equipment Reporting at Installations Is Generally Accurate

At the 12 Army installations (with tactical units) we visited, we compared military equipment as recorded in the Army's accountable records maintained in the Continuing Balance System-Expanded<sup>8</sup> with (1) each responsible unit's custodial records for equipment recorded in automated and manual property books and (2) the results of our physical counts of equipment on hand.

We found that the equipment on hand usually agreed with both the accountable records and the custodial records. However, we did find some discrepancies. For example, we found the following conditions at various locations.

- Accountable records at one unit showed 2 1-1/4 ton utility trucks on hand. However, 27 were actually on hand. The 25 trucks not recorded had a total value of about \$672,000.
- At a unit in Europe, 112 trucks were on hand but accountable and custodial records indicated only 91 trucks on hand. The 21 trucks not recorded were valued at over \$1.2 million.
- At a unit in Europe, 16 M1A1 Abrams tanks, valued at \$1.9 million each, were on hand, but only 15 were recorded on the unit's custodial and accountable records.
- A helicopter, valued at \$3.4 million, was shown on a unit's custodial record and on the accountable record as being on hand at the end of fiscal year 1991 even though the helicopter had been transferred to the Marine Corps during the year.

Also, while the units we visited generally complied with equipment authorizations, we did find instances, primarily in Europe, where that was not the case. For example, three units in Europe that were authorized a total of 42 M1A1 Abrams tanks actually had 46 tanks. At another unit in Europe, we found 284 various items on hand, valued at \$4.3 million, that were not authorized by the units' tables of allowance. These items included three fuel trucks valued at \$189,000 each, two trucks used to

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<sup>7</sup>Army Equipment: Distribution and Documentation Problems Impede Operations (GAO/NSIAD-89-71, January 13, 1989).

<sup>8</sup>The Continuing Balance System-Expanded is a centralized, automated Army system that is intended to maintain worldwide visibility over equipment. The system shows equipment procurement and distribution and documents unit status information. It is also the Army's accountable record for military equipment at deployable units.

move heavy equipment valued at \$129,000 each, five kitchen field trailers valued at \$27,000 each, and six M60 machine guns valued at about \$5,400 each.

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### Controls Over Sensitive Items

Physical inventories of items at several locations showed that controls over sensitive items were usually adequate. However, as discussed in detail in management letters to cognizant officials,<sup>9</sup> we did find several cases in which (1) small arms were not always recorded on accountable records promptly and (2) small arms could not be located. We conducted sensitive item physical inventory counts at 127 arms rooms and found that responsible personnel could not locate sixteen M16 rifles, four .45 caliber semiautomatic pistols, and one 60-millimeter mortar—sensitive items that were recorded on the custodial records.

After our inventory, these discrepancies were satisfactorily resolved except for two M16 rifles and the 60-millimeter mortar. Failure to promptly and accurately record the location of sensitive items on property books precludes effective accounting for and control over these items. The sensitivity and marketability of items such as weapons makes them very susceptible to theft. Moreover, the loss, theft, or misuse of even one weapon can result in tragic consequences.

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### Equipment Control at the Corps of Engineers Is Not Effective

The Corps of Engineers' management controls were ineffective for the \$1.3 billion the Army reported as Corps of Engineers equipment<sup>10</sup> in its September 30, 1991, financial statements. The Corps' equipment recorded in its property records included such transportable, marketable items as computer equipment, hand tools, motor vehicles, and outboard motors. However, we found that the Corps did not reconcile custodial and accountable records or record all its assets. Consequently, the Corps may have equipment in excess or below authorized levels because it does not have accurate information on the quantity, location, or value of its equipment. These conditions leave the Corps highly vulnerable to buying excess equipment and not being able to detect thefts or losses.

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<sup>9</sup>Management Letter to the Division Commander, Fort Stewart (GAO/AFMD-92-33ML, January 14, 1992); Management Letter to the Commander, Fort Hood (GAO/AFMD-92-34ML, January 22, 1992); and Management Letter to the Division Commander, Fort Campbell (GAO/AFMD-92-45ML, February 21, 1992).

<sup>10</sup>The Corps refers to equipment as personal property. Personal property as defined by the Corps includes all equipment, materials, and supplies, unless or until incorporated in or affixed to real property.

The following are examples of problems we found at the nine Corps locations we visited.

- Eight of the nine Corps locations we visited were not using prescribed allowance tables when acquiring equipment. These tables would ensure that the equipment was authorized or required.
- Six of the nine Corps locations had not recorded all equipment on hand in their property records. For example, the following equipment was not on the property books at four districts: 26 pieces of computer equipment valued at an estimated \$80,000, 7 Jeep Cherokee vehicles valued at an estimated \$79,000, and 3 outboard motors valued at an estimated \$10,000.
- None of the districts reconciled their accountable and custodial equipment records, and required annual physical inventories were not always conducted.

Many of the control weaknesses we found are problems that the Corps has been aware of for at least 5 years, but has not effectively addressed. Since at least 1987, the Corps of Engineers Inspector General and Corps internal review offices have reported problems the same as or similar to those we found. Corps headquarters officials agreed with our overall concerns and concurred with our proposed corrective actions.

A primary reason for these internal control breakdowns was that established control procedures were not followed. Specifically, inventories were not conducted as required and discrepancies between on-hand balances and custodial records were not investigated. In addition, units were not always complying with their authorization documents. We believe an underlying cause for this breakdown in controls was that managers did not recognize the importance of accurate records as a means of controlling these key resources. Lack of sufficient management attention and commitment to the existing internal control policies and procedures was also a major contributing factor to the continuation of the weaknesses we found.

## Inadequate Storage of Repairables at Selected Army Depots

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Unsecured and unprotected storage of inventories awaiting repair, as well as lax security over depot warehouses at selected Army depots and activities we visited, resulted in increased (1) equipment scrappage rates, (2) maintenance costs, and (3) risk of losses due to thefts.

The following are examples of problems we found at the four depots we visited.

- Inventory items awaiting repair and overhaul at depots were piled outdoors with no packaging or other protection from the elements. The unprotected items were extensively rusted and had otherwise deteriorated. Depot officials agreed that this contributed to the 70 percent scrappage rate for one depot's maintenance program, including almost 300 engines scrapped because of internal and external cracks and pitted cylinders resulting from exposure to the elements. These engines are valued at \$4,086 each.
- Several sensitive optical devices on M102 howitzers, valued in total at more than \$11,000, were stored in cases filled with stagnant rainwater.

In addition, in July 1991, we reported<sup>11</sup> that small arms parts that could be used in civilian weapons were susceptible to theft as a result of a combination of poor inventory controls, poor physical security, and inadequate oversight. Such weak physical safeguards over equipment and supply inventories increase the risk of unauthorized removal and unnecessary deterioration of assets. Prior audit reports have also cited weak controls over physical security, resource accountability, and receiving practices as factors facilitating theft at depots.<sup>12</sup>

Our work at the Army depots we visited showed that the depots were not always following DOD and Army shipment, storage, and security requirements. Also, inadequate depot storage practices precluded taking the accurate physical inventories needed to determine the extent of thefts.

## Army Recognizes Accountability Problems

The Army is aware of many of the problems we found with its controls and accountability over resources. In its Federal Managers' Financial Integrity Act annual assurance statement for fiscal year 1991, the Army reported that property accountability was a material weakness, acknowledging persistent Army-wide management control deficiencies in maintaining property accountability records. Also, in December 1991, the Army Audit Agency reported<sup>13</sup> that commanders and property managers did not fully implement or follow required policies and procedures for effectively accounting for and controlling property.

<sup>11</sup>Inventory Management: Strengthened Controls Needed to Detect and Deter Small Arms Parts Thefts (GAO/NSIAD-91-186, July 17, 1991).

<sup>12</sup>For example, Internal Controls: Theft at Three Defense Facilities in Utah (GAO/NSIAD-91-215, August 22, 1991).

<sup>13</sup>Property Management and Accountability, U.S. Army Audit Agency (HQ 92-A1, December 30, 1991).

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## Army 5-Year Plan

As part of its 5-Year Financial Management Improvement Plan for fiscal years 1991 through 1995, the Army established an initiative directed, in part, at gaining financial accountability over inventory, capital equipment, and real property. With the transfer of 16 of the Army's accounting systems to the Defense Finance and Accounting Service in fiscal year 1991, the Army recognized in the plan that it now shares responsibility with the Defense Finance and Accounting Service for establishing and maintaining financial accountability over its property. In establishing the initiative, the Army acknowledged that logistics and financial system interfaces needed to be addressed in terms of the separate but coordinated roles of Army and DOD managers.

According to the Army's 5-year plan, key managers and organizational elements needed to establish system interfaces and an executive steering committee for the initiative have already been designated. In addition, the Army's 5-year plan sets out milestones leading to its goal of achieving financial accountability for its property by fiscal year 1994. One of these milestones specified in the plan to be attained during fiscal year 1992 is obtaining a revised signed agreement between senior Army and DOD logistics and financial managers to commit the resources necessary to develop required logistical and financial system interfaces.

We agree with the overall objectives contained in the Army's plan and strongly believe that a more effective interface between financial and logistics activities is essential to correcting accountability problems. In addition, other reviews we have performed in this area show that basic changes are needed in Defense management culture in the logistics area.<sup>14</sup> We believe that focusing solely on responsiveness of logistics systems with little regard for effectively integrating logistics and financial data will undermine the full correction of accountability problems. In this regard, incentives are needed that reward managers for seeking and achieving efficiency in logistics systems operations.

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## Conclusions

We recognize the complexity and difficulty associated with distributing, controlling, and accounting for hundreds of billions of dollars of inventory and equipment worldwide. We also recognize that fiscal year 1991 presented unique resource management challenges as a result of Desert Shield and Desert Storm. However, the Army has had long-standing problems in effectively accounting for and controlling its inventories and

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<sup>14</sup>Defense Inventory: DOD Needs to Continue Efforts to Improve and Reduce Stock (GAO/NSIAD-92-11, February 19, 1992).

equipment, and substantial problems continue to persist in the management of wholesale and retail inventories. Action in this area holds the greatest opportunity for improving resource management. Also, controls over equipment provided to contractors and Corps of Engineers equipment have substantial weaknesses and need immediate improvements. Control over military equipment was generally effective, but some opportunities also exist for improvement in this area.

Accountable and custodial records need to be integrated to prevent inconsistent and inaccurate reporting to management. This integration is rarely accomplished effectively, thus setting the stage for many of the actual and potential problems that we found—excess procurements of inventories, equipment and inventory not being available to support missions, inventory that is highly vulnerable to loss or theft, and the inability to state accurately the value of the Army's property on financial statements. If these conditions persist as the Army's budget is reduced, achieving readiness in a cost-effective manner will not be possible.

Integrating accountable and custodial systems will not, by itself, resolve all of the problems that have been identified with the Army's ability to control and account for its property. A critical component to any effective property management structure requires an accurate inventory baseline and periodic physical inventories to verify quantities and locations of assets. Without these components, the Army cannot ensure the integrity of its property records. Further, the Army needs to create a management culture that strives for effectiveness and efficiency in its management of logistical activities. Establishing performance measures is a way of doing this.

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## Recommendations

We recommend that the Secretary of Defense ensure that the Defense Finance and Accounting Service has sufficient authority to obtain the individual military services' cooperation necessary for the integration of logistics and financial systems. Specifically, resources must be committed and established milestones met.

We also recommend that the Secretary of the Army ensure compliance with existing control policies and procedures over resources. Specifically, goals and performance measures should be established for compliance with requirements such as the following:

- conducting annual physical inventories of equipment and supplies, researching the differences, and adjusting the custodial records to reflect the results of these inventories (using statistical sampling methods to help reduce the resources required to accomplish the physical inventories);
- reconciling differences between the custodial records and accountable records, and researching discrepancies; and
- safeguarding and protecting assets from deterioration and theft.

Furthermore, we recommend that the Secretary of the Army direct that

- a high priority be given to the Army's initiative to record spare parts and supply inventories held at the division level in logistics records made visible to item managers in order to consider these inventories in procurement decisions and
- the Corps of Engineers develop and comply with tables of allowances.

As recommended in chapter 2, these actions should be overseen by the special action group.

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## Agency Comments and Our Evaluation

DOD generally concurred with our findings in this chapter except for those relating to (1) inaccuracies in the wholesale inventory records, (2) weaknesses in conventional ammunition inventory controls, and (3) inadequate storage of repairables at several Army depots. DOD concurred with the objectives of all of the recommendations presented in the chapter but said that it only partially concurred with five of the six because DOD did not agree with our proposal that the special action group (discussed in chapter 2) oversee implementation of the corrective actions throughout the Army. DOD stated that other oversight groups already exist, including the DOD Inspector General.

DOD reiterated its position, as discussed in the "Agency Comments and Our Evaluation" section at the end of chapter 2, that Army inventories were 93.5 percent accurate. We believe our statistical sample showing a 35-percent error rate is more representative of the actual condition of the Army's inventory and that consequently inventory accuracy is a serious problem that needs prompt attention.

We agree with DOD's assertion that a 100 percent physical inventory would not be a wise use of its limited resources. However, using statistical sampling methods, as DOD agreed to do and we recommended, would help reduce the resources needed to accomplish required physical inventories

and, if properly performed, would provide DOD and the Army a more accurate basis for reporting on inventory. Even more important is to continue such sampling periodically. Combined with actions to reconcile inventory records with the results of these physical inventories, these actions should, over time, contribute to improved inventory. This in turn should help to reduce the higher costs which stem from inaccurate records. DOD stated it plans to use statistical sampling for inventories beginning in October 1992.

DOD partially concurred with our finding that conventional ammunition inventory systems do not provide accurate data. DOD stated that the Federal Acquisition Regulation requires that contractors operating government plants maintain the official DOD accountability records for inventories they hold. According to DOD, for the government to maintain inventory records for government-owned, contractor-operated plants would duplicate efforts already undertaken by the contractors. While we agree that Army need not duplicate contractor records, it should maintain sufficient accounting records to comply with Army regulations requiring continuous central accounting for the status of all Army property. Moreover, we believe that DOD and the Army have a fiduciary duty to take reasonable steps to ensure that contractor records are reasonably complete and accurate. Until Army completes its implementation of the Standard Depot System, these control problems will continue to exist and unnecessary exposure to losses and costs will continue.

DOD did not agree with our finding that inadequate storage of repairables at depots subjects items to misuse and deterioration. While agreeing that the Army needs to safeguard and protect assets from deterioration and theft and that the Army Materiel Command is aware of the depots' vulnerability to theft of property, DOD stated that its policies provided for adequate safeguards. We recognize that policies and procedures exist to protect assets from damage and deterioration while in storage. But policies and procedures must be followed. As discussed in this chapter, repairables were not always properly packaged when sent to the depots and we found that the Army's maintenance depots had not effectively implemented the required policies and procedures by making sure the items were properly protected before storing them outdoors.

DOD expressed concern over our recommendation to direct the special action group to oversee actions on our recommendations. DOD also noted that a recently established senior-level steering committee would provide policy direction and oversight to the special action group. We agree that

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**Chapter 3**  
**Controls and Accountability Over Billions in**  
**Assets Need Substantial Improvement**

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other oversight groups exist. Our recommendations did not necessarily call for changes in existing Army management structures. However, we believe that because the special action group is an Army-wide team integrating both financial and operational perspectives, it should play a key role in providing a departmentwide perspective to individual efforts to implement our recommendations. It is particularly important to bring together the efforts of the various logistics and accounting groups. The special action group also plays an important role by providing information to the Army Secretariat. This should help ensure that the problems are dealt with and necessary actions are accomplished.

# Army's System of Internal Controls Cannot Be Fully Relied Upon

Since 1983, the Secretary of the Army has reported to the Secretary of Defense that the Army's system of internal controls is adequate to meet the objectives for internal control systems established in the Federal Managers' Financial Integrity Act (FMFIA). However, we found widespread weaknesses in the Army's system of internal controls that preclude the Secretary of the Army from meeting those objectives of providing reasonable assurance that assets are safeguarded or that account balances and financial reports are reliable.

To perform its part of the annual DOD-wide internal control review required by the act, the Army has developed a framework of policies and procedures for assessing its internal controls system. However, operational managers at all levels within the Army have not effectively implemented those policies and procedures to identify and report material weaknesses. The Army recognizes the need to improve its internal control systems and has initiated some corrective actions, but more needs to be done. The Secretary's ability to provide reasonable assurance depends on accurate information and managers' willingness to candidly report their problems.

## Legislative Mandate to Maintain Effective System of Control

Agencies are required by the Accounting and Auditing Act of 1950 to establish and maintain a cost-effective system of internal controls. These controls should provide reasonable assurance that government resources are protected against fraud, waste, mismanagement, or misappropriation and that activities are effectively and efficiently managed to achieve their goals. The Congress enacted the Federal Managers' Financial Integrity Act of 1982 to further strengthen internal control systems. The act specifies that the systems of internal accounting and administrative controls should provide management with reasonable assurance that:

- obligations and costs are in compliance with applicable law;
- assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures are properly accounted for and recorded to permit the preparation of accounts and reliable financial and statistical reports, and accountability of assets maintained.

Under the act and implementing OMB guidance, the Secretary of Defense is required to provide an annual statement to the President and the Congress on whether the Department's system of internal controls, taken as a whole, complies with the act's requirements. The annual report should

describe the progress made during the year in correcting any material control systems weaknesses previously reported, identify new weaknesses, and identify any uncorrected material weaknesses remaining at the end of the year.

Office of Management and Budget Circular A-123 specifies that all agencies must report "material" weaknesses. The Circular and Office of Management and Budget Memorandum M-88-29 establish the criteria for federal agencies to use in determining whether an internal control weakness is to be reported to the President and the Congress. According to this and other Army guidance, which are discussed in more detail in appendix II, a weakness is "material" if, for example, it significantly weakens safeguards against waste, loss, unauthorized use, or misappropriation of funds, property, or other assets.

The act requires that the agency head's annual assurance statement also include a separate report on whether the agency's accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements. Specifically, as required by the Comptroller General's standards, agency systems should provide for

- complete disclosure of the financial results of the activities of the agency;
- adequate financial information for agency management and for formulation and execution of the budget; and
- effective control over revenue, expenditures, funds, property, and other assets.

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## Army's Federal Managers' Financial Integrity Act Process

The Army and other DOD components are responsible for annually reporting to the Secretary of Defense on whether their internal control systems comply with the requirements of FMFIA. The annual reports from the Defense components are summarized in DOD's annual assurance statement and reported to the President and the Congress on December 31 of each year. Army Regulation 11-2 prescribes the policy and contains guidance for achieving the Army's internal management control requirements. The regulation established the Army's Internal Management Control Program, under the direction of the Assistant Secretary for Financial Management, as the primary office responsible for meeting these reporting requirements.

The Army requires each assessable unit—such as an activity at a military base—to identify, report, and correct internal control weaknesses within

their unit. Army managers are supposed to conduct internal control reviews using standard checklists which contain questions on the minimum essential internal controls for each unit.

Managers are supposed to report the results of their review through the various levels of command to the headquarters staff. The weaknesses are to be assessed by management for materiality at each organizational level. The managers' knowledge of the control environment and audit reports are to be considered when identifying internal control weaknesses. The Office of Management and Budget allows agencies to review their internal system of controls over a 5-year period. The Army has developed a 5-year plan that is updated annually to identify who will be responsible for conducting internal control reviews and how frequently the reviews are to be conducted. Accordingly, not all functional areas within an activity are required to conduct a review each year.

## Material Internal Control Weaknesses Not Reported by Army

As required under FMFIA, the Secretary of Defense issued the Department's fiscal year 1991 assurance statement and reported that its systems of internal controls, taken as a whole, met the objectives for internal control systems established in the act. During our review, we identified a number of additional weaknesses that we considered to be material, but were not reported by the Army in its annual statement of assurance and consequently not included in the Secretary of Defense's fiscal year 1991 annual statement of assurance. The weaknesses we identified met the materiality criteria because they (1) significantly weakened safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets or (2) did not ensure that revenues and expenditures were properly accounted for and recorded to permit the preparation of accounts and reliable financial and statistical reports.

Some of these additional weaknesses have been discussed in previous chapters. They are mentioned in our opinion<sup>1</sup> on the Army's financial statements and are summarized below.

- Abnormal and unusual account balances are not being investigated and resolved throughout the Army.
- Differences between general ledger and detailed records are not resolved. We found this problem at various locations visited.

<sup>1</sup>Financial Audit: Examination of the Army's Financial Statements for Fiscal Year 1991 (GAO/AFMD-92-83, August 7, 1992).

- Real property construction-in-progress reporting is inaccurate and untimely.
- The Army's accounting and property systems do not accurately track and monitor records for government furnished materials and equipment issued to contractors.
- The Army's inventory records accounts do not accurately report the quantities or values of the inventory maintained at the wholesale level.

The Army Audit Agency also reported in its 1991 assessment of Army-wide management controls that 46 audits performed during fiscal year 1991 evaluated a total of 792 key internal controls and determined that 265 controls, or 33 percent, were not in place or were not operating effectively.

Considering the internal control weaknesses identified by us, along with those reported by the Army and DOD as discussed below, we do not believe the Army's systems of internal controls provide reasonable assurance that its resources are safeguarded and accounted for consistent with the objectives of FMFIA.

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## Control Weaknesses Reported by DOD and Army

For fiscal year 1991, DOD reported 13 material weaknesses for the Army. The Secretary of the Army identified 11 of these weaknesses and the Director of DFAS reported 2 additional material weaknesses relating to the Army as well as the other military services. The weaknesses reported in the Secretary of Defense 1991 report to the President and the Congress that relate to the Army are summarized below.

- Supply operations have persistent management control deficiencies in maintaining property accountability records and lack reasonable assurance that controls are adequate to protect assets from fraud, waste, and abuse.
- Systemic weaknesses exist related to the growth of excess inventories, unnecessary procurement, and ineffective use of assets in supply.
- Contractors may have unauthorized access to DOD's supply system.
- Controls over small arms spare parts are weak.
- Contracting offices are improperly using contracting support from other federal agencies to obtain supplies and services, thus circumventing established controls.
- Civilian retirement and death claims are not promptly processed.
- Defense Telecommunication Services, Washington, D.C., does not have control over the payment for services or accountability of equipment

inventory that it leases on behalf of its Defense customers, which include the Army.

- Erroneous advance payments and overpayments were made to Desert Storm and Desert Shield soldiers.
- The Army had not defined a basic frame of reference for identifying, integrating, validating, and prioritizing information management initiatives by major commands.
- Drought contingency plans are not properly developed for all controlled reservoir storage projects.
- The Army reserve component was not capable of maintaining essential mobilization data.
- Financial accounting systems for real and personal property are not integrated with the property book systems; consequently, there is no reasonable assurance that controls are adequate to safeguard assets.
- Negative unliquidated obligations which represent either overpayments to contractors or poor recordkeeping continue to be a problem in the Army Materiel Command. As of September 30, 1991, negative unliquidated obligations within the Command totaled \$260 million.

The Secretary of Defense also reported that accounting support systems for the General Fund, Stock Fund, and Industrial Fund had material weaknesses and did not conform to the Comptroller General's standards. Some of these systems were previously under the Army's control and were used to provide information in the Army's fiscal year 1991 financial reports. The Secretary of the Army also reported as a material weakness in Army's 1991 assurance statement that its accounting system, in total, does not comply with the standards. The following material weaknesses relating to these systems were reported in DOD's annual report.

- The systems do not fully maintain double entry general ledger accounts, and accounting reports are not fully based on general ledger accounts.
- The value of property, plant, and equipment, or material, including government furnished property, is not recorded at full cost in the accounting system's records or is not maintained under continuous financial control.
- All operational costs are not recorded in the accounting records for prescribed activities.
- Amounts owed to the U.S. government are not always recorded.
- Passwords and other techniques are not employed to protect software and files from accidental or malicious modification, destruction, or unauthorized disclosure.

- Systems documentation does not always exist or does not adequately describe the system design and procedures.
- Systems or system segments do not adequately interface, and automated data processing hardware or software and related manual processes are incomplete, outmoded, nonstandard, and require duplicate processing.
- General ledger and subsidiary account structures and financial reports are not current and sufficiently detailed to satisfy user needs.
- Accounting information does not fully support budgetary requirements.

### Procedures for Assessing Control Systems Are Not Effectively Implemented

We found that although the Army has established a good framework for assessing the adequacy of its internal controls, the procedures set forth in that framework were not being effectively implemented at the various major commands and activities, and only a relatively small number of weaknesses were identified using these procedures. Over the past several years, the Army Audit Agency has also identified significant deficiencies in the process.<sup>2</sup> These deficiencies were similar to those found. Specifically, we found a variety of implementation problems, which included the following.

- Internal control checklists were not always developed or the checklists provided to managers in some cases were not relevant to the activities being assessed.
- Managers were not providing required supporting information with checklist results.
- Material internal control weaknesses identified were not always reported to higher commands.

Reasons for not reporting problems varied from command to command. At activities we visited, specific reasons were not provided beyond differences in judgments. In a few cases, Army personnel cited concerns such as the absence of higher-level commitment and managers' desire to avoid admissions of weakness for fear of potential adverse reactions.

### Self-Assessment Process Identified Small Number of Weaknesses

The Army's 1990 annual report to the Secretary of Defense stated that continued intensified efforts were needed to instill in management the benefits derived through the self-reporting of weaknesses. It also stated that the relatively small number of weaknesses reported indicated that a

<sup>2</sup>Review of the Army Internal Control Program (fiscal year 1991), U.S. Army Audit Agency (November 11, 1991); Review of the Army Internal Management Control Program (fiscal year 1990), U.S. Army Audit Agency (November 1990); and Army Internal Control Program (fiscal year 1989), U.S. Army Audit Agency (July 16, 1990).

potential disclosure problem exists, especially considering the size and magnitude of both the Army's mission and the continued findings reported by auditors and the Inspector General in the same or similar areas.

A primary feature of the program is self-identification and reporting of weaknesses by the program managers. However, only a few of the material weaknesses the Army reported were identified through the internal control checklist process. For example, the Army Materiel Command reported 27 material weaknesses to the Secretary of the Army in its fiscal year 1991 assurance statement. Of these, only 2 were self-reported by managers as a result of completing checklists. We believe Army managers should honestly assess and report on any weaknesses within their purview and not primarily rely on outside parties such as auditors to identify control weaknesses.

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### Checklists Not Always Applicable and Current

Under Army Regulation 11-2, headquarters staff functional chiefs, such as the Deputy Chief of Staff for Logistics, are responsible for designing the internal control review checklists pertaining to the functions for which they are responsible. Commanders of the major command and the field operating agencies may supplement the checklists with additional internal control questions to meet command-unique requirements. The checklists are to be used by operating managers—for example, a base operations or logistics directorate—in testing internal controls.

Recent Army Audit Agency reports disclosed that the Army commanders have not developed specific checklists for certain activities, including the Corps of Engineers and the Conventional Ammunition Working Capital Fund. Moreover, we found checklists designed for other activities were not always updated to reflect changes in regulations and in operations. Examples of the conditions found by the Army Audit Agency and during our current review are presented below.

- In July 1990, the Army Audit Agency<sup>3</sup> identified five Corps of Engineers' civil works functional areas which had serious control deficiencies and lacked internal control checklists adequate to evaluate these activities. The Army Audit Agency concluded that material weaknesses go undetected because there were no Corps-specific checklists available and recommended that appropriate checklists be developed. However, a

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<sup>3</sup>Review of the Army Internal Control Program (fiscal year 1989), U.S. Army Audit Agency (HQ 90-402, July 3, 1990).

February 1992 Engineering Inspector General report stated that little priority has been placed on developing Corps-specific checklists.

- We found that the Conventional Ammunition Working Capital Fund does not have specific checklists relevant to its operations. Our audit identified material control weaknesses in the Fund, such as, large unreconciled differences between government owned plants' inventory records and the Army Armament, Munitions and Chemical Command's accountable records. However, the checklist used did not provide a means for identifying such differences. Fund officials are now in the process of developing a checklist specific to ammunition component inventories based on the recommendation of the Army Audit Agency.<sup>4</sup>

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### Managers Are Not Documenting Checklist Results

Our review of completed checklists indicates that Army managers do not document the methodologies that they employ when completing checklists. Deputy Assistant Secretary of the Army for Financial Operations guidance provides that reviewers and auditors should be able to review the completed checklists and understand what was done to test the internal control systems. The guidance also suggests several methods for testing the internal control systems, including sampling and simulation.

Our audit disclosed that checklists were not properly documented for certain activities. For example, our review of the 109 checklists performed by nine Corps of Engineers districts during fiscal year 1991 disclosed that only 1 completed checklist included a description of the methodology used to answer the checklist questions. As a result, we could not determine whether the managers used appropriate procedures to assess their controls and whether they reached reasonable conclusions based on the results of their tests.

The Army Audit Agency has identified missing checklist documentation as a concern for the last several years. A 1990 Army Audit Agency report stated that operating managers relied on their general knowledge of operations and did not consider it necessary to test and document internal controls. For fiscal year 1991, the Army Audit Agency reported that it found the lack of testing and documentation in 18 of its 123 audits of Army's completed checklists.

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<sup>4</sup>Management of Ammunition Components, U.S. Army Audit Agency (AAA-CR 92-202, January 27, 1992).

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Not All Material Internal  
Control Weaknesses Are  
Reported to Higher  
Commands

Managers did not always report all material weaknesses in accordance with Office of Management and Budget and Army guidance. Many weaknesses we considered to be material were identified by managers during the assessment process, but were not reported as material weaknesses. Some of these were discussed in our earlier analysis of material weaknesses not reported.

For example, the Armament, Munitions and Chemical Command reported that management of ammunition component inventories is a material weakness to the Army Materiel Command. However, the Army Materiel Command did not report this as a material weakness. Officials from the Conventional Ammunition Working Capital Fund stated the problems identified were not significant and that the accounting information is not used to make decisions on inventory production.

We disagree with these officials because accurate records are necessary to safeguard assets from fraud, waste, and abuse. We not only found unreconciled differences between government owned plants' inventory records and with Army Armament, Munitions and Chemical Command accountable records, but also that significant quantities of ammunition were not under Army accounting control.

Army Regulation 11-2 requires material weaknesses to be reported to the next higher level to keep them informed of sensitive problems and issues. However, Corps of Engineers officials stated that they did not report 14 cases of noncompliance with the Comptroller General's principles and standards because they believed that they needed to report only those weaknesses that could not be resolved without assistance from higher command. After discussions with us, these officials agreed they should have reported these 14 cases of noncompliance.

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Accountability for Program  
Effectiveness Is  
Fragmented

The Assistant Secretary for Financial Management is responsible for the program implementation of FMFLA. Under 10 U.S.C. 3022, the Assistant Secretary for Financial Management is also responsible for directing and managing financial management activities and operations of the Army. This includes approving the establishment and supervising the operation of any asset management system, such as property and inventory accounting systems. However, operational managers have responsibility for running the day-to-day operations and the Assistant Secretary for Financial Management has not been given the authority to direct operational managers to allocate the resources needed to develop and

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maintain an effective control system. As a result, accountability for ensuring an overall system of effective controls is split.

Because day-to-day operation of the various systems are under the control of commanders other than the Assistant Secretary for Financial Management, corrective actions regarding noncompliance with accounting regulations will be difficult to enforce without strong cooperation from the respective commands. Our concerns with the lack of clear assignment of organizational responsibility for financial operations are discussed further in chapter 5.

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## Army Improvement Efforts

Army officials stated several actions were under way to improve their Internal Management Control Program.

- First, the Internal Management Control staff planned and implemented a strategy to provide an Army-wide training and assistance effort. The objective is to educate Army managers at all levels on the principles and practices of sound management controls. The training and assistance effort is currently being conducted at various Army institutions and also through Army-wide distribution of a professionally developed video cassette expected to be completed during fiscal year 1992.
- The second initiative is to minimize administrative burdens while pinpointing each manager's responsibility and accountability. Responsible managers and their functions are being identified and standard internal control review checklists are being developed to be used according to its 5-year Management Control Plan.
- The third initiative was to install means for stopping recurrent management control deficiencies by identifying the root causes of problems and taking actions to correct them. To this end, the Army began a project 5 years ago to develop an inventory of internal management control deficiencies. The result is a set of "Reminder Listings" that has evolved to the point where recurring problems and their significance can be isolated for in-depth research.

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## Conclusions

Based on the extent of material internal controls weaknesses identified by Army managers, Army auditors, and our review, we do not believe that the Army's system of internal controls provide adequate assurance that resources are safeguarded as contemplated consistent with the objectives of FMFLA.

The Army has taken actions to establish policies and procedures for assessing its control systems, but the effectiveness of this approach is dependent on adequate testing of the internal controls in place and a willingness to report identified weaknesses. Through this process, the Army has identified a large number of material weaknesses and has taken or has actions underway to correct these problems.

However, the Army is not fully realizing the benefits of effective control systems principally because its procedures are either not being followed or are not being implemented properly. Without management commitment at all levels, clear program accountability, and a clearly conducive and receptive environment to identifying and resolving problems throughout all levels of management, the Army will not be able to establish effective controls over its resources and operations. In addition, while responsibility for implementing this program rests with the Assistant Secretary for Financial Management, that position does not have the authority to require that resources be directed to identify and correct control problems.

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## Recommendations

We recommend that the Secretary of the Army take the following actions:

- give operational managers responsibility for ensuring effective internal controls and, as recommended in chapter 2, make the special action group responsible for overseeing that internal control system weaknesses are identified and corrected;
- disclose the material weaknesses identified in this report in the Army's fiscal year 1992 annual statement of assurance and in subsequent annual statements until the weaknesses are corrected; and
- advise the Secretary of Defense that FMFIA's objectives are not being met.

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## Agency Comments and Our Evaluation

In its comments, DOD disagreed with three findings in this chapter. Regarding the three recommendations, it concurred with one, partially concurred with another, and did not concur with the third.

DOD did not concur with our recommendation that the Secretary of the Army should advise the Secretary of Defense that the Army is unable to meet the objectives of FMFIA. DOD stated that "the Army does have reasonable assurance in the areas of program and budget reporting" and that Army management has reported many material weaknesses to the Secretary of Defense. We recognize that judgment will always be an

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integral part of deciding whether an agency is able to achieve FMFIA's objectives. However, in our view, a reasonable and objective evaluation of the internal control weaknesses that we, DOD, and the Army identified, along with the magnitude of the adjustments required to produce Army's financial statements, would lead to the conclusion that the Army does not have reasonable assurance that its resources are adequately safeguarded or that its operations were accounted for to permit the preparation of reliable financial reports—two of FMFIA's primary objectives.

DOD partially concurred with our recommendation that the special action group should be responsible for overseeing the identification and correction of internal control system weaknesses. It did not fully concur because established oversight groups already have these responsibilities. Although DOD's primary concern was that implementing our recommendation would require changes in the existing Army management structure, our recommendation did not necessarily call for such changes. We believe that because the special action group is an Army-wide team, integrating both financial and operational perspectives, it should be able to play a key role in providing top management's perspective to the individuals involved in correcting the problems. This special action group is particularly important because accountability for the Army's internal control program remains fragmented, and correction of so many weaknesses remains long overdue.

DOD did not concur with our finding that the problems cited in this report represent material weaknesses that should have been reported in the Army fiscal year 1991 statement of assurance required by FMFIA. DOD acknowledged that, for the most part, the Army's omission reflects a difference of opinion in the relative materiality of the problems we cited. While we recognize that judgment must be used in determining materiality, we believe that the problems discussed in this report clearly represent material weaknesses in accordance with OMB's guidance. As discussed in this chapter, each of the conditions we cited represented situations in which the designed procedures or degree of operational compliance therewith does not provide reasonable assurance that the objectives of internal control specified in FMFIA are being accomplished.

DOD also did not concur with our assessment that the checklists Army used to assess internal control effectiveness were not always relevant to the activities being assessed. DOD stated that the checklists developed for Army-wide use were properly generic. While we agree that generic checklists may be appropriate as a starting point, Army regulations

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provide that these checklists may be modified to meet the local requirements. We believe that adopting appropriate revisions will assist assessable unit managers in detecting internal control weaknesses. We also believe that individuals familiar with control concepts as well as with local requirements need to make the revisions.

Lastly, DOD did not concur with our finding that accountability for the internal control program's effectiveness is fragmented. DOD stated that the Secretary of the Army, through his commanders, has the authority to allocate resources. The Secretary of the Army has delegated responsibility for implementing Army's internal control review program to the Assistant Secretary of the Army for Financial Management, who, however, does not have the authority to delegate and direct the resources necessary to ensure that this responsibility is carried out effectively. Consequently, accountability for the Army's internal control program remains fragmented, and strong cooperation from the respective commands will be needed to ensure that controls are effectively implemented. Such cooperation would be facilitated by strong, sustained, and highly visible emphasis from the Secretary of the Army and other top officials. In this regard, we are encouraged that the Secretary of the Army plans to reinforce existing policy by restating and emphasizing the responsibility of top managers and their subordinates to ensure that effective internal controls are in place and working as intended.

# Financial Management Improvements Require Immediate Joint Army and DOD Actions

Previous chapters have focused on identifying specific problems the Army is experiencing in accounting for and controlling its resources and the actions it needs to take to address those problems. However, further steps that are needed can only be accomplished by DOD and the Army working together. Specifically, actions are needed to (1) clarify responsibilities for the quality of financial systems and operations data, (2) correct data accuracy problems in existing systems, (3) guide development and implementation of financial management systems, and (4) ensure the availability of trained financial management personnel. With appropriate actions, the Army and DOD have the opportunity to make substantial savings through more efficient operations, and some of these savings can be achieved almost immediately.

DOD has undertaken several major initiatives aimed at improving the accuracy, reliability, and effectiveness of its financial systems and operations, as well as to raise the level of cost consciousness throughout all DOD organizations. DOD's management initiatives are very promising. If carried out properly, they offer major savings in administrative costs and improved efficiency of operations for the Army as well as the other services. But these initiatives have two common elements that require cooperative efforts from the Army and DOD. First, they rely upon transferring most responsibility and control for financial and support operations from the military services to DOD. Second, they represent approaches which depend upon longer term solutions to deal effectively with the problems the Army is now experiencing. To achieve savings and improved efficiency, these initiatives need to place greater emphasis on cooperative management and corrections to existing systems and control problems that do not require major systems changes.

## Organizational Responsibility for Financial Data

With DOD assuming greater responsibilities for financial and support functions previously operated by the Army, it becomes vitally important that both DOD and Army more clearly establish accountability and responsibility for financial data accuracy and financial reporting. Simply centralizing authority does not necessarily increase control or accountability, and unless it is done properly, the outcome can be just the reverse.

Our audit found that the Army's Assistant Secretary for Financial Management did not have a reliable basis for assurances made to DOD's CFO that Army's fiscal year 1991 financial statements were accurate. In addition, we also found that although DFAS performed financial

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management services for the Army in preparing its financial statements, DFAS was not held fully accountable for these services.

Many Army components, as well as DFAS, played key roles in recording, processing, and reporting the Army's operations and resources during fiscal year 1991. Essentially, DFAS prepared the Army's financial statements based on information provided by numerous Army sources; in doing so, it made numerous adjustments to the data for inaccuracies and deficiencies in the information it received. DFAS then submitted the statements to the Assistant Secretary of the Army for Financial Management, who in turn provided the Army's financial statements to the Defense CFO.

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**Army Assistant Secretary  
for Financial Management  
Did Not Have Assurance  
That Information Reported  
Was Accurate**

The Army's Assistant Secretary for Financial Management was given responsibility for overall Army financial reporting in 1988.<sup>1</sup> By reporting to DOD's CFO that the Army's fiscal year 1991 financial statements fairly and accurately presented the Army's financial condition and operating results, the Assistant Secretary took overall responsibility for their accuracy.

The Army used a network of accounting and finance operations at about 360 fiscal stations. This network includes 136 finance and accounting offices at depots, posts, camps, installations, and engineering districts to initially record the financial transactions applicable to its operations in fiscal year 1991. These data were summarized by 21 accounts offices, processed at the Army's data processing centers, and transmitted to DFAS for inclusion in the Army's financial statements. While these accounting entities reported that, where possible, accounting operations were performed under general ledger control, they were not required to certify the accuracy of the data they reported.

In addition to the information provided by this finance and accounting network, DFAS also used data from Army components' operating programmatic systems—such as logistics systems—as the initial source for certain information included in its financial reports. For example, as discussed in chapter 2, Army non-financial accounting components reported an estimated \$78 billion of tactical military equipment and \$11.3 billion of government owned property in the hands of contractors. However, Army components responsible for reporting on these assets were not required to review and certify the accuracy of the financial data they reported.

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<sup>1</sup>Under 10 U.S.C. 3022, the Assistant Secretary of the Army for Financial Management is responsible for managing the Army's financial management activities.

## Need to Clearly Define DFAS Role and Accountability

In reporting the Army's financial statements for fiscal year 1991 to the Army's Assistant Secretary for Financial Management, the Director of DFAS stated that "the attached FY 1991 financial statements are supported by reports and other data provided by Army components. These Department of the Army financial statements are a correct consolidation of such reports and other data reported to the Defense Finance and Accounting Service."

According to senior DOD officials, DFAS is intended to operate like a service bureau, processing financial data provided by the Army and other military services. If a service bureau only processes data and does not maintain related accountability for data accuracy, then the customer accounting organization has responsibility for the data accuracy. Accordingly, the customer accounting organization would normally make any needed adjustments to the data it receives from the service bureau and would take full responsibility for the accuracy of information reported in the financial statements. Therefore, if DFAS is only responsible for accurately processing and consolidating data it receives, the military services would remain responsible and accountable for the statements, including any adjustments needed to ensure their accuracy and fair presentation. However, DOD documents show that DFAS has a far greater role and is in fact assuming overall accounting responsibility for the Army and the other military services.

In preparing the Army's fiscal year 1991 financial statements, DFAS initiated over \$250 billion in adjustments to data received from Army components. However, DFAS generally did not have adequate documentation or evidence of supervisory approval for the adjustments it made.

On April 6, 1992, DFAS issued its strategic plan showing its concept of future DOD accounting and finance operations. The plan states, "DFAS assumes full management responsibility for the finance and accounting functions of the DOD components." The strategic plan further provides that DFAS is responsible for

- developing and implementing finance and accounting policy throughout DOD;
- selecting interim finance and accounting systems for use throughout DOD; and
- consolidating into DFAS the finance and accounting functions previously performed by the DOD components, including the military services.

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The primary role of DFAS was further defined in a May 18, 1992, memorandum documenting agreements reached on DFAS responsibilities by the DOD Comptroller, the military services' top financial management officials, and the DFAS Director. Among other things, this memorandum stated,

“As of this date, DFAS is ‘the accounting firm’ for DOD. DFAS will assume responsibility and ownership for all accounting systems and accounting processes in DOD. In addition, except as noted, DFAS will perform accounting for all General Funds; DBOF [the Defense Business Operations Fund] Revolving and Industrial Funds; Trust Funds; Accounts Payable; Billings; Accounts Receivable; Debt Management; Cash Accounting; etc. The goal is to centralize these functions over a period of years. However, in the interim, DFAS will capitalize these functions in place, which will require a DFAS presence at the base/field/intermediate level until consolidation is effected.”

After we completed our audit work, DOD officials told us that a report due by July 15, 1992, would document their final plans for transferring most of the existing Army accounting activities into DFAS. However, officials later told us that the report would be issued several months after the July 15 date.

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## Organizational Issues

While recent documents show that DOD is moving toward total control of its accounting functions, there will be a transition period. Unless corrected, problems with existing systems will continue during this period. In addition to transition problems, this move to centralize the accounting function raises organizational issues. For example, while some units will retain finance functions, they will, in effect, be acting as DFAS agents.

The Assistant Secretary for Financial Management must be responsible for working with other Army units to use the information provided by DFAS for management and control and to communicate user information needs to DFAS. In addition, a designated Army official, such as the Assistant Secretary for Financial Management, will need to coordinate the information flow from Army program components that report to the Assistant Secretaries for Installations, Logistics, and Environment; Manpower and Reserve Affairs; and Civil Works.

## Efforts to Improve Systems

The Army has acknowledged that inadequacies in its financial systems are one cause of the low reliability of its financial data and has undertaken a number of initiatives to improve its systems. However, a Defense Management Review centralized responsibility for all DOD systems improvement efforts within the Office of the Secretary of Defense under the Corporate Information Management (CIM) initiatives, which were initiated in October 1989. CIM's objectives include (1) implementing new or improved business methods, (2) creating more uniform practices for common functions, and (3) improving the standardization, quality, and consistency of data from DOD's management information systems. CIM is intended to eliminate or reduce systems that perform the same functions. We believe the CIM initiatives, if properly carried out, can promote major savings and efficiencies. However, a project of this magnitude will require many years to complete.

Under CIM, DFAS is establishing requirements for standard financial systems and is selecting "migratory systems"—those systems which represent the best of a particular type of system (for example, a civilian payroll system)—to be adopted by all DOD organizations and to serve as a baseline system for continuing improvements. By fiscal year 1997, DFAS plans to implement standard migratory systems throughout DOD. Ultimately, DOD plans to have a single integrated financial and accounting system.

According to information DOD officials provided subsequent to our audit work, DOD has selected eight migratory systems and, as shown in table 5.1, plans to have them implemented between 1993 and 1995.

**Table 5.1: Implementation Dates for Migratory Systems Selected Under CIM**

<b>Financial system</b>	<b>Projected completion date</b>
Defense Civilian Pay System	September 1995
Defense Joint Military Pay System	December 1994
Defense Retiree and Annuitant Pay System	December 1994
Non-Appropriated Fund Central Pay System	March 1994
Defense Transportation Payment System	November 1993
Mechanization of Contract Administration System	1993
Defense Travel Pay System	June 1994
Defense Debt Management System	December 1993

DOD officials stated that they have not yet selected migratory systems for the major accounting functions, such as installation level accounting, general accounting for direct appropriations, accounting for DBOF, and

property accounting. These systems will account for hundreds of billions of dollars and will be key elements needed to achieve accurate, reliable financial reporting. According to information senior Defense Comptroller officials provided after we completed our audit work, they plan to select a general accounting system before January 1993. Further, DOD plans to select a Defense Business Operations Fund accounting system by March 1993.

Furthermore, while DOD has established milestones for the final implementation of some systems, it has not yet established a detailed plan with specific short-term tasks identifying milestones, resource needs, and specific organizations responsible for guiding the evolution of each migratory system.

In identifying and developing DOD systems, the CIM methodology requires defining and improving business processes including internal controls and interfaces with programmatic functions and systems. We agree with this concept. Many of the weaknesses discussed in chapters 2 and 3 of this report result from inefficient or ineffective business processes. However, DOD officials told us that the process of defining and improving business processes was not followed in selecting the migratory systems. Therefore, unless corrected, DOD's migratory systems will have the same problems as the existing systems; thus, they will continue to generate inaccurate, unreliable data.

We are concerned that DOD and the military services may be relying too heavily on technology to resolve financial problems. In addition, as discussed previously, many of the CIM migratory systems will not be implemented for a number of years, and other critical systems have yet to be selected. Therefore, DOD and the military services will have to continue to rely on existing systems and reports produced from those systems for decision-making purposes.

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## Problems in Identifying Operating Costs and in Data Accuracy Persist

DOD has undertaken a significant initiative to apply more businesslike management practices to improve the planning and control of operational costs. DBOF is intended to improve the tools and incentives to manage existing resources by identifying the total costs of operations and highlighting the cost implications of management decisions. To help accomplish these objectives, DBOF charges customers for all costs associated with the goods and services provided to them. DBOF is intended

to provide all levels of management with information on the costs of support activities for evaluation of possible alternatives.

Under DBOF, DOD has assumed overall policy direction responsibility for the Army's stock and industrial funds. For fiscal year 1991, these funds accounted for almost \$14 billion in Army expenses and \$20 billion in assets, or about 15 percent and 6 percent of DBOF's total expenses and assets, respectively. Under current DOD plans, the Army stock and industrial funds will no longer be reported in Army's financial statements, rather they will be included in separate financial statements for DBOF.

In addition to incorporating Army's stock and industrial funds, DBOF consolidates seven other existing industrial and stock funds operated by the military services and DOD. It also incorporates the activities of DFAS, the Defense Industrial Plant Equipment Services, the Defense Commissary Agency, the Defense Reutilization and Marketing Service, and the Defense Technical Information Service. For fiscal year 1993, DOD estimates that DBOF will have sales of goods and services of about \$81 billion.

Some changes have been implemented to date. DOD has developed a plan which outlines the tasks to be performed and the milestones for the accomplishment of these tasks. For example, the plan calls for most of DBOF's policies and procedures to be developed by September 30, 1992. As of June 1992, Defense planned to meet those milestone dates. The House of Representatives has also incorporated the key tasks and milestone dates mentioned above in the National Defense Authorization Act for Fiscal Year 1993 (H.R. 5006, passed on June 5, 1992). Achieving DBOF's goals and objectives will require a sustained commitment from top management for a number of years and close coordination with the CIM initiatives.

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**Accurate and Reliable Cost Accounting Systems Key to Fund's Success**

DBOF's ultimate success depends on accurate, reliable, and integrated cost systems which would provide information for (1) establishing accurate prices to charge customers for goods and services, (2) furnishing key elements of cost information to managers to enable them to better control costs, and (3) generating required information on inventory values and the cost of sales for the preparation and audit of DBOF's financial statements. However, the existing cost accounting systems used by the stock and

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industrial funds are inadequate to achieve these objectives.<sup>2</sup> Further, DOD has not finalized requirements for migratory cost accounting systems.

In early 1991, DFAS initiated two projects to standardize and improve the various stock and industrial fund accounting systems. In February 1992, DFAS decided to incorporate these projects into an ongoing study to select a DOD-wide standard general accounting and funds distribution system. Although DFAS has identified 18 systems that it plans to evaluate in selecting migratory systems, it does not plan to select them until early 1993. Moreover, DOD officials stated that once the systems are selected, it will take about 3 years to implement them at all DBOF activities.

Improvements in financial management systems and the quality of financial information must begin with concerted efforts to improve data in existing systems. Reliable financial data are needed for management decision-making now, as well as in 2 or 3 years when migratory systems are implemented. Furthermore, unless errors are corrected, inaccurate data contained in existing systems will be entered into any migratory systems adopted as a result of the CIM initiatives, and the migratory systems will not be able to produce reliable cost information. If data reliability problems in present accounting systems are not corrected, DBOF will be unable to achieve its goal of focusing on the cost of operations in the short term.

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## **Progress Toward Achieving CFO Goals**

The CFO Act provides a framework for addressing many of the Army financial management problems we have identified. It establishes a CFO in DOD to oversee the financial management activities of the military services, including financial management leadership, personnel resources, and systems development. In April 1991, DOD developed a plan to implement the act.

Under the plan, however, achievement of many of the act's objectives is tied to the DFAS and CIM initiatives. While these initiatives are quite promising and conceptually sound, as we have already discussed, we are concerned about some practical aspects of their planned implementation. Another important requirement covered in the plan is the CFO's responsibility for professional development and retention of financial management personnel. We are also concerned about DOD's progress in this area.

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<sup>2</sup>Financial Management: Defense Business Operations Fund Implementation Status (GAO/AFMD-92-8, April 30, 1992).

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As set forth in the act, directing and managing the recruitment, selection, and training of financial management personnel is the CFO's responsibility. Our work shows that some actions have been taken to improve financial personnel resources. Specifically, in response to Defense Management Review Decision 985, issued in December 1991, DOD has

- issued a financial management education and training management plan, focusing on providing a basis for more systemic management of changes in financial management education and training;
- established the Defense Resource Management Institute to provide education in advanced resource management and develop curricula with assistance from functional experts; and
- created a model of DFAS learning centers that will allow for training by providing automated training courses.

These actions are steps in the right direction. However, given the major reorganization of financial management and the major changes in systems in the CIM initiatives and DBOF operations, DOD's CFO needs to ensure that experienced, trained personnel are available to handle this difficult transition period. At the same time, the CFO needs to deal with existing differences in the systems of the Army and other services that are both costly and inefficient.

As a result of the CFO Act, OMB requires agencies to prepare a 5-year financial management plan that should identify and address personnel needs and actions to ensure those needs are met. Plans are also to provide a blueprint for change with a clear set of expectations and should include milestones for implementation.

DOD's April 1991 implementation plan and DOD Directive 5118.3 established responsibilities for recruitment, selection, and retention of financial management personnel, but it did not specify a framework for identifying financial management deficiencies or the actions needed to correct identified financial personnel deficiencies. DOD officials have informed us that resource requirements will be addressed in DOD's July 1992 report on consolidation of its accounting functions. DOD officials also stated that the Department's revised CFO implementation plan will be issued in August 1992 as part of its required reporting under the CFO Act.

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## Significant Improvement Achievable Within Existing Systems and Processes

The magnitude of the problems noted in this report resulted, to a large extent, from widespread failure to operate existing systems properly or to comply with established policy and procedure requirements. Thus, effective efforts to make current systems operate effectively can result in immediate improvement.

This is clearly illustrated in the area of inventory management, which has long been an area of difficulty for DOD and the military services. Inaccuracies in the logistics and financial records' quantities and values of inventories on hand have been a persistent problem. Accurate records of inventory quantities and values are vital to achieving effective inventory management. Without them, management cannot make sound decisions about the items it needs to buy or those it no longer needs and should dispose of. Inevitably, this is a contributing factor to DOD's buildup of unrequired inventories, which reportedly exceeded \$21 billion as of September 1991.<sup>3</sup>

As discussed in chapter 3, we found widespread inaccuracies in the Army's inventory records. Yet the most basic controls to remedy this problem are not being implemented consistently and comprehensively. These controls include such steps as investigating obvious errors, performing counts of items on hand, and making corresponding corrections to the records.

Another contributing factor in DOD's inventory management problems is the need for greater integration of inventory operations with the financial management function. While the Army's Assistant Secretary for Financial Management has responsibility over systems that help to manage the investment in assets like inventories, in practice those systems have been controlled by the Army's logistics function. As pointed out earlier, organizational problems are exacerbated with DBOF's absorption of Army's stock funds and DFAS's assumption of responsibility for accounting systems improvements under the CIM initiatives.

It is apparent that even if present plans can be accomplished within stated time frames, it will be some years before migratory systems are implemented and more years before we see new modern systems. We believe that existing systems providing accounting information can operate more efficiently with disciplined adherence to existing plans and procedures and that immediate payoffs can be obtained. For example,

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<sup>3</sup>Supply System Inventory Report, Department of Defense, Washington Headquarters Services Directorate for Information Operations and Reports (September 30, 1991).

unnecessary purchasing of items for inventory and unnecessary inventory losses which waste taxpayer dollars can be reduced by using current systems more effectively. Because of DFAS's expanded responsibility for accounting information, it is essential that both DOD and Army make disciplined adherence to existing policies and procedures, as well as a clean-up of the existing data flow, major priorities.

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## Conclusions

Improving financial systems and operations will enable managers to optimize the use of available resources and contribute to realizing a smaller but still highly capable Army force by fiscal year 1997. The reduced threat environment and budget constraints, barring unforeseen events, will inevitably result in a smaller Army. The challenge for Army leaders is to efficiently and economically ensure that the Army's smaller force remains highly capable.

Effective financial management within the Department of the Army is partly dependent upon the successful implementation of DOD organizational programs—like CIM, DFAS, and DBOF. However, many issues need to be resolved before the organizations can operate effectively and accounting systems improvements are implemented. The consolidation of business activities under DBOF will not focus on the cost of operations or result in greater efficiencies unless proper systems and policies are in place. Consolidating responsibility for accounting systems improvements under CIM can result in substantial cost and efficiency benefits, but important interim actions are needed to ensure success and accelerate the achievement of benefits. In addition, DOD needs to ensure that adequately trained personnel resources are available to achieve its objectives.

The Army must improve the quality of data in its existing systems. This will require dedicated leadership at all levels and cooperative arrangements with DOD if savings and efficiencies are to be obtained. The opportunity to save taxpayers' dollars now should not be deferred even 2 or 3 years. Furthermore, before migratory systems can be effectively introduced, especially those affecting inventories and cost accounting, data inaccuracies in existing systems must be corrected. There is little to gain and much to lose by not making a major effort to deal immediately with the basic deficiencies noted in this report.

Because DOD is assuming greater responsibilities for financial support and functions previously operated by the Army, it is vitally important that DOD and the Army clearly establish their respective responsibilities in order for

the DOD initiatives to have a reasonable chance of succeeding and for the Army to improve its financial management operations.

DOD has linked achievement of the CFO Act's key objectives to the effective operation of DFAS and to accomplishment of the CIM objectives. However, DOD's CFO plan does not clearly set out milestones, resources, or personnel expertise needed to accomplish DOD's various financial management initiatives. Nor does it address the need for DOD organizations to resolve the Army accounting and financial management problems identified in this report.

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## Recommendations

We recommend that the Secretary of Defense, in consultation with the DOD's Chief Financial Officer and Service Secretaries, clearly delineate the respective responsibilities and authorities of the Assistant Secretaries for Financial Management and DFAS and their relationships with service operating units having responsibility for data integral to accounting operations and systems. We further recommend that the Secretary of Defense direct DOD's Chief Financial Officer and Service Secretaries to ensure that (1) the planned implementation of migratory systems includes steps to correct data inaccuracies in existing systems and (2) existing accounting and control policy requirements are applied rigorously until changed systems are actually implemented. Because of the high payoff potential, special emphasis should be given to systems and policies relating to inventory.

We also recommend the Secretary of Defense require the CFO to

- accelerate the definition of functional requirements for the remaining migratory systems to be selected under CIM and establish specific milestones and target dates for meeting the set implementation dates of migratory systems throughout DOD and
- ensure that specific resource needs to implement financial management initiatives are also included in DOD's August 1992 revised CFO implementation plan.

We further recommend that the Secretary of Defense (1) make financial management improvement projects a DOD-wide priority to be supported by adequate resources and (2) direct DOD managers to consider the projects in setting budget priorities.

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## Agency Comments and Our Evaluation

DOD concurred with all five recommendations presented in this chapter. However, DOD did not concur with one finding and partially concurred with four others.

DOD did not concur with the finding that DOD's existing stock and industrial funds accounting systems are inadequate. While acknowledging that improvements are desirable, DOD stated that its current systems are adequate to manage the Defense Business Operations Fund. As discussed in our April 1992 testimony on DBOF, the concept of DBOF is good but there are significant improvements that need to be made in the accounting systems to assure the ultimate success of DBOF. DOD has made little progress in improving the existing cost accounting systems used by the stock and industrial funds. Until those improvements can be made, more needs to be done in the short term to improve the quality of the financial data processed by the existing systems. We are concerned that unless steps are taken now to ensure that data inaccuracies in existing systems are corrected, DBOF will lose its credibility. Further, the new migratory systems introduced in the future will not correct basic data accuracy problems. DOD stated it is ensuring appropriate improvements within current systems. This is fundamental and critical.

DOD partially concurred with our finding that the data obtained from nonfinancial systems that were used in Army's financial statements are inaccurate. DOD stated that its nonfinancial systems effectively safeguard its property and that its systems carry out required fiduciary functions extremely well. We agree with DOD that these nonfinancial systems could provide reasonable assurance that reported information is accurate if the systems are operated with effective controls. However, as discussed in chapter 2, Army's nonfinancial systems cannot be relied on to report accurate, timely information for its accounting systems.

DOD partially concurred with our finding that organizational responsibilities for financial data need additional clarification. DOD stated that the DOD Comptroller is responsible for developing and promulgating financial management policy and that DFAS and the DOD components are responsible for implementing that policy. DOD also stated the DOD components are responsible for the accuracy of information initially entered into financial systems. However, as discussed in this chapter, we believe that it is still unclear (1) whether DFAS or the Army should be held accountable for adjustments to Army's financial reporting made at DFAS and (2) how accountability was established for nonaccounting and finance components' submission of accurate and timely data. As discussed above,

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Army components responsible for reporting information from nonfinancial systems are not required to certify the accuracy of the data they report. With the number of different organizations involved with developing information for and producing the Army's financial statements, organizational responsibilities for data accuracy must be clearly delineated.

DOD also partially concurred with our finding concerning its efforts to improve systems. DOD stated that it is premature to firmly fix the expected dates for selecting standard systems. We continue to believe that DOD needs an overall timetable for its system improvement efforts which would include not only expected dates for the selection of systems, but also expected dates for the migratory systems' implementation throughout DOD. By setting specific milestone dates, top management and the Congress will be able to monitor and assess accountability for progress.

The fourth finding with which DOD partially concurred addressed the need to place more emphasis on identifying and controlling operating costs and data accuracy. Specifically, DOD stated that as part of the implementation of DBOF, it has not assumed overall responsibility for operating or managing the Army's stock and industrial funds. While we agree that DOD does not have direct responsibility to operate and manage the Army's stock and industrial funds, it does have overall policy direction responsibility for these funds. We also remain concerned that DOD has not yet established an overall plan for selecting and implementing DBOF's systems. An overall plan would help establish the priority these projects deserve, assist in determining the resources that should be included in DOD's budget requests to properly control operating costs and data, and help guide successful implementation of these projects. Moreover, DOD's DFAS is assuming increasing responsibilities for the military services' accounting operations—including those for organizations included in DBOF—and for preparing the services' financial statements. Thus, DFAS will have an increasingly important role in identifying and reporting on operating costs, and ensuring data accuracy.

DOD concurred with our recommendations to ensure that existing accounting and internal control policies are applied rigorously and that steps be taken to correct data inaccuracies in existing systems. But it is critical that DOD work with Army to deal with these problems immediately. In addition, DOD must give priority to improvements in inventory accuracy. DOD stated that it cannot afford to emphasize improvements in inventory

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accuracy at the expense of other equally important areas and that it will strive to address such issues in a balanced, prioritized approach.

# Locations Where Audit Work Was Conducted

During our review, we conducted work at the following locations:

- Office of the Secretary of Defense, Pentagon, Washington, D.C.;
- Army Headquarters, Pentagon, Washington, D.C.;
- Defense Finance and Accounting Service-Indianapolis Center, Indianapolis, Indiana;
- Army Materiel Command Headquarters, Alexandria, Virginia;
- Aviation Systems Command Headquarters, St. Louis, Missouri;
- Missile Command Headquarters, Redstone Arsenal, Alabama;
- Tank-Automotive Command Headquarters, Warren, Michigan;
- Armament, Munitions and Chemical Command Headquarters, Rock Island, Illinois;
- Radford Army Ammunition Plant, Radford, Virginia;
- Indiana Army Ammunition Plant, Charlestown, Indiana;
- Iowa Army Ammunition Plant, Middletown, Iowa;
- Crane Army Ammunition Activity, Crane, Indiana;
- Depot Systems Command Headquarters, Chambersburg, Pennsylvania;
- Corpus Christi Depot, Corpus Christi, Texas;
- Anniston Depot, Anniston, Alabama;
- Tooele Depot, Tooele, Utah;
- Letterkenny Depot, Chambersburg, Pennsylvania;
- Red River Depot, Texarkana, Texas;
- Savanna Depot Activity, Savanna, Illinois;
- Pueblo Depot Activity, Pueblo, Colorado;
- Training and Doctrine Command Headquarters, Ft. Monroe, Virginia;
- Forces Command Headquarters, Atlanta, Georgia;
- Ft. Benning, Georgia;
- Ft. Leavenworth, Kansas;
- Ft. Eustis, Virginia;
- Ft. Irwin, California;
- Ft. Devens, Massachusetts;
- Ft. Sam Houston, Texas;
- Ft. Meade, Maryland;
- Ft. Belvoir, Virginia;
- Ft. Richardson, Alaska;
- Ft. Shafter, Hawaii;
- 5th Army Corps, Frankfurt, Germany;
- Eighth U.S. Army Headquarters, Seoul, Korea;
- 24th Infantry Division, Ft. Stewart, Georgia;
- 101st Airborne Division, Ft. Campbell, Kentucky;
- 1st Cavalry Division, Ft. Hood, Texas;
- Corps of Engineers Headquarters, Washington, D.C.;

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**Appendix I**  
**Locations Where Audit Work Was**  
**Conducted**

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- Corps of Engineers, Ft. Worth District Office; Forth Worth, Texas;
- Corps of Engineers, Tulsa District Office, Tulsa, Oklahoma;
- Corps of Engineers, Vicksburg District Office, Vicksburg, Mississippi;
- Corps of Engineers, Louisville District Office, Louisville, Kentucky;
- Corps of Engineers, Pittsburgh District Office, Pittsburgh, Pennsylvania;
- Corps of Engineers, Buffalo District Office, Buffalo, New York;
- Corps of Engineers, New York District Office, New York, New York;
- Corps of Engineers, Baltimore District Office, Baltimore, Maryland;
- Corps of Engineers, Walla Walla District Office, Walla Walla, Washington;
- Corps of Engineers, Detroit District Office, Detroit, Michigan;
- Corps of Engineers, New England Division, Waltham, Massachusetts;
- Corps' Accounting Systems and Procedures Branch Office, Huntsville Alabama;
- Military Traffic Management Command Headquarters, Falls Church, Virginia;
- Military Ocean Terminal, Bayonne, New Jersey;
- Military Ocean Terminal, Oakland, California;
- Military Ocean Terminal-Sunny Point, Southport, North Carolina;
- System Integration and Management Activity-West, St. Louis, Missouri;
- System Integration and Management Activity-East, Chambersburg, Pennsylvania;
- Army Information Processing Center, Huntsville, Alabama;
- Army Information Processing Center, Chambersburg, Pennsylvania; and
- Army Information Processing Center, Rock Island, Illinois.

# Office of Management and Budget and Army Guidance on Material Weaknesses

Office of Management and Budget Circular A-123 and Office of Management and Budget Memorandum M-88-29 established the materiality criteria for federal agencies to be used in determining whether an internal control weakness is to be reported to the President and the Congress. For a weakness to be material, the Office of Management and Budget guidance provides that the weakness should

- significantly impair the fulfillment of an agency or component's mission;
- deprive the public of needed services;
- violate statutory or regulatory requirements;
- significantly weaken safeguards against waste, loss, unauthorized use, or misappropriation of funds, property, or other assets;
- result in a conflict of interest;
- merit the attention of the agency head or senior management, the Executive Office of the President, or the relevant congressional oversight committee;
- exist in a majority of agency components or in a major program or activity;
- risk or result in the actual loss of either \$10 million or 5 percent of the resources of a budget line item; or
- reflect adversely on the credibility of the agency report when subsequently made public.

Army Regulation 11-2 provides additional guidance in making the decision on whether the absence or the noncompliance of a management control constitutes a material weakness. A principal point in the guidance is that the decision is one that must be based on the manager's professional judgment. The guidance provides that Army managers should consider the following factors: actual or potential loss of resources; sensitivity of the resources involved; magnitude of funds, property, or other resources involved; actual or potential frequency of loss; current or probable media interest (adverse publicity); unreliable information causing unsound management decisions; diminished credibility or reputation of management; impaired fulfillment of an essential mission; violations of statutory or regulatory requirements; information security risk; and public deprivation of needed government services. It also provides that while dollar significance should be considered, it is not necessarily a deciding factor.

# Excerpts From the Department of Defense's Comments

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



COMPTROLLER OF THE DEPARTMENT OF DEFENSE  
WASHINGTON, DC 20301-1100

JUL 29 1992

Honorable Charles A. Bowsher  
Comptroller General of the  
United States  
Washington, DC 20548

Dear Mr. Bowsher:

This is the Department of Defense (DoD) response to General Accounting Office draft report, "FINANCIAL AUDIT: Immediate Actions Needed to Improve Army Financial Operations and Controls," dated June 26, 1992 (GAO Code 917220), OSD Case 8674-L and General Accounting Office revised Chapter 5 of that report dated July 7, 1992. The DoD generally concurs with most of the GAO findings and recommendations.

The Department had only a limited period of time to review this very important report and to present comments on the report. Because of the complex issues involved, in some instances it was not feasible to provide a detailed response within the stringent deadline. Therefore, in a few cases, it has been noted that additional review and consideration by the Department is required prior to taking a position on the applicable recommendation.

As stated in the report, many of the cited deficiencies were known to the Department, and the Department had taken, is taking, or has plans to take remedial action. In such instances, the Department has concurred and addressed applicable DoD actions.

Implementation of necessary improvements will be a long-term, extensive (perhaps massive), and somewhat costly effort. Additionally, corrective actions will require the cooperation of numerous managers outside of the financial management community. Further, many of the areas where the need for improvements in the Army was noted are areas where similar improvements in other DoD Components also will be required. Nevertheless, the GAO's audit has provided an important foundation and baseline for the Department as it continues to implement a wide range of financial management improvement initiatives.

Neither the Executive Summary nor the report as a whole give adequate recognition to the Army role in OPERATION DESERT SHIELD/DESERT STORM as the single most important event for the Army during fiscal year 1991. The Army management achievements in FY 1991 cannot be adequately assessed without recognition of the successful deployment of over 300,000 men and women, and

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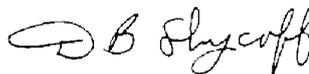
their equipment, to Saudi Arabia and surrounding areas. That effort required significant management accomplishments associated with transportation, feeding, housing, medical, training, personnel, paying, procurements, communications, and other support efforts.

In addition, the Department looks upon this first year of audited financial statements under the Chief Financial Officers Act of 1990 as establishing a baseline from which future performance can be judged. In that regard, it should be noted that the General Services Administration did not receive an unqualified opinion until the fourth year of actively preparing audited financial statements. Other Federal agencies, such as the Department of Labor, Veterans Affairs, and the Social Security Administration, have been preparing audited financial statements since FY 1986 and FY 1987, and still have not received an unqualified opinion.

Further, it is important to recognize that the Department's systems were primarily designed to perform fiduciary functions, exclusive of financial statements. While the systems perform the required fiduciary functions extremely well, the report provides virtually no recognition of that accomplishment. Also, while the Department may not have transaction driven general ledger financial controls over property, it does have various non-financial systems which safeguard such property.

The Department is committed to improving the quality, efficiency, and effectiveness of all DoD financial operations. Detailed DoD comments on the various report findings and recommendations are provided in the enclosure. The Department appreciates the opportunity to review and comment on the draft report.

Sincerely,



Donald B. Shycoff  
Acting Comptroller

Enclosure

See comment 1.

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Excerpts From the Department of Defense's  
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GAO DRAFT REPORT - DATED JUNE 26, 1992  
(GAO CODE 917220) OSD CASE 8674-L

"FINANCIAL AUDIT: IMMEDIATE ACTIONS NEEDED TO IMPROVE ARMY  
FINANCIAL OPERATIONS AND CONTROLS"

DEPARTMENT OF DEFENSE COMMENTS

CHAPTER 1: "THE ARMY'S CHALLENGE: REDUCING FORCES  
AND MAINTAINING MILITARY CAPABILITY"

[Text omitted.]

CHAPTER 2: "FINANCIAL REPORTING IS UNRELIABLE"  
DEPARTMENT OF DEFENSE COMMENTS

- o FINDING A: Reported Financial Information Has Limited Reliability Because Policies Were Not Followed or Were Not Appropriate: Policies and Procedures Not Followed For Reporting Inventories. The GAO explained that, as of September 30, 1991, the Army reported \$17 billion in wholesale and retail level inventories of supplies and spare parts. The GAO found, however, that the Army inventory records and accounts do not accurately portray either the quantities or the values of the reported \$12.5 billion in wholesale inventories. Using a statistically projectable physical inventory of the wholesale item inventories, the GAO concluded that almost 35 percent of the perpetual records differed by 10 percent or more from quantities actually in storage. The GAO explained that it is Army policy to price inventory based on most recent acquisition cost of an item. The GAO observed that each item, regardless of where it is stored or located, should be valued at the same price. The GAO concluded, however, that the policy was not consistently followed, since 7,405 items had more than one price recorded. As a result, the GAO was unable to verify the reported value of the inventory.

The GAO further reported that, at the retail level, an \$18.4 billion adjustment proposed by the GAO for ammunition at installations and an \$0.9 billion adjustment for division level inventories were not recorded. The GAO explained that, according to Army officials, DoD and Army accounting policy provide that material, supplies, and ammunition are to be expensed when issued to operating units. The GAO found, however, that division level inventories and ammunition--which was not yet issued to operating

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Now on pp. 4-5 and 24.

See comment 2.

units--was not recorded in the accounting systems or reported in the Army financial statements. (pp. 8-11, pp. 34-38/GAO Draft Report)

DoD RESPONSE: Nonconcur. The Army has established policies and procedures in Army Regulation 37-60 pertaining to prices of Army items. The price of an item is entered into the Army Master Data File by the Major Subordinate Command designated as the source of supply/item manager. The price in the Army Master Data File is a standard price, i.e., the latest procurement price plus the DoD surcharge. The price recorded in the Army Master Data File is the price the Army uses for supply procedures. If different prices are recorded for the same item, the following may apply (1) a time lag could result from posting the latest acquisition price to the Army Master Data File and, in turn, to the standard and unique or local systems, (2) local or unique systemic problems, and/or (3) the local file containing the data to be forwarded to the Catalog Data Agency for input to the Army Master Data File may have reflected a different effective or "as of" date.

The DoD disagrees that its wholesale inventory records are 35 percent inaccurate. The goal for wholesale physical inventory is that 90 percent of inventories taken do not have a variance of more than \$800 of the extended value of the item (quantity times price). The DoD Inventory Control Effectiveness report, which measures extended value (quantity times price) and only counts items with a variance of more than \$800 as out of balance, shows that Army inventories are 93.5 percent accurate. The GAO keyed on quantity alone, and counted individual items out of balance when it cited 35 percent of wholesale records differed from the amounts on hand.

In Fiscal Year 1991, the Army inventoried approximately 35 percent of the required inventories--while deploying to, and redeploying from, Southwest Asia. In addition to sensitive and controlled inventory items, depots inventoried any item that was requested by an item manager and experienced a materiel release denial. While the Army places critical emphasis on accurate physical inventory accounting measures, its ability to perform 100 percent physical inventories is constrained by limited resources, both manpower and automation. As of March 1992, the Army had transferred 99 percent of its supply depot function to the Defense Logistics Agency, which will perform all future inventories. The Defense Logistics Agency intends to perform more inventories in the future, but it too is not fully funded for physical inventory control operations.

To compensate for funding shortfalls, in June 1992, statistical sampling physical inventory methods were approved by the DoD for ammunition and general supplies, with the exception of controlled inventory items (small arms, radioactive, classified, etc.) and category 1 non-nuclear missiles and rockets. The DoD approved the use of random annual sampling with the following criteria as

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a minimum: property accountability records are 85 percent accurate (95 percent for ammunition) with 95 percent assurance of confidence, and a maximum margin of error of 2 percent. The Army will implement random annual statistical sampling in October 1992. That effort should provide a statistically valid inventory picture using fewer resources.

[Text omitted.]

- o FINDING C: Reported Financial Information Has Limited Reliability Because Policies Were Not Followed or Were Not Appropriate: Policies and Procedures Not Followed For Reporting Contractor-Held Property. The GAO found that the Army does not have systems or records to track or monitor effectively about \$11.3 billion of property owned by the Army, but held by contractors. The GAO noted that, based on adjustments it proposed, the Army statements were changed to reflect those values. Specifically, the GAO found that contractor records showed almost \$7.4 billion of contractor-held--but Government-owned--inventory and equipment, and \$3.9 billion of Government-furnished real property. The GAO found that the assets were not accounted for or reported by the responsible commodity commands. The GAO explained DoD policy requires that, when a Federal agency determines delegating control of assets--like Government-furnished material or equipment--to contractors is a prudent course of action, the agency nonetheless retains a responsibility to establish accountability and to exercise appropriate oversight and control over assets. (pp. 8-11, pp. 39-40/GAO Draft Report)

Now on pp. 7 and 25.

DoD RESPONSE: Partially concur. The Army has accurate records of quantities furnished to contractors. To handle contractor access to Government furnished material, Management Control Activities at all Inventory Control Points have been established. Army wholesale Management Control Activities went on line in November 1991, and the Defense Automatic Addressing System began validating requisitions for existing retail contracts on January 1, 1992. Once a wholesale contract is let, the contractor is assigned a single DoD Activity Address Cost and the authorized National Stock Numbers and maximum number authorized are registered in a control file. The control file covers end items, repair parts, tools and test, etc., for all sources of supply (Defense Logistics Agency, General Services Administration, and Army Inventory Control Points). When the contractor submits a requisition, it is validated prior to submission to the source of supply. The Management Control Activities are used to control and monitor issues to the contractor and establishes a master file that will be used to reconcile the contractor records upon completion/ termination of the contract and provide disposition instructions. The master file is an auditable record used to account for Government furnished material, since the Federal Acquisition Regulation prohibits duplicate accountable records. Under Federal Acquisition Regulation procedures, the Government

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must certify the contractor's accounting procedures as an adequate accountable system, and that becomes the accountable record.

The Federal Acquisition Regulation provides specific guidance on all areas of property accountability and disposal. The DD Form 1662 is the designated record to report all Government property in the hands of contractors. The Under Secretary of Defense for Acquisition gave the Defense Logistics Agency the lead for developing a computerized automated property management system and data base. No later than October 31 each year, contractors are required to report all assets in its possession to the data base. The Army designated the Industrial Engineering Activity at Rock Island, Illinois, as the automated processing point for Army administered contracts. The Industrial Engineering Activity produces an annual report on the 800+ Army contracts for procurement and property administration personnel.

[Text omitted.]

- o FINDING I: Performance Measurement Information Can Be Improved. The GAO observed that the Army FY 1991 reporting under the Chief Financial Officer Act also included the first attempt by the Army to link performance measurement information with financial data reflected in the financial statements. The GAO explained that, under the Act, agency Chief Financial Officers are responsible for developing and maintaining integrated accounting and financial management systems that allow performance measurement. The GAO found that performance measures in the Army financial statements related to peripheral functions and did not provide meaningful and accurate information on Army success in achieving its principal mission. The GAO reported that, for the most part, problems in the Army performance measurement information resulted from (1) not establishing procedures to verify the accuracy of performance measurement data and (2) not assigning accountability for measures preparation and data accuracy. The GAO concluded that, as a result, the measures presented are of little use to managers, the public, or the Congress.

The GAO noted that Office of Management and Budget guidelines on developing performance measures for financial statements provide that the measures should (1) present significant results achieved by programs and compare those results to the entity's mission, (2) include data showing the extent to which the program's missions, goals, and objectives were achieved, and (3) represent program goods and services that most reflect legislative intent and that recipients, managers, and the public value.

While recognizing the information included in the FY 1991 Army financial statements represented the first attempt to assemble such information, the GAO nonetheless concluded that the Army performance measures presented were not useful in assessing Army

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military capability, because the measures were not always related to the Army principal mission. The GAO noted that the measures covered a variety of activities collateral to the Army principal mission--such as (1) debt management, (2) civil works programs, and (3) foreign military sales. In summary, the GAO concluded that the measures also did not provide complete information about the activity being measured or demonstrate whether program goals or objectives were being achieved.

The GAO also noted that Army officials recognized that the performance measures presented in the Army FY 1991 financial statements were not relevant to the Army principal mission. The GAO reported that, according to responsible Army officials, the performance measurements data included in the Army FY 1991 financial statements reflected data that was readily available and supportable.

The GAO maintained performance measures could be greatly enhanced by developing a framework that defines the overall Army mission and the missions of the subordinate commands performed in support of that overall mission. According to the GAO, the Army could develop performance measures that would address how well those missions are being performed. The GAO reported that Army performance measurement financial information was presented in terms of obligations rather than costs, and that the obligation data included in reported performance measurement information was not complete because the Army accounting systems are unable to allocate all relevant obligations to the program being measured. (pp. 8-11, pp. 53-56/GAO Draft Report)

Now on pp. 33-34.

DoD RESPONSE: Nonconcur. The first Army effort at financial statements under the requirements of the new Chief Financial Officer's Act did not attempt to develop financial performance measures to assess Army military capability. Army performance measures that assess military capability have existed--these are not financial in nature, and should not be. The Army performance during OPERATIONS DESERT SHIELD/DESERT STORM is testimony to the effectiveness of existing "military" performance measures.

See comment 2.

[Text omitted.]

- o RECOMMENDATION 1. The GAO recommended the Secretary of Defense direct that the Defense accounting policy be revised to require all retail level inventories be recorded as assets--including ammunition held at installations and spare parts and supplies held at the division level. (pp. 58-59/GAO Draft Report)

Now on p. 36.

DoD RESPONSE: The Department is currently reviewing the recommendation and will respond in detail at a later date.

See comment 2.

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Now on p. 36.

See comment 2.

- o RECOMMENDATION 2. The GAO recommended the Secretary of Defense direct that the Defense accounting policy be revised to require cash held by disbursing officers be recorded as an asset with a corresponding liability. (pp. 58-59/GAO Draft Report)

DoD RESPONSE: Partially concur. Current DoD policies require that Department of the Treasury cash held by disbursing officers as personal risk be recorded in the general ledger as an asset entitled, "Disbursing Officers Cash," with an offsetting liability to "Treasury Cash Advances to Disbursing Officers." "Treasury Cash Advances to Disbursing Officers" represents the amount of disbursing officers' personal liability for cash advanced by the Department of the Treasury.

Although recorded in the DoD general ledger, such amounts have not been required to be reported in DoD financial statements. Reporting such amounts in both the DoD and the Treasury financial statements could result in duplicate reporting of such funds. The reporting of Treasury cash held by disbursing officers must be reported on a consistent basis Government-wide. The DoD will coordinate with the Department of the Treasury regarding the reporting of Disbursing Officers Cash on DoD financial statements as an asset with the appropriate offsetting liability. It is anticipated that such reporting could be implemented for FY 1992 financial statements.

[Text omitted.]

Now on p. 36.

See comment 2.

- o RECOMMENDATION 5. The GAO recommended that the Secretary of the Army improve the accuracy and reliability of financial data and reporting by ensuring commands have accurate records of the quantities and values of property held by contractors. (pp. 58-59/GAO Draft Report)

DoD RESPONSE: Partially concur. In fiscal year 1985, the Army identified the physical control of Government furnished material and contractor access to wholesale systems as a material weakness. The Army is a member of the Assistant Deputy Secretary of Defense (Logistics) on-going process action team, which is standardizing the control of contractor access to Government owned property throughout the Department. The integration of custodial and financial accountability will be accomplished in conjunction with the Financial Corporate Information Management initiatives.

[Text omitted.]

- o RECOMMENDATION 16. The GAO recommended that the Secretary of the Army (1) approve a plan for improvement and demonstrate sufficient commitment and involvement so all concerned Army

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Now on p. 37.

See comment 2.

functions and activities understand the priorities for improvement, and (2) direct the special action group to report quarterly to him on progress made in achieving the milestones set in the improvement plan.  
(p. 60/GAO Draft Report)

DoD RESPONSE: Partially Concur. The Secretary of the Army has clearly demonstrated his commitment and involvement on the issues. The establishment of the special action group in May, and the senior level steering group headed by the Assistant Secretary (Financial Management) in June, already clearly established the involvement and priority of the Secretary of the Army. Establishment of the improvement plan and achievement of milestones will be accomplished under the auspices of the senior level steering group and special action group. The Secretary of the Army will be kept informed on a continuing and frequent basis.

CHAPTER 3: "CONTROLS AND ACCOUNTABILITY OVER BILLIONS  
IN ASSETS NEED SUBSTANTIAL IMPROVEMENT"

[Text omitted.]

- o FINDING B: Inventory Systems Do Not Provide Accurate Data: Wholesale Inventory Records Are Inaccurate. The GAO reported that, as of the end of FY 1991, the Army wholesale spare part inventory had an estimated 356,500 types of items valued at \$12.5 billion. According to the GAO, although the Army reported that the inventory as of the end of FY 1991 was 93.5 percent accurate, a statistically based physical inventory conducted by the Army showed that about 35 percent of the wholesale records differed from the amounts on hand by 10 percent or more. The GAO found that the Army statistical physical inventory of balances, as of FY 1991, showed significant differences between the accountable records and actual inventory quantities on hand. The GAO noted that, of the 278 items on the accountable records, 99 were overstated, 93 were understated, and 86 were correct. The GAO noted, however, that the 93.5 percent accuracy was reported on the Army Inventory Control Evaluation report. The GAO concluded that, as a result, top managers are not receiving information that clearly depicts the severity of problems with inventory record inaccuracy.

The GAO concluded that inaccuracies in accountable records adversely affect the ability of the Army to identify excesses or shortages and to detect losses or theft. The GAO further concluded that, when accountable records show inventory quantities less than inventory quantities actually on hand, items in storage are vulnerable to undetected loss or theft and/or may trigger unneeded procurements. The GAO noted that when

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accountable records show more inventory than is actually on hand, items may have been lost or stolen. In addition, the GAO observed that the information in the accountable records may portray an inaccurate picture of the amount of wholesale level inventories available to support repairs needed for mission essential equipment.

The GAO concluded that the lack of controls over Army wholesale level inventories occurred primarily as a result of (1) weaknesses in management oversight over the acquisition, use, retention, and disposal of wholesale inventory, (2) the ineffective integration of financial and inventory records, and (3) the absence of regular physical inventories and the lack of reconciliations of inventory results with accountable records. (pp. 11-13, pp. 64-67/GAO Draft Report)

DoD RESPONSE: Nonconcur. The DoD disagrees that its wholesale inventory records are 35 percent inaccurate. The goal for wholesale physical inventory is that 90 percent of the inventories taken do not have a variance of more than \$800 of the extended value (quantity times price) of the item. The DoD Inventory Control Effectiveness report, which measures extended value (quantity times price) and only counts items with a variance of more than \$800 as out of balance, shows that the Army's inventories are 93.5 percent accurate. The GAO keyed on quantity alone and counted individual items out of balance when it cited 35 percent of wholesale records differed from the amounts on hand.

In Fiscal Year 1991, the Army inventoried approximately 35 percent of the required inventories, while deploying to, and redeploying from, Southwest Asia. In addition to sensitive and controlled inventory items, depots inventoried any item that was requested by an item manager and experienced a material release denial. While the Army places critical emphasis on accurate physical inventory accounting measures, it believes that 100 percent physical inventories is an unwise use of its limited resources, both manpower and automation. As of March 1992, the Army had transferred 99 percent of its supply depot function to the Defense Logistics Agency, which will perform all future inventories. The Defense Logistics Agency has indicated that it intends to perform more inventories in the future, but it also believes that 100 percent physical inventories is not a wise use of its limited resources.

In June 1992, statistical sampling physical inventory methods were approved by the DoD for use for ammunition and general supplies with the exception of controlled inventory items (small arms, radioactive, classified, etc.) and category 1 non-nuclear missiles and rockets. The DoD approved the use of random annual sampling with the following criteria as a minimum: property accountability records are 85 percent accurate (95 percent for ammunition) with 95 percent assurance of confidence, and a maximum margin of error of 2 percent. The Army will implement

Now on pp. 7-8 and  
41-43.

See comment 3.

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random annual statistical sampling in October 1992. That effort should provide a statistically valid inventory picture with fewer resources.

[Text omitted.]

- o FINDING D: Inventory Systems Do Not Provide Accurate Data: Conventional Ammunition Inventory Control Weaknesses. According to the GAO, the Ammunition Command attempts to manage sensitive and marketable inventories with logistical and financial records maintained in the Commodity Command Standard System. The GAO pointed out that the Ammunition Command controls ammunition production through the Conventional Ammunition Working Capital Fund--a revolving fund. The GAO explained that the Command uses logistics records to control the requisition, receipt, storage, sale, and disposal of inventory--and to generate financial records and reports, with the ammunition plants maintaining the custodial records for the inventory.

The GAO found that the Ammunition Command did not maintain logistical records for the estimated \$760 million of components in work-in-process and in-transit. The GAO concluded that, without logistical records to control the movement of ammunition components at Government-owned plants, the Ammunition Command could not ensure (1) the raw material inventories in the production process are maintained within prescribed levels and (2) that lost or stolen Government material would be detected. The GAO reported that, even when logistical records were maintained, the Ammunition Command did not or could not perform the required reconciliations between logistical records and custodial records; in addition, few of the required physical inventories were conducted. The GAO concluded, therefore, that the Armament, Munitions, and Chemical Command cannot reliably track or control the movement of an estimated \$3.6 billion of raw materials, work-in-process, and in-transit inventories. (pp. 11-13, pp. 70-71/GAO Draft Report)

DoD RESPONSE: Partially concur. The Federal Acquisition Regulation states that there will only be one accountable officer, and that is the contractor. Accordingly, the DoD pays contractors operating its plants to maintain the official DoD accountability records for those inventories. The DoD does not establish formal accountability records for inventories and property in the hands of contractors. To require such records would duplicate effort already undertaken by the contractors.

The Army Armament, Munitions and Chemical Command uses the Commodity Command Standard System to account for component inventories, supplemented by contractor custodial and work-in-process records. It is a multi-process system that tracks the components until they are assembled into, or used to repair end items. As production is completed, the end item is accepted by

Now on pp. 44 and 45.

See comment 3.

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the Government into the Commodity Command Standard System (as end item stocks versus components) and the balance of components that are residual are returned to the component inventory. The system requires that the Army Armament, Munitions and Chemical Command accountability officials and on-site staff to work system "rejects" to correct variances between the Commodity Command Standard System records and the actual material on hand at the assembly plant. Validating the inventory is a continuous process

The checks and balances currently in place within the Commodity Command Standard System are adequate to track work-in-process but the Department agrees that several measures need to be taken to assure more accurate management. On May 1, 1992, the Army Armament, Munitions and Chemical Command initiated the work-in-process/ Consumption Report and is in the process of determining a balanced baseline for the inventory in the production process at Army Ammunition Plants. The Army is installing the Standard Depot System at the Army Ammunition Plants. Lake City Army Ammunition Plant went on-line in November 1991. The Milan Army Ammunition Plant is scheduled for the first quarter in 1993; the Holston Army Ammunition Plant for January 1993; and the remaining three Army Ammunition Plants in FY 1993. The Standard Depot System will provide a standard means for all Government-owned, contractor-operated plants to conduct business. The Standard Depot System will enhance the Army Armament, Munitions and Chemical Command ability to research and spot errors generated by the Government-owned, contractor-operated plants in reporting.

While the Army Armament, Munitions and Chemical Command has a control system (as described), it is nonetheless recognized there are opportunities for error that could cause the accountable record to vary from the quantity on hand. The DoD does not agree, however that such errors result in an absence of Army Armament, Munitions and Chemical Command controls over the movement of ammunition components. Conventional ammunition and components are received and stored in secure sites subject to rigid security so theft, covered by accountability errors, is highly unlikely. The Army Armament, Munitions and Chemical Command is aggressively pursuing immediate, mid and long-term solutions to discipline the current system at all points in the process described.

[Text omitted.]

- o FINDING I: Inadequate Storage of Repairables At Selected Army Depots. The GAO concluded that unsecured and unprotected storage of inventories awaiting repair, as well as the lax security over depot warehouses at the selected Army depots and activities it visited, resulted in (1) an increased equipment scrappage rates, (2) an increased maintenance costs, and (3) an increased risk of losses due to thefts. The GAO found that inventory items awaiting repair and overhaul at depots were piled outdoors with

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no packaging or other protection from the elements. The GAO noted that the unprotected items were extensively rusted and otherwise deteriorated. The GAO reported that depot officials agreed the cited practice contributed to the 70 percent scrappage rate for one depot maintenance program, which had included about 300 engines valued at about \$5,779 each that were scrapped because of internal and external cracks and pitted cylinders resulting from exposure to the elements. The GAO also found several sensitive optical devices on M102 howitzers, valued at more than \$340 each, that were stored in cases filled with stagnant rainwater.

In July 1991, the GAO reported small arms parts, which could be used in civilian weapons, were susceptible to theft as a result of a combination of poor inventory controls, poor physical security, and inadequate oversight (OSD Case 8705). The GAO concluded that weak physical safeguards over equipment and supply inventories increase the risk of unauthorized removal and unnecessary deterioration of assets. The GAO noted that prior audit reports also have cited weak controls over physical security, resource accountability, and receiving practices as factors facilitating theft at depots (OSD Case 8630).

The GAO reported that the Army depots it visited showed DoD and Army shipment, storage, and security requirements were not always followed, and that inadequate depot storage practices precluded taking an accurate physical inventories needed to determine the extent of thefts. (pp. 11-13, pp. 80-81/GAO Draft Report)

DoD RESPONSE: Nonconcur. The DoD logistics policy prescribes two primary programs to protect assets from deterioration--(1) the Care of Supplies in Storage program and (2) the Shelf-Life Item Management Program. Both programs have quality control and internal control standards to ensure that items are maintained in a ready-for-issue condition.

With regard to protecting assets from theft, Chapter 8 of DoD 5200.8-R, "Physical Security Program," requires the installation commander to establish protective measures based on comparative incident rates and prescribed policy-- i.e., trend analysis-- pertaining to different types of material.

Oversight on physical security in those areas--i.e., protection of Army property, has been conducted and continues to be conducted by the Army Material Command Security Support Activity which, on a 24 month cycle, reviews local installation security programs for protection of army property; law enforcement programs; arms, ammunition and explosives; crime prevention; etc. Reported deficient conditions require corrective actions. Waivers/exceptions have been granted in areas that have identified substandard structures or substandard conditions, such as inadequate structures that require funding for repairs and must be delayed until appropriate funding can be obtained. In all cases, compensatory measures are addressed.

Now on pp. 49 and 50.

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Additionally, effective August 1, 1991, the Army Material Command revised Army Regulation 190-13, "Army Physical Security Program," to reduce theft and other security deficiencies. The Army Material Command has supplemented both Army Regulation 190-13 and Army Regulation 190-11, "Army Physical Security of Arms, Ammunition, and Explosives." Both these supplements were updated and reissued in August 1990. The Army Material Command continues to follow security requirements addressed within Army Regulations 710-2, 190-11, 190-13, 190-51 and all Army Material Command supplementations, as applicable to security of Army property.

The Army Material Command continues to emphasize the proactive crime deterrent program. Established crime prevention programs are being continued throughout the command and allow for the expansion and tailoring of the program at the installation levels, as deemed appropriate by local commanders. The U.S. Army Criminal Investigation Command continues to conduct crime prevention surveys at Army Material Command sites upon request. The U.S. Army Criminal Investigation Command has not notified the Army Material Command of any crime conducive conditions requiring modification or expansion of existing security programs. However, the Army Material Command is aware of the vulnerability that exists for theft of property.

The Army Material Command is also actively pursuing the Mobile Detection Assessment Response System which is a state-of-the-art robotics system that will be used within depot warehouse and like facilities to safeguard against theft of Government property and criminal activities. The Army Material Command is working closely with the Defense Logistics Agency with regard to the use of the Mobile Detection Assessment Response System at depots. Estimated fielding of the Mobile Detection Assessment Response System is in FY 1996.

Losses and theft of Army property are reported to the Department of the Army under Army Regulation 190-11, Army Regulation 190-40, "Serious Incident Reports," and Army Regulation 190-45, "Law Enforcement Reporting."

Additionally, similar subjects have been previously addressed in the GAO Audits identified below:

- "The Army Could Do More to Detect and Deter Small Arms Parts Thefts," March 1991,
- "Strengthened Controls Needed to Detect and Deter Small Parts Thefts," July 1991, and
- "Theft in the DoD," November 1991,

The situation involving outside storage of depot level reparable occurred at Tooele Army Depot. The items were eight cylinder, 6.2 liter diesel engines that were not originally intended to be

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overhauled. Internal and external cracks occurred during use, not because of outside storage. The engines were received at Tooele Army Depot in a disassembled and deteriorated condition, unprotected and strapped to pallets. Many had excessive corrosion when received and had been stripped of components, which allowed rain and moisture into the engines. As a result of the condition of the engines, over 300 engines were classified as uneconomically repairable and scrapped.

The situation involving optical devices for M102 Howitzers occurred at Letterkenny Army Depot. The optical devices are in a suitcase attached to the howitzer. The howitzers are returned from the field in an unserviceable condition and are stored outside until selected for repair. The physical condition in which they are received varies; in some instances the cases are cracked or the latches broken and moisture gets into the case. As part of the overhaul process, the devices are sent for repair. Since the optical device is a component of an end item for the howitzer, it would take a disassembly order to remove them prior to repairing the howitzer. The case is designed for outdoor storage during normal usage. There is no room to store howitzers indoors.

[Text omitted.]

GENERAL

Concerning the oversight group cited in recommendations 2 through 6--the Special Action Group is not the appropriate oversight group to monitor the implementation of financial and logistics improvements. The Army has oversight groups aligned with management commands and the Auditor General is assigned the oversight mission.

CHAPTER 4: "ARMY SYSTEMS OF INTERNAL CONTROL CANNOT  
BE FULLY RELIED UPON"

[Text omitted.]

- o FINDING C: Material Internal Control Weaknesses Not Reported By Army. The GAO reported that, as required, the Secretary of Defense issued the DoD FY 1991 assurance statement and reported that the DoD systems of internal controls, taken as a whole, met the objectives for internal control systems established in the Act. During its review, the GAO identified a number of additional material weaknesses that were not reported by the Army in the annual statement of assurance and, consequently, were not included in the DoD FY 1991 annual statement of assurance. The

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GAO asserted that the additional weaknesses it identified met the materiality criteria because the weaknesses (1) significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets or (2) did not ensure that revenues and expenditures were properly accounted for and recorded to permit the preparation of accounts and reliable financial and statistical reports. The GAO noted that some of the weaknesses were discussed in previous chapters and are mentioned in the GAO opinion on the Army's financial statements (OSD Case 8674-M).

The GAO found that, in the 1991 assessment of Army-wide management controls, the Army Audit Agency also reported 46 audits performed during FY 1991 evaluated a total of 792 key internal controls and determined that 265 controls (or 33 percent) were not in place or were not operating effectively. The GAO concluded that the Army systems of internal controls do not provide reasonable assurance that its resources are safeguarded consistent with the objectives of the Federal Managers' Financial Integrity Act. (p. 14, pp. 92-94/GAO Draft Report)

Now on pp. 8 and 58-59.

DoD RESPONSE: Nonconcur. The Army is fully aware of the problems cited by the GAO, and is committed to resolving them. The omission of the problems in the Army fiscal year 1991 annual statement of assurance reflects, in large part, a difference of opinion on the relative materiality. The final determination to categorize an internal management control deficiency as a material weakness results from a management judgment about the relative impact of the weakness. With respect to the Army Audit Agency's 1991 assessment of Army-wide management controls, the Auditor General indicated that the percentage of controls not in place and operating was a problem requiring additional management attention. The problem is one of the primary reasons behind the current initiative to improve Army leadership education by incorporating internal control instruction into key leadership schools. With respect to the related GAO conclusion that the Army systems of internal controls do not provide reasonable assurance that its resources are safeguarded, it should be noted that the Auditor General reached a different conclusion, indicating that the areas needing additional management attention did not materially affect the Secretary of the Army's annual assurance statement.

See comment 4.

[Text omitted.]

- o FINDING E: Procedures For Assessing Control Systems Are Not Effectively Implemented. The GAO reported that, although the Army has established a good framework for assessing the adequacy of internal controls--(1) the procedures set forth in that framework were not being effectively implemented at the various major commands and activities and (2) only a relatively small

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number of weaknesses were identified using the cited procedures. The GAO noted that, over the past several years, the Army Audit Agency also had identified significant deficiencies in the internal control identification process. Specifically, the GAO found a variety of implementation problems, which included the following:

- internal control checklists were not always developed or the checklists provided to managers in some cases were not relevant to the activities being assessed;
- managers were not providing required supporting information with checklist results; and
- material internal control weaknesses identified were not always reported to higher commands.

The GAO found that the reasons for not reporting problems varied from command to command but, at most installations, specific reasons were not provided beyond differences in judgments--while, in a few cases, officials cited concerns such as the absence of higher-level commitment and responsible managers' desire to avoid admissions of weakness for fear of potential adverse reactions.

The GAO observed the Army 1990 annual report to the Secretary of Defense stated that continued intensified efforts were needed to instill in management the benefits derived through the self-reporting of weaknesses. The GAO further observed the Army annual report also stated that the relatively small number of weaknesses reported indicated a potential lack of full disclosure problem exists, especially considering the size and magnitude of both the Army mission and the continued findings reported by auditors and the Inspector General in the same or similar areas. The GAO pointed out that, while it is appropriate to use outside sources to identify weaknesses, a primary feature of the program is self-identification and reporting of weaknesses by the program managers. The GAO found, however, that most of the material weaknesses the Army reported were identified by outside sources, such as the GAO and the Army Audit Agency. (p. 14, pp. 99-104/GAO Draft Report)

Now on pp. 8 and 61-65.

Now on p. 62.

See comment 5.

Now on p. 63.

DoD RESPONSE: Nonconcur. The GAO states (on pages 100-101 of the draft report) that, at the Army Materiel Command, only two of 27 reported material weaknesses were a result of completing checklists. While true, the statement is nevertheless incomplete and misleading. Of the 27 material weaknesses, 17 (59 percent) were originated by management using all means at their disposal, not just checklists. On page 104 of the draft report, the GAO states that "For fiscal year 1991, the Army Audit Agency reported that it found the lack of testing and documentation in 51 of its 154 audits of Army's completed checklists." The numbers referred to relate to fiscal year 1990 audits. The Army Audit Agency reviewed the internal management control program in 123 FY 1991

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audits and found deficiencies with checklist testing or documentation in only 18.

See comment 4.

In addition, the GAO cited an Army Audit Agency report identifying five Corps of Engineers civil works functional areas that lacked internal control checklists. The GAO also stated that little priority has been placed on developing Corps-specific checklists. The Army has, in fact, recently developed ten new internal control checklists for civil works functional areas, to include those areas identified in the Army Audit Agency report. The checklists are included in Department of the Army Circular 11-92-1, which will be published and distributed in August 3, 1992.

The GAO also found that, in some cases, the checklists provided to managers were not relevant to the activities being assessed. It should be noted that checklists developed for Army-wide use are inherently generic in content, and all test questions include "not applicable" as one possible response. Internal control checklists are intended to be used by local managers to the extent that they are applicable to their operations.

[Text omitted.]

- o FINDING G: Procedures For Assessing Control Systems Are Not Effectively Implemented: Accountability For Program Effectiveness Is Fragmented. The GAO noted that the Assistant Secretary for Financial Management is responsible for the program implementation of the Federal Managers' Financial Integrity Act in the Army. The GAO further noted that, under 10 U.S.C. 3022, the Assistant Secretary for Financial Management also is responsible for directing and managing financial management activities and operations of the Army to include approving the establishment and supervising the operation of any asset management system, such as property and inventory accounting systems. The GAO noted, however, that operational managers have responsibility for running the day-to-day operations, and the Assistant Secretary for Financial Management has not been given the authority to direct operational managers to allocate the resources needed to develop and maintain an effective internal control system. The GAO concluded that, as a result, accountability for ensuring an overall system of effective controls is split. The GAO further concluded that, because day-to-day operation of the various systems are under the control of commanders other than the Assistant Secretary for Financial Management, corrective actions regarding noncompliance with accounting regulations will be difficult to enforce without strong cooperation from the respective commands. (p. 14, pp. 105-106/GAO Draft Report)

Now on pp. 64-65.

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See comment 4.

DoD RESPONSE: Nonconcur. The Assistant Secretary of the Army (Financial Management), as a member of the staff of the Secretary of the Army, is responsible for the implementation and administration of the Army Internal Management Control Program. Other Headquarters Department of the Army senior functional officials, as members of the Secretariat or Army Staff, are responsible for conducting risk assessments in their areas of responsibility and for developing internal control checklist that reflect the minimum controls needed to provide reasonable assurance. The GAO is correct in noting that the Assistant Secretary of the Army (Financial Management) does not have the authority to direct operational managers to allocate the resources needed to develop and maintain effective internal control systems. The Army Internal Management Control Program is not predicated on giving such total resource allocation authority to the Assistant Secretary of the Army (Financial Management). It does not mean, however, that accountability for ensuring the overall effectiveness of internal controls is split. The Secretary of the Army, through the Chief of Staff, Army, and the Commanders of the major Army commands, has the authority to direct any allocation of resources deemed necessary to ensure effective internal control systems. In that respect, accountability for ensuring an overall system of effective controls is maintained, is not split.

[Text omitted.]

Now on p. 66.

- o RECOMMENDATION 1. The GAO recommended that the Secretary of the Army (1) give operational managers responsibility for ensuring effective internal controls, and (2) make the special action group responsible for overseeing that internal control system weaknesses are identified and corrected. (p. 109/GAO Draft Report)

See comment 4.

DoD RESPONSE: Partially concur. Under the policy directive for the Army Internal Management Control Program (Army Regulations 11-2, "Internal Management Controls"), operational managers are held responsible for ensuring effective internal controls in their functional areas. To reinforce existing policy in September 1992, a Secretary of the Army memorandum will be issued to all Headquarters Department of the Army principal officials and to all Commanders of major Army commands, to restate and emphasize their responsibility, and that of their subordinate operating managers, for ensuring effective internal controls are in place and working as intended. Oversight of all corrective actions will not be performed by the Special Action group, but by already established oversight groups already assigned such responsibility as an integral part of their normal mission.

[Text omitted.]

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Now on p. 66.

See comment 4.

- o RECOMMENDATION 3. The GAO recommended the Secretary of the Army advise the Secretary of Defense that the objectives of the Federal Managers' Financial Integrity Act are not being met. (p. 109/GAO Draft Report)

DoD RESPONSE: Nonconcur. The Army has fully implemented the Federal Managers' Financial Integrity Act and that the objectives of the Act are being met. The Army has developed a process for centrally conducting risk assessments and has established an extensive system of internal control review checklists to help managers assess the effectiveness of internal controls. Emphasis has been placed on training Army managers by addressing internal controls in all major Army leadership schools. The Army does have reasonable assurance in the areas of program and budget reporting. The funds distribution and allocation process is sound and subject to controls at each stage of the process. Funds are certified at every level of distribution and obligation. Obligation reports are consolidated and certified during the budget execution phase. Controls are in place to ensure that funds are not overobligated nor overexpended. The Defense Finance and Accounting Service submits consolidated Army reports and certifies that reports are properly consolidated. Reports are submitted to the Treasury in accordance with 31 U.S.C. 1501. The Chief Financial Officer's Act of 1990 requires consolidated agency-wide financial statements. Required actions are being identified to produce reliable financial statements and proper internal controls are being worked to achieve that new requirement.

The Army identified over 450 specific subtasks performed in the course of the Army missions. It developed a process for centrally conducting the risk assessments for the subtasks and established an extensive system of internal control review checklists that help managers assess the effectiveness of internal controls. In addition, considerable emphasis has been placed on the training of Army managers, to include the current initiative to address internal controls in all of the Army major leadership schools.

Army management has reported weaknesses that have been determined to be material. Since the passage of the Federal Managers' Financial Integrity Act and the implementation of the Army Internal Management Control Program, Army managers have reported 922 material weaknesses to the Secretary of the Army. After review by Army senior functional managers to consolidate, and to add and delete weaknesses, 188 material weaknesses have been reported by the Secretary of the Army to the Secretary of Defense. In fact, it was the Army reporting of a material weakness on "Financial Accountability of Property" that brought the problem to the attention of the Office of Management and Budget and resulted in the establishment of the new High Risk Area-- Accounting for Real and Personal Property.

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CHAPTER 5: "FINANCIAL MANAGEMENT IMPROVEMENTS REQUIRE  
IMMEDIATE JOINT ARMY AND DOD ACTIONS"

- o FINDING A: Organizational Responsibility For Financial Data: Army Assistant Secretary For Financial Management Did Not Have Assurance That Reported Financial Information Was Accurate. The GAO observed that, in 1988, the Assistant Secretary of the Army (Financial Management) was given responsibility for overall Army financial reporting. The GAO asserted, by representing to the DoD Chief Financial Officer that the Army FY 1991 financial statements fairly and accurately presented the Army financial condition and operating results, the Army Assistant Secretary (Financial Management) assumed overall responsibility for the accuracy of the statements. The GAO concluded, however, that the subordinate-level certification process used to provide financial statement information to the Assistant Secretary did not provide adequate assurance that the data in the Army financial statements was accurate.

The GAO explained that the Army used a network of accounting and finance operations at about 280 fiscal stations, as well as an estimated 220 finance and accounting offices at depots, posts, camps, installations, and engineering districts, for the initial recording of the financial transactions applicable to operations in FY 1991. The GAO explained that the data was (1) summarized by 21 accounts offices at the Army major commands, (3) processed at the six Army data processing centers, and (4) transmitted to the Defense Finance and Accounting Service for inclusion in the Army financial statements. The GAO reported that each of the reporting entities was required to review and certify to the Defense Finance and Accounting Service that the financial data reported were accurate.

The GAO further reported that, in addition to the information provided by the finance and accounting network, the Defense Finance and Accounting Service also used data from Army components operating programmatic systems--such as logistics systems--as the initial source for certain information included in its financial reports. The GAO referenced the example discussed in chapter 2--that Army non-financial accounting components reported an estimated \$78 billion of tactical military equipment and \$11.3 billion of Government-owned property in the hands of contractors, but were not required to review and certify the accuracy of the financial data reported. (pp. 15-16, pp. 112-114/GAO Draft Report)

DoD RESPONSE: Partially concur. The Department recognizes that much of the information used in the Army's financial statements, especially information regarding real and personal property, came from sources outside the financial community. Before the establishment of the Defense Finance and Accounting Service, Departmental management knew that the Military Service and Defense Agency accounting and finance offices were making

Now on pp. 8-9 and  
69-70.

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thousands of adjustments to record billions of dollars for property, inventory, and other balances from non-integrated systems. The number of adjustments cited in the report only serve to highlight the problem being addressed, not only in the Army, but DoD-wide. However, that does not mean the information in the non-financial systems is inaccurate, or that non-financial systems cannot provide reasonable assurances the reported information is accurate. For example, while the Department may not have transaction-driven general ledger financial controls over property, it does have various non-financial systems that safeguard such property. Further, it is important to recognize that the Department's systems were primarily designed to perform fiduciary functions exclusive of financial statements. Those systems perform the required fiduciary functions extremely well.

- o FINDING B: Organizational Responsibility For Financial Data: Need To Clearly Define Defense Finance And Accounting Service Roles And Accountabilities. According to the GAO, in reporting on the Army financial statements for FY 1991 to the Assistant Secretary of the Army (Financial Management, the Director, Defense Finance and Accounting Service, stated that "... the attached FY 1991 financial statements are supported by reports and other data provided by Army components. These Department of the Army financial statements are a correct consolidation of such reports and other data reported to the Defense Finance and Accounting Service."

The GAO observed that, according to senior DoD officials, the Defense Finance and Accounting Service is intended to operate like a service bureau--processing financial data provided by the Army and the other Military Services. The GAO further observed that, typically, a service bureau only processes data and takes no responsibility for the data accuracy (other than for the processing function). While the customer accounting organization would normally make any needed adjustments to the data received from the service bureau, and would take full responsibility for the accuracy of information reported in the financial statements.

The GAO explained that, as a service bureau, the Defense Finance and Accounting Service would be responsible and accountable only for accurately processing and consolidating the data it receives. The GAO concluded that the Military Services--not the DoD--would remain responsible and accountable for the statements, including any adjustments needed to assure their accuracy and fair presentation. The GAO concluded, however, that the Defense Finance and Accounting Service has a far greater role and is, in fact, assuming overall accounting responsibility for the Army and the other Military Services. The GAO found that, in preparing the Army FY 1991 financial statements, the Defense Finance and Accounting Service made over 12,000 adjustments (totaling about \$250 billion) to data received from Army components. The GAO further conclude, however, that the Defense Finance and

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Accounting Service generally did not have adequate documentation or evidence of supervisory approval from the Army to support the specific adjustments.

The GAO reported that, on April 6, 1992, the Defense Finance and Accounting Service issued the Strategic Plan showing the concept of future DoD accounting and finance operations, which states that "DFAS assumes full management responsibility for the finance and accounting functions of the DOD components." The GAO noted that the strategic plan further provides that the Defense Finance and Accounting Service is responsible for:

- developing and implementing finance and accounting policy throughout the DoD;
- selecting interim finance and accounting systems for use throughout the DoD; and
- consolidating into the Defense Finance and Accounting Service the finance and accounting functions previously performed by the DOD components, including the Military Services.

The GAO explained that the primary role of the Defense Finance and Accounting Service was further defined in a May 18, 1992 memorandum documenting agreements reached on responsibilities of the Service by the DoD Comptroller, the top financial management officials of the Military Services, and the Director, Defense Finance and Accounting Service. The GAO provided the following quote from the memorandum, which stated:

"As of this date, DFAS is the accounting firm for DOD. DFAS will assume responsibility and ownership for all accounting systems and accounting processes in DOD. In addition, except as noted, DFAS will perform accounting for all General Funds; DBOF Revolving and Industrial Funds; Trust Funds; Accounts Payable; Billings; Accounts Receivable; Debt Management; Cash Accounting; etc. The goal is to centralize these functions over a period of years. However, in the interim, DFAS will capitalize these functions in place, which will require a DFAS presence at the base/ field/intermediate level until consolidation is effected."

The GAO observed that subsequent to the completion of the audit work, DoD officials planned to issue a report (due by July 15, 1992) documenting the final plans for transferring most of the existing Army accounting activities into the Defense Finance and Accounting Service. (pp. 15-16, pp. 114-116/GAO Draft Report)

**DoD RESPONSE:** Partially concur. The Office of the Comptroller, DoD, is responsible for developing and promulgating financial management policy, including accounting policy. The Defense Finance and Accounting Service, and the DoD Components, are responsible for implementing such policies. While the Defense Finance and Accounting Service does recommend interim standard

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71-72.

See comment 6.

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DoD-wide finance and accounting systems, the selection of such systems is made by a Financial Management Steering Committee headed by the DoD Comptroller/Chief Financial Officer. Each of the Military Departments, the Defense Logistics Agency, the Washington Headquarters Services, and the Defense Finance and Accounting Service are also represented on the Committee. Additionally, while the Defense Finance and Accounting Service is charged with consolidating certain finance and accounting functions into the Defense Finance and Accounting Service, it will not assume responsibility for performing all accounting and finance functions currently performed by the DoD Components. Further, it is important to note that the DoD Components, rather than the Defense Finance and Accounting Service, are responsible for the accuracy of information they initially input into financial systems.

[Text omitted.]

- o **FINDING D: Efforts To Improve Systems.** The GAO reported the Army acknowledged that inadequacies in the financial systems are one of the causes of the low reliability of Army financial data, and has begun a number of initiatives to improve its systems. The GAO observed, however, that as a result of a recommendation from the Presidentially directed Defense Management Review, responsibility for all systems improvement efforts were centralized under the DoD--system improvements needed to address deficient financial system were centralized within the Office of the Secretary of Defense, under the Corporate Information Management initiative initiated in October 1989. According to the GAO the objectives of the initiative include:

- implementing new or improved business methods through the use of modern automated systems and creating more uniform practices for common functions; and
- improving the standardization, quality, and consistency of data from the DoD multiple automated information systems--the initiative is intended to eliminate or reduce systems that perform the same functions.

The GAO concluded that, if properly carried out, the Corporate Information Management initiative can deliver major savings and efficiencies. The GAO further concluded, however, that it will require many years to complete.

The GAO reported that, under the initiative, the Defense Finance and Accounting Service is establishing requirements for standard financial systems and is selecting "migratory systems"--i.e., systems representing the best of a particular type of system--to be adopted by all DoD organizations and serve as a baseline system for continuing improvements. The GAO explained that, by FY 1997, standard migratory systems are planned to be implemented

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throughout the DoD--ultimately, a single integrated financial and accounting system is planned. The GAO provided a table indicating the implementation dates for the various migratory systems selected under the initiative, as follows:

<u>Financial system</u>	<u>Projected Completion Date</u>
Defense Civilian Pay System	September 1995
Defense Joint Military Pay System	December 1994
Defense Retiree and Annuitant Pay System	December 1994
Defense Non-Appropriated Fund Central Pay System	March 1994
Defense Transportation Payment System	November 1993
Defense Contract Payment System	1993
Defense Travel Pay System	June 1994
Defense Debt Management System	December 1993

The GAO reported that, the DoD has not yet selected migratory systems for the major accounting functions--such as installation level accounting, general accounting for direct appropriations, accounting for the Defense Business Operations Fund, and property accounting. According to the GAO, the systems will account for hundreds of billions of dollars and will be the key elements needed to achieve accurate, reliable financial reporting. The GAO commented that, according to information senior Defense Comptroller officials provided subsequent to the completion of the its audit work, the plan is to select a general accounting system before September 1992, and Defense Business Operations Fund accounting systems by March 1993.

The GAO reported that, while the DoD has established milestones for the final implementation of some of the systems, interim tasks have not been established and related milestones to guide the evolution of each migratory system--specifically, a detailed plan with specific short term tasks identifying milestones, resource needs, and specific organizations responsible for completing the tasks. The GAO pointed out that, before identifying migratory systems, the Corporate Information Management initiative methodology requires defining and improving (1) business processes--which include internal controls--and (2) interfaces with programmatic functions and systems. The GAO concluded that many of the weaknesses discussed in chapters 2 and 3 resulted from inefficient or ineffective business processes. The GAO further concluded that, unless corrected, the migratory systems will have the same problems as the existing systems--and, thus, will continue to generate inaccurate, unreliable data. (pp. 15-16, pp. 118-121/GAO Draft Report)

**DoD RESPONSE:** Partially concur. The Defense Finance and Accounting Service is evaluating systems for the purpose of recommending a standard general accounting system. Until that selection process is completed, it is premature to speculate

Now on pp. 8-9 and  
73-74.

See comment 6.

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whether the Department will have a general accounting system different from that used by the Defense Business Operations Fund activities. For that reason, it is also premature to state whether the dates for selecting such standard systems will be different or not.

To the extent that interim tasks for implementing migratory systems have not been developed by the Defense Finance and Accounting Service, the Office of the DoD Comptroller will direct the Defense Finance and Accounting Service to do so.

Improved business processes and integrated systems are part of the Department's Corporate Information Management initiative. However, it should be noted that in addition to new systems anticipated as a result of the Corporate Information Management initiatives, the Department wishes to implement improvements to existing systems now, rather than wait until the Corporate Information Management initiative is fully complete. As noted by the GAO, many of the problems identified in the current report resulted from a failure to operate existing systems properly, or a failure to comply with established policy and procedures requirements. Thus, effective efforts to make current systems operate effectively can result in immediate improvement.

Additionally, as explained by the GAO, existing systems that provide accounting information can be made to operate much better with disciplined adherence to existing plans and procedures. The Defense Finance and Accounting Service, in conjunction with the Army and other DoD Components, can, and should be permitted to, improve current operations incrementally while the Department moves towards new systems expected from the Corporate Information Management initiative.

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FINDING E: More Emphasis Needed On Identifying And Controlling The Costs Of Operations And On Data Accuracy. The GAO reported that the Defense Business Operations Fund is intended to improve the tools and incentives to manage existing resources by identifying the total costs of operations and highlighting the cost implications of management decisions. The GAO explained that the Fund charges customers for all costs associated with the goods and services provided, and is intended to provide all levels of management with information on the costs of support activities for evaluation of possible alternatives.

The GAO explained that, under the Defense Business Operations Fund, the DoD assumed overall responsibility for operating the Army stock and industrial funds--which, for FY 1991, accounted for \$14 billion in Army expenses and \$20 billion in assets. The GAO noted that, under current plans, the Army stock and industrial funds will no longer be reported in the Army financial statements, but will be included in separate financial statements for the Fund. The GAO further explained that, in addition to incorporating Army stock and industrial funds, the Defense

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Business Operations Fund consolidates seven other existing industrial and stock funds operated by the Military Services and the DoD, as well as the activities of the Defense Finance and Accounting Service, the Defense Industrial Plant Equipment Services, the Defense Commissary Agency, the Defense Reutilization and Marketing Service, and the Defense Technical Information Service. The GAO noted that, for FY 1993, the DoD estimated Fund will have sales of goods and services of about \$81 billion.

The GAO reported that the DoD developed a plan outlining the tasks to be performed and the milestones for the accomplishment of those tasks, such as the development of most of the Fund policies and procedures by September 30, 1992. The GAO noted that, as of June 1992, the DoD planned to meet the milestone dates. The GAO explained that the House Armed Services Committee has also incorporated the key tasks and milestone dates in the FY 1993 Defense authorization bill (H.R. 5006, as reported in House Report 102-527). The GAO concluded that achieving the goals and objectives of the Fund will require a sustained commitment from top management for a number of years and close coordination with the Corporate Information Management project. (pp. 15-16, pp. 121-123/GAO Draft Report)

Now on pp. 8-9 and  
74-75.

See comments 6 and 7.

DoD RESPONSE: Partially concur. The DoD has not assumed, and does not intend to assume, overall responsibility for operating or managing the Army stock and industrial funds, or any of the other Component funds. Such responsibility will continue to rest with the DoD Components.

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FINDING F: More Emphasis Needed On Identifying And Controlling The Costs Of Operations And On Data Accuracy: Accurate and Reliable Cost Accounting Systems Key to Fund's Success. The GAO pointed out that the ultimate success of the Defense Business Operations Fund depends on accurate, reliable, and integrated cost systems--which would provide information for (1) establishing accurate prices to charge customers for goods and services, (2) furnishing key elements of cost information to managers to enable them to better control costs, and (3) generating required information on inventory values and the cost of sales for the preparation and audit of the Defense Business Operations Fund financial statements. The GAO noted, however, that the existing cost accounting systems used by the stock and industrial funds, as presently operated, are inadequate to achieve the objectives--and the DoD has not finalized requirements for the migratory cost accounting systems it plans to use to replace existing systems.

The GAO reported that, in early 1991, the Defense Finance and Accounting Service initiated two projects to standardize and improve the various stock and industrial fund accounting systems. The GAO further reported that, in February 1992, the projects were incorporated into an ongoing study to select a DoD-wide

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standard general accounting and funds distribution system. The GAO commented, that although the Defense Finance and Accounting Service has identified 18 systems to be evaluated in selecting the standard systems, the Department does not plan to select the systems until early 1993. The GAO concluded, however, that once the systems are selected, it will take about 3 years to implement them at all Fund activities.

The GAO concluded that improvements in financial management systems and the quality of financial information must begin with concerted efforts to improve data in existing systems. The GAO emphasized that reliable financial data is needed for management decision-making now, as well as in 2 or 3 years from now, when migratory systems are implemented. The GAO concluded that, unless corrected, inaccurate data contained in existing systems will be entered into any migratory systems adopted as a result of the Corporate Information Management, and the migratory systems will not be able to produce reliable cost information and the Fund will be unable to achieve the goal of focusing on the cost of operations in the short term.  
(pp. 15-16, pp. 123-124/GAO Draft Report)

Now on pp. 8-9 and  
75-76.

See comment 6.

**DoD RESPONSE:** Nonconcur. The Department takes exception to the statement that existing cost accounting systems used by the Department's stock and industrial funds are inadequate. While recognizing further improvements are desirable, the Department views its current systems as adequate to manage the Fund; and that other better alternatives are not available.

The Department has been operating some of the stock and industrial funds for almost 40 years. While the Department recognizes improvements to existing systems are desired, and are being vigorously sought, existing financial systems, in conjunction with non-financial systems, currently yield sufficient information to manage such funds adequately.

Additionally, as noted by the GAO, it could be some years before full implementation of migratory systems and even more years before new modern systems are available. Nevertheless, the GAO has concluded that many of the identified problems resulted from a failure to operate existing systems properly, or to comply with established policy and procedures requirements. Thus, effective efforts to make current systems operate effectively can result in immediate improvement. The GAO also concluded that existing systems that provide accounting information can be made to operate much better with disciplined adherence to existing plans and procedures and that immediate payoffs can be obtained.

The Department is vigorously pursuing appropriate improvements within current systems at the same time it is pursuing newer, and more improved, processes and systems for the future.

[Text omitted.]

The following are GAO's comments on the Department of Defense's letter dated July 29, 1992.

## GAO Comments

1. DOD's comments on a draft of this report contained 80 pages. Generally, DOD concurred or partially concurred with our findings and recommendations. We have included only those comments in which DOD did not fully concur with our findings and recommendations. The full text of DOD's comments are available from us by contacting David M. Connor, Director, at (202) 275-7095.
2. The DOD response is discussed in the "Agency Comments and Our Evaluation" section at the end of chapter 2.
3. The DOD response is discussed in the "Agency Comments and Our Evaluation" section at the end of chapter 3.
4. The DOD response is discussed in the "Agency Comments and Our Evaluation" section at the end of chapter 4.
5. We have modified the report to show that few of the weaknesses were identified using checklists. We also modified the report to show that the Army Audit Agency report found the lack of testing and documentation in 18 of its 123 audits of Army's completed checklists.
6. The DOD response is discussed in the "Agency Comments and Our Evaluation" section at the end of chapter 5.
7. We have modified the report to indicate that DOD's responsibility for the Army's stock and industrial funds is limited to policy direction.

