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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Director,
Defense Logistics Agency

Defense Logistics Agency's Progress
In Implementing The Federal
Managers' Financial Integrity Act

GAO reviewed 23 federal agencies' continuing efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse in the federal government through annual agency assessments of internal controls and accounting systems and correction of systems' weaknesses.

This report focuses on the Defense Logistics Agency's progress and efforts to correct identified weaknesses in its internal controls and accounting systems and efforts to improve its assessment program.



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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-216946

General Donald M. Babers
Director, Defense Logistics Agency

Dear General Babers:

This report presents the results of our review of the Defense Logistics Agency's (DLA's) continuing efforts to implement and comply with the Federal Managers' Financial Integrity Act (FIA) of 1982 [31 U.S.C. 3512(b) and (c)]. Our review was part of a governmentwide assessment of the act's implementation at 23 agencies. The act seeks to strengthen internal controls and accounting systems in federal agencies to help detect and reduce fraud, waste, and abuse, and thereby improve government management.

The Department of Defense's (DOD's) implementing instructions require each component to submit two annual reports to the Secretary of Defense. The instructions require one report to state whether systems of internal accounting and administrative controls, taken as a whole, fully comply with the act's requirements. The act requires that controls be established in accordance with the Comptroller General's standards and provide reasonable assurance that (1) obligations and costs comply with the law; (2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures are properly recorded and accounted for. Any material weaknesses, along with plans and schedules for their correction, must also be reported if controls do not fully comply with the act's requirements. The second report must state whether accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General (hereinafter referred to as the Comptroller General's requirements).

The objectives of our review were to

- determine whether actions taken as a result of the act are improving internal controls and accounting systems;
- evaluate DLA's progress in implementing its program for evaluating its internal controls and accounting systems;
- and

--assess the adequacy of the basis for determining that the requirements of the act have been met and that accounting systems do or do not conform with the Comptroller General's requirements.

Appendix I contains information on the objectives, scope, and methodology of this review. A glossary is also attached as appendix III.

In deciding whether an agency has an adequate basis for determining that its internal control systems, taken as a whole, meet the requirements of the act, we believe the agency head must consider the (1) significance of the weaknesses disclosed, (2) status of corrective actions, (3) comprehensiveness and quality of the management control evaluation work performed, and (4) extent to which accounting systems conform to the Comptroller General's requirements.

In November 1984, you reported to the Secretary of Defense that, taken as a whole, DLA's evaluation of its internal controls provided reasonable assurance that the objectives of the act were achieved. You identified three agencywide and six program-specific material weaknesses and the corrective actions taken or planned. A complete list of material weaknesses reported in fiscal years 1983 and 1984 is included in appendix II. You also stated that 7 of 28 accounting systems were in substantial conformance with the Comptroller General's requirements.

We found that DLA has made progress toward implementing a program for evaluating its systems of internal accounting and administrative controls. However, like any new program, it is experiencing developmental problems that have delayed full implementation. To illustrate, several significant management control problems in areas such as financial management, information resources management, and supply management were not identified during the evaluation process and, as a result, were not included in DLA's letter of assurance to the Secretary of Defense. Also, DLA's evaluation of its accounting systems did not include testing systems in operation. As a result, we do not believe the system for evaluating the internal accounting and administrative controls in DLA has evolved to the point that it provides an adequate basis to determine if internal control systems, taken as a whole, meet the requirements of the act.

DLA'S EVALUATION OF INTERNAL CONTROLS
DID NOT IDENTIFY SIGNIFICANT MANAGEMENT
CONTROL PROBLEMS

During fiscal year 1984, DLA issued guidance for implementing its program for evaluating and reporting on its internal

accounting and administrative controls. The Internal Review Division was established within the Office of the Comptroller to monitor the DLA-wide program and to prepare DLA's letter of assurance to the Secretary of Defense. Letters of assurance were submitted to the Internal Review Division by each of the field activities and the headquarters directorates and staff offices. The Internal Review Division compiled the DLA assurance letter based on these reports. Although substantial resources had been devoted to the internal control program, the process did not identify all the significant management control problems that exist in DLA. During our review of DLA, we identified several management practices, policies, or procedures that we believe should have been considered material weaknesses. These problems were not identified during DLA's evaluation of its internal controls and, therefore, were not included in their annual assurance letter. Some of these problems are shown below.

- DLA's Automatic Data Processing (ADP) Modernization efforts (software modernization and hardware replacement) lack adequate long range planning. DLA is highly dependent upon automated systems to carry out its missions and administrative functions and has decided that many of its systems need to be modernized to better support DLA systems' users. The modernization effort presently involves developing new systems, redesigning existing systems and replacing all the hardware at 24 facilities. Total life-cycle costs is estimated at \$731 million. Although DLA is undertaking this substantial modernization effort, it does not have an overall strategic plan for managing/ coordinating the effort. Numerous plans had been prepared to support the modernization effort; however, they did not establish adequate hardware capacity to support software requirements nor did they provide for coordination of interrelated software systems. DLA recognized the weakness in their plans and on May 25, 1985, issued a draft ADP strategic plan for the modernization effort.
- The Defense Inactive Item Program, established to identify and remove unneeded supply items from DLA's inventory, is not operating as intended. The program is structured to identify items which have been in the supply system for extended periods of time with little or no demands. DLA refers each item meeting the program criteria to all registered users. Each user is required to evaluate the item for possible deletion from the inventory. Defects in the automated system have caused the deletion of needed items, while inadequate reviews by the military services resulted in unneeded items being retained. For example, computer software errors resulted

in the Navy being erroneously deleted as a potential user for 50,000 items. In another case, over 7,000 items were retained in inventory because the user did not have the time or resources to assess the need for each item.

--Large amounts of overaged unliquidated obligations (ULOs) exist in the fuels and clothing and textiles commodities. At the end of fiscal year 1984, the Defense Fuels Supply Center reported \$261 million and the Defense Personnel Support Center reported \$103 million (clothing and textiles)¹ in ULOs over 180 days old.² This represents approximately 85 percent of DLA's total ULOs over 180 days old. DLA regulations require periodic reviews of ULOs. However, it was not until January 1985, that DLA established formal goals for reducing ULO balances by age category.

--Disbursements to contractors for purchases of fuels for posts, camps, and stations transactions were made before receiving adequate documentation. Disbursement regulations require that a copy of the receiving report be submitted and received before a disbursement is made. At DLA, these regulations were not being followed during fiscal year 1984. During this period, DLA processed about 77,000 invoices with a total value of about \$367 million. Agency officials estimated that at least 75 percent of these invoices were paid before receiving the proper documentation. In January 1985, DLA took action to address this problem by restating the need for proper documentation before funds are disbursed.

In our opinion, DLA's process for reporting on the status of internal controls should have resulted in the identification of these and possibly other material weaknesses. We believe the failure to identify these weaknesses was caused, at least in part, by (1) the limited involvement of the headquarters elements in the internal controls evaluation process and (2) the lack of a comprehensive approach for evaluating the internal controls for automated systems.

¹In its fiscal year 1983 letter of assurance, DLA reported that review of ULOs at the Defense Personnel Support Center has not significantly reduced the dollar value still outstanding (see app. II).

²DLA ages ULOs in several increments. Balances are monitored, beginning at 120 days. DLA officials begin to question the validity of amounts when they reach 180 days old.

Limited involvement by DLA headquarters elements hampers full disclosure of all material weaknesses

Each DLA headquarters element has overall responsibility for their particular functional area. This responsibility includes establishing policies and procedures and monitoring their implementation by the field activities. To adequately perform their duties, the headquarters elements must acquire the expertise and knowledge for all aspects of their functional area. They are, therefore, in the best position to identify and report any material weaknesses that should be included in the annual assurance letter. We found these groups identified very few material weaknesses in their functional areas. In fact, only 2 (Supply Operations and the Comptroller) of 16 headquarters elements reported any material weaknesses. In our view, this limited involvement of the headquarters elements was a primary cause of DLA's failure to identify material weaknesses similar to those previously discussed.

Our concerns with headquarters elements were also noted by the Internal Review Division. In a memorandum dated July 27, 1984, the Division concluded that the headquarters elements have not been fully cooperative with the FIA program office. Some of the problems encountered by the Internal Review Division are summarized below.

- While the headquarters elements claim to be participating, they were often not responsive to requests made by the Internal Review Division.
- None of the headquarters elements provided adequate reports on the status of their internal controls during the third quarter of fiscal year 1984.
- Four headquarters elements have not responded formally on a request to develop checklists for conducting internal control reviews.³
- At least three headquarters elements did not coordinate with the Internal Review Division before sending apparent conflicting guidance to the field activities.

During our review, many officials from the headquarters elements claimed a lack of knowledge and/or understanding of the requirements of FIA. We found, however, that these officials had been exposed to DLA's internal control evaluation process. For example, they attended training classes and received formal and informal guidance from Internal Review Division staff. We

³As of February 1985, these headquarters elements had not responded.

also found that most headquarters elements we visited did not begin performing the functions required by DLA's internal control evaluation process until the fourth quarter of fiscal year 1984. This late involvement reduced their opportunity to provide meaningful input to the draft DLA letter of assurance prior to its submission to the Secretary of Defense. If these headquarters elements had been more involved in the internal controls evaluation process, we believe the possibility of identifying and reporting material weaknesses, similar to those previously discussed, would have been greatly enhanced.

Several actions are being implemented, or are in the planning stages, that should improve DLA's ability to identify agencywide material weaknesses. For example, officials from the eight headquarters elements we visited told us they plan to increase their visits to field activities to monitor internal control practices. In addition, some of the following actions are being taken by these headquarters elements in order to improve their internal control programs:

- Assisting the Internal Review Division in developing major subfunctions, or core assessable units, in order to assess a particular functional area.
- Developing specific procedures in order to evaluate internal controls.
- Developing internal control checklists for performing internal control reviews.

Also, the Internal Review Division staff is attempting to increase the involvement of the headquarters elements by providing additional training and conducting visits to each headquarters office.

The problems discussed in this section are indicative of a program that has not fully matured. The Internal Review Division's current plans, if implemented, should substantially improve the effectiveness of the evaluation process, and therefore, put DLA in a better position to identify and report material weaknesses.

DLA needs to improve its approach
for evaluating ADP internal controls

DLA is heavily dependent on automated data systems to meet its mission of supporting the military services and its other customers. Associated with the use of automation are elements of risk which can increase the chances for fraud, waste, and abuse. Internal controls are used to reduce these potential risks. Therefore, it is necessary to review and evaluate ADP internal controls to ensure these risks are minimized.

DLA's major automated information systems support the agency's major mission areas of supply operations, contract administration, cataloging, and other activities. These systems are large centrally designed systems that are operated at one or more of DLA's 24 computer facilities. Many of these systems also involve more than one major function (accounting, supply, procurement, etc.); and thus, the management control of many of these systems involves more than one manager in headquarters and the field activities. In our opinion, evaluating ADP internal controls in these systems require (1) common assessable units for common activities, (2) standard methodology for evaluating internal controls, and (3) a headquarters ADP focal point to assess and report on systemwide weaknesses.

Although DLA's regulations require an evaluation of ADP internal controls, they do not clearly establish a methodology for performing the evaluations. As a result, DLA adopted a decentralized approach for conducting the evaluations. In DLA's approach, each activity was allowed to develop its own inventory of assessable units and to conduct independent evaluations. Further, DLA did not designate an ADP focal point to assess and report on systemwide weaknesses. This approach did not provide a systemwide view of the status of ADP internal controls.

DLA's decision to allow activities to perform independent reviews, in addition to the absence of a designated headquarters ADP focal point, also has contributed to its failure to report several ADP internal control problems that were identified during the FIA evaluation process. The DLA Systems Automation Center centrally designs and maintains 11 of DLA's standard systems, which are operated throughout the agency. Internal control weaknesses identified at the Center could, therefore, affect operations throughout the agency. The Center, in its 1984 letter to the Director, DLA, reported 22 material internal control weaknesses in its automated systems. According to the Center Commander, all of the reported weaknesses were of equal importance.

The Internal Review Division, responsible for preparing DLA's letter of assurance to the Secretary of Defense, included only one--the absence of procedures to preclude unauthorized updating of ADP library files--of the 22 weaknesses reported. Some of the weaknesses not reported involve the

- test procedures for assuring that computer programs function as intended,
- program for assuring that computer systems operate efficiently and that sufficient computer resources are

available to support the implementation of modernized systems, and

--procedures for computer systems security.

These material weaknesses, in our opinion, should have been reported because of the potential adverse impact on operational systems and DLA's modernization effort.

These weaknesses were not reported because of DLA's decentralized approach to reviewing ADP internal controls and the limited participation of the headquarters ADP office. Under the DLA approach to reviewing ADP internal controls, the Internal Review Division considered the Center as an independent field activity; and thus, the Division did not recognize the DLA-wide importance of the Center's reported ADP material weaknesses. Additionally, the Internal Review Division analysts reviewing reported internal control weaknesses had limited ADP expertise and received limited input from the headquarters ADP office. They were, therefore, unable to determine the relative importance of the Center's reported weaknesses. A designated headquarters ADP focal point could provide this expertise and assist in identifying those weaknesses that should be reported to the Secretary of Defense.

DLA has taken, or plans to take, several actions that we believe will improve its ADP evaluations. For example, it has revised its segmentation process to establish common assessable units among its major functional areas. We believe that this will provide a more consistent basis for reviewing automated systems, and therefore, an opportunity to obtain systemwide visibility of ADP internal controls. Also, DLA agrees that better visibility of ADP internal controls would result from increased involvement of its headquarters elements, and has taken steps to ensure that this will occur. While DLA recognizes the need to provide greater coordination for its reviews of ADP internal controls, it has not yet formulated its approach. DLA plans to develop an approach through a joint effort of cognizant headquarters managers. We believe that DOD's ADP Internal Control Guidelines, issued in November 1984, would greatly assist DLA in developing its approach for evaluating its ADP systems because it provides effective guidance on managers' responsibilities for ADP internal controls and on ADP control objectives and techniques.

ACCOUNTING SYSTEM CONFORMANCE--AN IMPROVED
COMMITMENT, BUT LIMITED PROGRESS

In its annual assurance letter, DLA reported that 7 of its 28 accounting systems, including most of the large agencywide systems, were in substantial conformance with the Comptroller

General's requirements. In the same report, DLA identified eight major areas of deficiency in its accounting systems. In addition to those identified, we found several other system and control deficiencies that we believe are significant enough to have been reported. In our opinion, DLA did not have an adequate basis for reporting that any of its accounting systems are in conformance because of the significant deficiencies that exist and the lack of review of those systems in operation, including testing.

DLA has taken a number of actions to correct the system deficiencies and to increase the systems' conformance with the Comptroller General's requirements. The most significant actions are (1) identifying long-term initiatives for the overall redesign, modernization, and/or replacement of many of its accounting systems and (2) establishing a financial systems evaluation office to review and test the accounting systems in operation.

DLA reported that even though 21 of its accounting systems have features that do not adequately meet our standards, the financial control and reporting features of the systems are satisfactorily supporting their fiduciary and management accounting responsibilities. We believe DLA does not have an adequate basis for making this statement about any of its accounting systems until those systems and financial controls have been reviewed and tested in operation to assure that the systems function as designed.

Major deficiencies
reported by DLA

In its 1984 FIA report, DLA identified eight major areas of deficiency in its accounting systems. Many of the eight major areas of deficiency reported by DLA, as well as system and control weaknesses that were not reported, affect several of the seven systems that DLA deems to substantially conform with the Comptroller General's requirements. Listed below are the eight major deficiencies identified by DLA in this year's letter of assurance:

- overaged goods-in-transit;
- lack of depreciation accounting;
- incomplete or outdated system documentation;
- possible overpayments to contractors when emergency manual payments bypass system controls;
- accounting systems which do not facilitate reconciliation of undistributed cash transactions;

- general ledger accounting systems not being properly interfaced with consolidated reporting requirements;
- lack of adequate monetary control and amortization of capital equipment; and
- systems not being as accurate, reliable, timely, and useful as today's technology will allow.

We agree that these are major deficiencies, and we believe that they may have a significant adverse impact on the effective operation of DLA's accounting systems. For example, DLA reported significant losses in overaged goods-in-transit. In certain cases, DLA pays contractors for material based on a notification of shipment or the receipt of a contractor's invoice. In 1984, DLA reported losses of over \$22.6 million for items which were paid for, but were not verified as received. As of the end of fiscal year 1984, an additional \$53 million had been paid for material that was over 90 days past its delivery date. Another case is the possibility for error when manual operations are used to bypass the automated system controls. We found that about 48 percent of all contract disbursements were being performed manually; that is, there was some degree of manual intervention by clerical personnel over the automated payment system. In certain situations, some of these manual payments entirely circumvented the normal payment system, and thus, the established system controls. This significantly increases the risk of over or under payments to contractors.

Additional deficiencies not reported

We believe that DLA did a better job in 1984 of reporting accounting system deficiencies. However, we found several other significant deficiencies that should also have been reported. For example, supervisory and management controls were not adequate to ensure that systems reported only valid unliquidated obligations in the DLA stock fund. In another area, supervisory and management controls were also inadequate to ensure that disbursements to contractors for purchases of fuels for posts, camps, and stations were properly authorized--disbursements were being made prior to receiving required documentation. Based on our work, DLA initiated action to eliminate this weakness, and as of January 1985, reported this problem corrected.

In addition, recent studies by DLA and a certified public accounting firm identified the need for improved controls and edits in DLA's major accounting systems. The deficiencies identified in the studies, many of which were not identified in DLA's assurance letter need to be corrected to (1) increase the accuracy and timeliness of financial data, (2) reduce massive manual efforts currently being applied to researching and

correcting errors, (3) reduce manual processing of payments that by-pass automated system controls, and (4) help to prevent erroneous or duplicate payments to contractors. For example, the public accounting firm study reported that the equivalent of 22 personnel at one supply center were manually researching rejected transactions and inaccurate contract data. This effort consumed so many resources that little time was left for report preparation and analysis. The study concluded that this was becoming an intolerable situation and that similar situations exist at other activities. The study report recommended a coordinated effort to improve the agency's systems and procedures.

We believe these deficiencies and the planned corrective actions should be included in subsequent annual FIA reports on DLA's accounting systems.

Corrective actions are mostly long range

DLA recognizes that a lot needs to be done to correct known accounting system deficiencies and to bring all of its systems into conformance with the Comptroller General's requirements. Most of the actions DLA plans to take to correct the accounting system deficiencies are in the form of system modernizations, enhancements, redesigns, or replacements. We estimated that these long-term accounting systems improvement projects will cost in excess of \$280 million, and are dependent upon a proposed ADP equipment replacement program.

DLA expects that the planned system changes and modernizations will correct many of its accounting system deficiencies. DLA recognizes, however, that the agency has historically experienced problems and delays in developing and implementing new systems and system enhancements. For example, we found system development and modernization projects that have been on-going for 7 to 10 years. Moreover, there are over 400 system change requests, some as old as 4 years, applicable to DLA accounting systems. DLA is, therefore, devoting more management resources to improve the timeliness of future changes and modernizations. We believe that the planned accounting system improvements will enhance DLA's ability to correct its accounting system deficiencies and, therefore, improve its financial management system.

Little progress in 1984 in reviewing accounting systems

During 1984, DLA did not perform any detailed reviews or testing of its accounting systems in operation. Rather, DLA began making headquarters staff assistance visits to selected field activity accounting offices at the rate of one per month. A checklist was developed for reviewing the manual controls over

systems in operation and the reconciliation processes. Following the current schedule, each field activity will be visited every 2 years. While benefits may be derived from these staff visits, they are not an adequate substitute for reviewing and testing systems in operation, and they do not provide a satisfactory basis for stating that any of those systems are in conformance with the Comptroller General's requirements.

Recognizing the need for more meaningful system reviews, on October 1, 1984, DLA established the Financial Systems Evaluation Office. The new office, which was still being staffed during our review, will be responsible for

- conducting evaluations of accounting and financial management systems operated by DLA to determine the degree of conformance with the Comptroller General's requirements;
- recommending improvements to accounting systems and procedures;
- maintaining a tracking system to ensure that corrective actions are taken for any nonconforming conditions;
- preparing quarterly evaluation reports to support the system conformance section of DLA's annual assurance letter; and
- planning, designing, and conducting training courses on the Comptroller General's requirements.

At the time of our review, DLA's planned methodology for reviewing its systems centered on the use of test programs. We note, however, that the method and extent of testing should be considered carefully. A description of what we consider adequate testing of accounting systems is included in the glossary.

The establishment of this office is a positive action. We believe, however, that the benefits derived from the efforts of the new office could be enhanced by (1) incorporating milestones and estimated costs for new systems and major enhancements into the planned tracking system, and reporting slippages in the annual FIA report and (2) coordinating accounting system reviews with agency efforts in reviewing ADP controls.

CONCLUSIONS

We believe that DLA's system for evaluating its internal accounting and administrative controls, when fully implemented, will provide an adequate basis for determining that DLA's internal controls, taken as a whole, comply with the requirements of the act. Like any new system, it has encountered several

developmental problems that have reduced its effectiveness. Specifically, the limited involvement of the headquarters elements and the lack of a coordinated approach for evaluating ADP systems resulted in a report that did not identify several significant management control problems. We believe these problems are significant and should have been reported as material weaknesses. In our opinion, DLA's evaluation system has not yet developed to that point where it can provide a sufficient basis to ensure the requirements of the act have been met.

We believe DLA's efforts to fully integrate the headquarters elements into the internal control evaluation process should enhance DLA's ability to identify and report material weaknesses. Because of the heavy reliance placed on ADP systems by DLA, it must develop a methodology to coordinate its evaluation of agencywide ADP systems. We believe DOD's ADP Internal Control Guidelines should be used for this purpose.

In our opinion, DLA does not have an adequate basis to state that any of its accounting systems conform with the Comptroller General's requirements. Further, we do not believe that DLA has an adequate basis to state that the financial control and reporting features of its accounting systems satisfactorily support the fiduciary and management responsibilities. Such a basis will not be obtained until the systems are reviewed and tested in operation and major deficiencies are corrected. We believe that DLA has taken a key first step by establishing a Financial Systems Evaluation Office to conduct those reviews. If this office carries out its mission with the full support of management, and the accounting systems deficiencies are corrected, we believe DLA will move closer to achieving the accounting systems improvements and other benefits intended under FIA. Since DLA has plans to begin testing its accounting systems during 1985, we are not making any recommendations on this subject.

RECOMMENDATIONS

We recommend that the Director, DLA, discontinue reporting that its systems of internal accounting and administrative control, taken as a whole, meet the requirements of FIA until the program provides an adequate basis for determining the overall status of internal controls. We also recommend that DLA's accounting systems not be reported as being in conformance with the Comptroller General's requirements until the systems are reviewed and tested in operation and the major deficiencies are corrected.

We also recommend that the Director establish a centrally controlled, coordinated approach for evaluating internal

controls within ADP systems and that DLA use the DOD's ADP Internal Control Guidelines as a guide.

AGENCY COMMENTS AND OUR ANALYSIS

DOD's official comments on our report are contained in appendix IV. DOD agreed with the facts and conclusions presented in our report, and that DLA had several material weaknesses that should have been included in its assurance letter. However, DOD did not agree with our recommendation that DLA should discontinue reporting that its internal control systems meet the requirements of the act until the program can provide an adequate basis, and that its accounting systems are in conformance with the Comptroller General's requirements. DOD also disagreed with our recommendation that DLA establish a panel to develop a coordinated approach for evaluating ADP systems.

Disagreement on the basis for determining that requirements of the act have been met

DOD disagreed with our recommendation that DLA discontinue reporting that its systems of internal accounting and administrative control, taken as a whole, are meeting the requirements of the act until the evaluation program can provide an adequate basis for determining the status of its overall internal controls. DOD stated that DLA's Internal Management Control Program has evolved and improved over the last 2 years. The program, in conjunction with DLA's total management process, is directed towards establishing a valid basis for evaluating its internal controls. DOD stated that this total process--which includes policies and procedures, audits, inspections, and the assurances of the commanders of the field activities--must be considered in determining whether an adequate basis exists.

We agree that the entire management process must be considered in determining whether an agency has an adequate basis for evaluating its internal control systems. However, our report identifies several problems that we believe should have been considered material weaknesses, and therefore, included in the annual assurance letter. DOD concurred with our conclusion that these problems were material and should have been reported. DOD also agreed with the causes for the problems that we identified in the report. These causes--the limited involvement of the headquarters elements and the lack of a comprehensive approach for evaluating ADP internal controls--are indicative of an undeveloped system for evaluating internal controls. We, therefore, continue to believe that DLA should not have reported it had met the requirements of the act, and it should not do so until its system is capable of identifying, reporting, and correcting material weaknesses in their programs.

Disagreement on accounting systems conformance

DOD disagreed with our recommendation that DLA not report its accounting systems to be in conformance with the Comptroller General's requirements until those systems have been reviewed and tested in operation and major deficiencies have been corrected. DOD recognized that testing of systems is needed, but stated that such reviews may not be completed during the current (1985) reporting cycle. Until DLA's newly established Financial Systems Evaluation Office can complete the full extent of system testing that we are advocating, DLA will continue to rely upon "its total management process to provide assurance of compliance reporting."

We believe the newly established systems review office is a positive action toward meeting the requirements of the act. However, in its 1984 assurance letter, DLA disclosed a number of major areas of deficiency in its accounting systems. These areas of deficiency, along with several other problems we noted in our report, affect most of the accounting systems that DLA reported to be in substantial conformance with the Comptroller General's requirements. Accordingly, we continue to believe that until DLA reviews and tests its accounting systems in operation, and corrects all known major system deficiencies, it does not have an adequate basis for concluding that those systems conform with the Comptroller General's requirements.

Disagreement on establishing a panel for developing a coordinated approach for evaluating ADP internal controls

DOD agreed with the basic intent of our recommendation that DLA needs a coordinated approach for evaluating the controls within its ADP systems. However, DOD did not agree with our recommendation that a panel of experts be established for this purpose. DOD stated that DLA will continue to use a decentralized approach for evaluating ADP systems, and each staff element and field activity will continue to review the design and/or operation of their systems. In addition, DLA will designate a focal point in the Office of Telecommunications and Information Systems whose responsibility will be to monitor the evaluations throughout the agency. Our primary concern was for DLA to establish a coordinated approach for ADP evaluations. A panel of experts was only one way to do this. We believe a

centralized focal point could also be successful. Therefore, we have revised our recommendation by deleting the reference to a panel of experts.

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

We are sending copies of this report to the above Committees. We are also sending copies to the Director, Office of Management and Budget; the Secretary of Defense; and the Chairmen of the House and Senate Committees on Armed Services, and the Budget.

We appreciate the courtesy and cooperation extended to us by your staff during our review.

Sincerely yours,



Frank C. Conahan
Director

C o n t e n t s

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ABBREVIATIONS

| | |
|-----|---------------------------------|
| ADP | Automated Data Processing |
| DOD | Department of Defense |
| DLA | Defense Logistics Agency |
| FIA | Financial Integrity Act |
| GAO | General Accounting Office |
| OMB | Office of Management and Budget |
| ULO | Unliquidated Obligations |

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to

- evaluate DLA's progress in implementing its program for evaluating systems of internal control and accounting;
- determine whether, through corrective actions, internal control, and accounting systems are improving; and
- assess the adequacy of the basis for determining that the objectives of the act had been met and that accounting systems do or do not conform with the Comptroller General's requirements.

We initiated our review in June 1984 at the following headquarters elements and field activities. The review was completed in March 1985.

Headquarters elements

Office of the Comptroller
Office of Telecommunications and Information Systems
Office of Command Security
Directorate of Supply Operations
Directorate of Contracting
Directorate of Technical and Logistics Services
Directorate of Contract Management
Directorate of Quality Assurance

Field activities

Defense Contract Administration Services Region,
Cleveland, Ohio
Defense Depot, Mechanicsburg, Pennsylvania
Defense Fuel Supply Center, Alexandria, Virginia
Defense General Supply Center, Richmond, Virginia
DLA Systems Automation Center, Columbus, Ohio
Defense Logistics Services Center, Battlecreek, Michigan
Defense Property Disposal Service, Battlecreek, Michigan

To accomplish our objectives, we reviewed DLA's internal control regulations, directives, and correspondence. We reviewed the results of DLA's vulnerability assessments and internal control reviews. We also interviewed cognizant DLA officials. In addition, we interviewed officials from the DOD Inspector General's office (Assistant Inspector General for Auditing) and reviewed their workpapers and their report on DLA's implementation of the act. Also, we reviewed work done by our General Management Study team, currently reviewing the operations of DLA.

We limited our review to DLA's FIA implementation and reporting process. We did not attempt to independently determine the status of DLA's internal controls or the adequacy of the corrective actions taken to improve DLA's reported weaknesses. Because of the integration of ADP in DLA's programs and functions (e.g., financial, supply, procurement, etc.), we examined the consideration given to ADP during the internal control evaluation process. In addition, we evaluated DLA's report on whether its accounting systems were in conformance with the Comptroller General's requirements.

During the course of our review, we kept agency officials informed of the status of our work and, in March 1985, we briefed them on the positions we would take in our draft report so they could consider our views in planning their 1985 FIA implementation effort. Our review was performed in accordance with generally accepted government auditing standards.

DLA'S FISCAL YEARS 1983 and 1984 MATERIALWEAKNESSES AND CORRECTIVEACTIONS PLANNED OR COMPLETED⁵AGENCYWIDE

WEAKNESS : Policies and procedures do not ensure the receipt
(FY 1983) of materials requisitioned by the military services
from DLA activities or delivered directly to DLA
customers from vendors and contractors.

CORRECTIVE
ACTION : Requirements and a draft procedure have been
developed which will provide complete material
receipt acknowledgement reporting. Staffing with
the services/agencies was planned. A Customer
Depot Complaint System is also being developed
which will provide trend analysis on a continuing
basis to allow DLA to identify causes, assess prob-
lem areas, and take corrective action. The target
date for this system was October 1985. Other
related initiatives include reviewing the status of
second materiel receipt follow-ups (to be completed
in the third quarter of fiscal year 1985) and
evaluating the Report of Inventory in Transit
(completed).

WEAKNESS : The "remit to" name and address on Supply Center
(FY 1984) computer records can be changed without
authorization.

CORRECTIVE
ACTION : A systems change request has been sent to the DLA
Systems Automation Center. In the interim, super-
visors have been instructed to input all "remit to"
changes and monitor a computer-generated listing of
all such changes.

WEAKNESS : Contractor debts on records of Defense Contract
(FY 1984) Administration Services Regions were not reported
to Supply Centers maintaining the general ledgers
for the applicable account.

CORRECTIVE
ACTION : An interim letter of instruction was sent to con-
tract administration activities. Comprehensive
procedures were to be issued by March 1985.

⁵The weaknesses and corrective actions are those identified by
DLA in its FY 1984 letter of assurance. We have not evaluated
those actions.

WEAKNESS : Procedural weaknesses at Supply Centers and Depots (FY 1984) result in incorrect physical inventories.

CORRECTIVE

ACTION : DLA plans to improve causative research for major inventory adjustments; augment the quality control program to isolate recurring deficiencies; and revise the inventory scheduling methodology. The scheduled completion date was June 1985.

PROGRAM SPECIFIC

WEAKNESS : Receipt inspections of the Defense Electronics (FY 1983) Supply Center assets were not performed at the Naval Supply Center, Norfolk.

CORRECTIVE

ACTION : Inspections are now being accomplished as required, based on the Department of the Navy's April 20, 1984, letter to the Director, DLA.

WEAKNESS : Due to data being forwarded by contract administration (FY 1983) activities in a format that cannot be processed directly by the recipient's automated data processing equipment at the contract administration activities, excessive manual processing of expenditure data at the accounting activities is occurring.

CORRECTIVE

ACTION : The system used by contract administration activities is being redesigned to produce more automated expenditure data. The redesigned system was expected to be completed by July 1986.

WEAKNESS : Review of ULOs at the Defense Personnel Support (FY 1983) Center has not significantly reduced the dollar value still outstanding.⁶

CORRECTIVE

ACTION : DLA implemented three system changes to its Standard Automated Materiel Management System in June 1984. These changes, in conjunction with revised review procedures, should result in a reduction of overaged ULOs.

WEAKNESS : Policies and procedures on demilitarization of (FY 1984) small arms are not consistent within the Defense Property Disposal Service.

⁶As of February 1985, this continued to be a problem at the Defense Personnel Support Center.

CORRECTIVE

ACTION : Mandatory training programs are being prepared by the Defense Property Disposal Service Regions for fiscal year 1985. The training package was submitted to Defense Property Disposal Service Headquarters in October 1984.

WEAKNESS : Reasonable assurance cannot be given at one Defense (FY 1984) Contract Administration Services Region that overhaul and maintenance contractors are billing and being paid for work that has been actually performed.

CORRECTIVE

ACTION : A team of functional experts are reviewing this area. The estimated date of completion was April 1985.

WEAKNESS : Inadequate security of data terminals at two (FY 1984) Defense Contract Administration Services Regions could allow unauthorized access to data and software.

CORRECTIVE

ACTION : Access programs are being modified and procedures are being strengthened to preclude unauthorized usage. The anticipated date for implementation of necessary procedures was April 1985.

WEAKNESS : DLA Systems Automation Center does not have estab- (FY 1984) lished procedures which preclude unauthorized updating of ADP library files.

CORRECTIVE

ACTION : They have recently purchased and are testing a Security Access Control which should reduce their vulnerability. Installation of the Security Access Control package should be in by the fourth quarter of fiscal year 1985.

WEAKNESS : Security of government aircraft in the possession (FY 1984) of contractors is not sufficient to prevent access by unauthorized individuals.

CORRECTIVE

ACTION : DLA is addressing the problem and Defense Contract Administration Services Region personnel have been requested to inform contractors that the government is relying on their approved property management system to protect government aircraft in the

absence of other specific contractual security requirements. Estimated completion date was June 1985.

WEAKNESS : A significant part of the lumber that DOD received (FY 1984) was not in accordance with the contractual provisions under which the lumber was procured.

CORRECTIVE ACTION : DLA is continuing to inform installation commanders and other customers of its Wood Products School. DLA also contacted the military services about including such training at their schools. DLA coordinates all high dollar shipments of lumber with the American Lumber Standards Committee. DLA is currently studying various methods of acquisition. The next phase involves the use of indefinite delivery contracts and/or basic ordering agreements. The estimated completion date was January 1985. DLA is also studying the use of consecutively numbered seals on bundles of lumber being shipped overseas. Initial implementation was scheduled for November 1984.

GLOSSARY

We developed the following definitions that apply to our review of the implementation of the Federal Managers' Financial Integrity Act.

Accounting System

The total structure of the methods and procedures used to record, classify, and report information on the financial position and operations of a government unit or any of its funds, balanced account groups, and organizational components. An accounting system should assist in the financial management functions of budget formulation and execution, proprietary accounting, and financial reporting.

ADP Application Controls

Controls that are unique to each software application system. Application controls are intended to ensure the quality of data origination, input, processing, and output.

ADP General Controls

Controls that apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls affect most ADP hardware and application software systems, and include:

- organizational controls for the ADP unit;
- system design, development, and modification controls;
- data center management controls;
- data center security controls;
- system software controls; and
- hardware controls.

These controls should be evaluated by ADP managers as part of an analysis of the general control environment.

Comptroller General's Requirements

Our Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, while titles 4, 5, 6, and 7 specify requirements governing claims; transportation; pay, leave and allowance; and fiscal procedures, respectively.

Also, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements such as Treasury Fiscal Requirements Manual and OMB circulars.

Documentation

That information which would allow an independent reviewer to understand the rationale for conclusions the reviewer reached regarding an agency's internal controls, as well as the methods used, and personnel involved. This information should be current and be available for review. "Documentation" of internal controls is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Internal Controls

The plan of organization and all coordinate methods and measures adopted by an agency to provide reasonable assurance that the three objectives of the Federal Managers' Financial Integrity Act of 1982 are achieved. Internal controls should be established in accordance with the Comptroller General's Internal Control Standards. Typically, an internal control represents the combination of a control objective, along with a control technique (or set of techniques) that is being relied on to achieve that control objective.

Internal Control Review

A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner. OMB guidelines recommend six steps for an internal control review: (1) identification of the event cycle, (2) analysis of the general control environment, (3) documentation of the event cycle, (4) evaluation of internal controls within the cycle, (5) testing of the internal controls, and (6) reporting the results. Internal control reviews should normally be conducted for those areas rated as highly vulnerable in the vulnerability assessment process, where corrective action is not readily apparent. An agency should allocate resources for these detailed reviews of internal control based on vulnerability. Those most vulnerable should be reviewed first.

Internal Control Standards

The Federal Managers' Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with,

among other things, standards issued by the Comptroller General. In 1983, the Comptroller General issued a set of 12 Standards for Internal Controls in the Federal Government. The standards include five general control standards, six specific standards, and an audit resolution standard. The five general standards are: (1) reasonable assurance, (2) supportive attitude, (3) competent personnel, (4) control objectives, and (5) control techniques. The six specific standards are: (1) documentation, (2) recording of transactions and events, (3) execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources.

Quality Assurance

The process(es) or system(s) of an agency which provide(s) reasonable assurance that the internal control evaluation, improvement, and reporting process established in accordance with the OMB guidelines is carried out in a consistent, accurate, and reliable manner. These processes or systems will form part of the basis for the annual assurance letters and statement to the President and the Congress. An agency's quality assurance has several essential elements, including appropriate documentation for the internal control evaluation process; appropriate Inspector General role in the process; adequacy of resources and overall organization of the process; appropriate training for managers with internal control responsibilities; and assuring that actions taken will correct weaknesses permitting fraud, waste, or mismanagement.

Reasonable Assurance

Internal controls systems should provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This concept recognizes that the cost of internal control should not exceed the benefit expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of internal controls. Errors or irregularities may occur and not be detected because of inherent limitations in any internal control, including those resulting from resource constraints, or congressional restrictions. "Reasonable Assurance" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Segmentation

The process by which an agency identifies assessable units; that is, its programs and administrative functions. The inventory of assessable units developed as a result of this process must be appropriately detailed so as to provide a basis for the conduct of meaningful vulnerability assessments. OMB guidelines provide that all the agency activities, except those concerned with policymaking, should be included in the inventory. There is no single best method to segment an agency, particularly in light of variations in agency organization structure and responsibilities.

Testing Systems in Operation

Testing should be conducted on all critical system aspects and may include interviewing persons who operate the systems, observing operating procedures, examining system documentation, applying procedures on live transactions and comparing results, direct testing of computer-based systems by use of simulated transactions, and reviewing error reports and evaluating error follow-up procedures. Tests should be designed to disclose whether valid transactions are processed properly, and whether the system rejects invalid transactions. The tests should cover the entire transaction--from initial authorization through processing, posting to the accounts, and reporting. Accordingly, manual as well as automated operations should be included. In developing test plans, consideration should be given to the results of any prior system testing.

This testing criteria has been adopted by OMB and included in Appendix H of its publication, Guidelines for Evaluating Financial Management/Accounting Systems (May 20, 1985). In determining the tests that would be appropriate for any system, it is important to keep in mind that in most cases, more than one of the above techniques are needed to test all key aspects of an accounting system.

Vulnerability Assessment

A biennial review of the susceptibility of an assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. OMB guidelines prescribe three basic steps for the conduct of vulnerability assessments: (1) analyze the general control environment, (2) analyze the inherent risk, and (3) perform a preliminary evaluation of existing safeguards. The primary purpose of vulnerability assessments is to determine if and in what sequence resources should be allocated for the performance of internal control reviews.



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

16 SEP 1985

Mr. Frank C. Conahan
 Director, National Security and
 International Affairs Division
 U.S. General Accounting Office
 441 G. Street, N.W.
 Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Final Letter Report (GAO/NSIAD-85-116, OSD Case 6814) Draft Reports, "Department of Defense's Implementation of the Federal Managers' Financial Integrity Act (FMFIA)," dated July 29, 1985 (GAO Code 390017, OSD Case 6809), and related reports to the Military Departments (GAO Codes 390018 through 390020, OSD Cases 6810 through 6812) and the Defense Logistics Agency (GAO Code 390017, OSD Case No. 6813).

The DoD is pleased that the GAO acknowledged the Department's progress in successfully implementing the FMFIA. At the same time, the GAO expressed reservations as to whether the DoD had an adequate basis for reporting that the objectives of the FMFIA had been met. The GAO's reservations may be more a result of its limited evaluation criteria than uncertainties in the IMC process. Whereas the GAO generally relied on its criteria in assessing reasonable assurance, the DoD used its complete network of management systems and audits.

The DoD will continue to improve its guidance for the annual evaluation of accounting systems. The DoD, however, also will continue its view that the accounting systems provide adequate internal and fund control features and that the certified systems are in compliance with GAO accounting requirements, unless detailed audits prove otherwise. Along these lines, on May 23, 1985, the DoD issued an advance copy (to be finalized in September) of guidance requiring testing of accounting systems to assure that prescribed accounting requirements are satisfied.

Specific DoD comments on each of GAO's findings and recommendations are enclosed. The DoD appreciates GAO efforts in assisting the DoD to meet the requirements of the FMFIA. Thank you for the opportunity to comment on the draft reports.

Sincerely,

John R. Quetsch

Principal Deputy Assistant Secretary of Defense
 (Comptroller)

Enclosure

GAO DRAFT REPORT - DATED AUGUST 9, 1985
(GAO CODE 390017 - OSD CASE 6813)

"THE DEFENSE LOGISTICS AGENCY'S IMPLEMENTATION OF THE FEDERAL
MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)"

DOD COMMENTS

* * * * *

FINDINGS

- o FINDING A: DLA's Evaluation Of Internal Controls Did Not Identify All Significant Management Control Problems. GAO noted that the DoD implementing instructions require annual reports to the Secretary of Defense on the adequacy of DLA's internal controls and accounting systems, and the reports must state whether the controls fully comply with the FMFIA requirements. GAO also noted that DLA has established a headquarters-level Internal Review Division (and field Internal Review Offices with similar functions) to monitor the FMFIA Program and prepare the letter of assurance to the Secretary of Defense. In spite of the commitment of considerable resources, GAO found that the process has not identified all of the significant DLA management control problems. For example, GAO found:
 - DLA was undertaking a substantial ADP modernization effort without an overall strategic plan for managing and coordinating the effort. (GAO noted that DLA recognized this weakness and issued a draft ADP strategic plan for the modernization on May 25, 1985.)
 - The Defense Inactive Item Program is not operating as intended. Defects in the automated system have caused the deletion of needed items, and inadequate reviews by the Services have resulted in unneeded items being retained.
 - Large amounts of overaged unliquidated obligations existed in the fuels and the clothing and textiles commodities, i.e., \$261 million and \$103 million, respectively, at the end of FY 1984. Although DLA regulations require periodic reviews, it was not until January 1985 that DLA established formal goals for reducing these balances.
 - Disbursements to fuel contractors for post, camp and station transactions were made without adequate receipt documentation. (GAO noted that DLA took action to address this problem in January 1985.)

Note: Where applicable, the page numbers have been changed to correspond to those in this report.

GAO concluded that DLA's process for reporting on the status of internal controls should have resulted in the identification of these and possibly other material weaknesses. (Pages 2-4)

DoD Response: Concur. DoD agrees that the DLA process did not result in the reporting of all of the significant management control problems in its annual statement of assurance. However, as noted by GAO in Finding B, actions have been taken by Headquarters, DLA staff elements and the Internal Review Division that should improve DLA's ability to identify agencywide material weaknesses. The Internal Review Division is working to increase headquarters and field involvement through published guidance, training and visitation, and seminars.

- o **FINDING B: Limited Involvement By DLA Headquarters Elements Hampered Full Disclosure Of All Material Weaknesses.** GAO found that of the 16 DLA headquarters elements, which should be in the best position to identify and report material weaknesses in their functional areas, only two (Supply Operations and Comptroller) reported any material weaknesses. Such limited involvement by headquarters elements was, GAO concluded, a primary cause of DLA's failure to identify material weaknesses similar to those discussed in Finding A. GAO also found that the Internal Review Division had also concluded that headquarters elements had not been fully cooperative with the FMFIA Program office. GAO further found that most headquarters elements it visited did not begin performing the functions required by DLA's internal control evaluation process until the fourth quarter of FY 1984, resulting in reduced opportunities to identify and report material weaknesses. GAO reported, however, that actions have been taken since that time by DLA's headquarters elements that should improve DLA's ability to identify agencywide material weaknesses. Further, GAO found that the Internal Review Division staff is also attempting to increase headquarters staff involvement through additional training and visitation. GAO concluded that DLA's problems are indicative of a program not fully mature, and that the Internal Review Division's current plans, if fully implemented, should substantially improve the effectiveness of DLA's process and ability to identify and report material weaknesses. (Pages 5-6)

DoD Response: Concur. As noted by GAO, actions have been taken by DLA headquarters that should improve DLA's ability to identify agencywide material weaknesses. More emphasis has been placed on identifying systemic problems. Actions taken require headquarters staff elements to review audit and inspection reports for the purpose of identifying

material weaknesses for inclusion in annual statements of assurance. In addition, at the Director's staff meetings, emphasis has been placed on the importance of identifying and reporting material weaknesses.

- o **FINDING C: DLA Is Improving Its Approach For Evaluating ADP Internal Controls.** GAO pointed out that evaluating ADP internal controls in major automated information systems requires (1) common assessable units for common activities, (2) a standard methodology for evaluating internal controls, and (3) a headquarters ADP focal point to assess and report on systemwide weaknesses. GAO found material weaknesses which should have been reported but were omitted because of the lack of a standard methodology for reviewing and reporting on ADP material weaknesses and the limited participation of a headquarters ADP focal point. GAO also found (1) while DLA regulations require an evaluation of ADP internal controls, a methodology for the evaluations was not clearly established, (2) DLA did not designate an ADP focal point to assess and report on systemwide weaknesses, and (3) while DLA's Data System Automation Center reported 22 internal control weaknesses as systemwide, and all of them were of equal importance, the Internal Review Division included only one in DLA's letter of assurance to the Secretary of Defense. GAO further found that, in an attempt to improve its ADP evaluations, DLA has already or plans to: (1) establish common assessable units among the major functional areas, (2) ensure increased involvement of headquarters elements resulting in better visibility of ADP internal controls, and (3) develop an approach to provide greater coordination of its reviews of ADP internal controls. GAO concluded that DoD's ADP Internal Control guidelines, issued in November 1984, would greatly assist DLA in developing its approach for evaluating ADP systems. (Pages 6-8)

DoD Response: Concur. DoD's ADP Internal Control Guidelines have been distributed to assist in performing decentralized reviews of ADP controls.

- o **FINDING D: Accounting Systems Conformance -- An Improved Commitment, But Limited Progress.** GAO noted that in 1984, DLA reported 8 major accounting system deficiencies. GAO found, however, that several other significant deficiencies should also have been reported, for example;
 - inadequate supervisory and management controls to ensure that systems reported only valid unliquidated obligations in the DLA stock fund.
 - inadequate supervisory and management controls to ensure that disbursements to contractors of fuels for posts, camps and stations were properly authorized (GAO noted

that DLA initiated action based on the GAO work and reported this problem corrected as of January 1985).

GAO also cited a recent study that identified the need for improved controls and edits in DLA's major accounting systems. Many of these needed improvements, according to GAO, were not identified in DLA's FMFIA report. GAO found that many system and control weaknesses reported, and not reported, affect several of the seven systems that DLA deems to substantially conform with the Comptroller General's requirements. GAO concluded, therefore, that until the systems are reviewed and tested in operation and major deficiencies are corrected, DLA does not have an adequate basis to state any of its accounting systems conform with the Comptroller General's requirements. (Pages 8-11, and 13)

DoD Response: Partially Concur. Five of DLA's accounting systems were designed in compliance with GAO principles and standards and had GAO system design approval prior to implementation of the FMFIA. Although the systems were not tested in operation in fiscal year 1984, there is no reason to believe that they were not operating as intended.

- o **FINDING E: DLA Planned Corrective Actions Will Bring Improvement.** According to GAO, DLA has recognized that much needs to be done to correct known accounting systems deficiencies and to bring all its systems into conformance with the Comptroller General's requirements. GAO found that DLA plans to correct system deficiencies through system modernizations, enhancements, redesigns or replacements. GAO estimated that these long term improvement projects will cost over \$280 million, and noted that they are dependent upon a proposed ADP equipment replacement program. GAO found that DLA, recognizing that the agency has historically experienced problems and delays in implementing new and enhanced systems, is devoting more management resources to improving the timeliness of future changes and modernizations. GAO also found that DLA, recognizing the need for more and more meaningful system reviews (DLA performed no detailed reviews or testing of its accounting systems in 1984), has established the Financial Systems Evaluation Office. The benefits derived from this new office, GAO concluded, could be enhanced by (1) incorporating milestones and estimated costs into the planned tracking system and reporting slippages in the annual FMFIA report, and (2) coordinating accounting systems reviews with agency efforts in reviewing ADP controls. GAO also concluded that if this office carries out its mission with the full support of management, and accounting systems deficiencies are corrected, DLA will move closer to achieving the accounting systems improvements and other benefits intended under FMFIA. (GAO noted that since DLA

plans to begin testing its accounting systems in 1985 it would make no recommendations in this area.) (Pages 11-13)

DoD Response: Concur. As noted by GAO, DLA plans to correct accounting systems deficiencies through system modernization and other actions, including the establishment of the Financial Systems Evaluation Office which is testing systems in operation.

RECOMMENDATIONS

- o **RECOMMENDATION 1:** GAO recommended that the Director, DLA discontinue reporting that the systems of internal accounting and administrative control meet the requirements of FMFIA until the program provides an adequate basis for determining the status of internal controls. (Page 13)

DoD Response: Nonconcur. Refer to DoD response to Recommendation 2 (Enclosure 1, page 6) of GAO Draft Report, "Department of Defense's Implementation of the Federal Managers' Financial Integrity Act (FMFIA)," dated July 29, 1985 (GAO Code 390017 - OSD Case 6809). That response is reprinted here in its entirety, as follows:

"DoD Response: Nonconcur. The DoD Internal Management Control Program is a maturing, evolving and improving program. The first significant steps to establish the program were taken in 1983. As specified in Enclosure A to the 1984 DoD Annual Statement of Assurance, the primary objective for 1984 was to establish the basic framework for a comprehensive program. According to the IG, DoD and the GAO report, that was accomplished. During fiscal year 1985, the DoD has made substantial progress toward developing, strictly within the context of the program, reasonable and adequate assurance that the requirements of the FMFIA have been met. Similar to the way that IMC weaknesses may be discovered by means outside the structure of the IMC program, assurances of adequate internal control are provided by alternative means. The 1984 Annual Statement of Assurance concludes that adequate internal control was obtained by the institution of an effective framework for the conduct of the IMC Program, assurances given by appropriate DoD officials, and other information obtained from related programs. The other information upon which DoD assurances are based were obtained from reports issued in response to existing instructions and guidance published by the OSD and DoD Components, the efforts and reports of the IG, DoD, agency audit results, internal review organizations, and even findings derived from GAO reports. It is this

combination of factors, and not the results of the IMC Program alone, that provides reasonable assurance to the Secretary of Defense that adequate internal control exists in the DoD. In our view, the FMFIA never intended that the soundness of the internal control program and its related safeguards be the only means for making the reasonable assurance determination. Nor was it intended that one program should be so burdensome and costly when alternative and complementary measures may be employed to obtain reasonable assurance. Tangential means also provide the DoD with adequate assurance. In fact, we believe that these tangential means should be included in the GAO definition of "reasonable assurance" to make the definition more objective and provide some practical methods which can be universally employed within the context of that definition. Until that takes place there will continue to exist a divergence of opinion as to when reasonable assurance has been achieved."

- o **RECOMMENDATION 2:** GAO recommended that the Director, DLA not report DLA's accounting systems to be in conformance with the Comptroller General's requirements until the systems are reviewed and tested in operation and the major deficiencies are corrected. (Page 13)

DoD Response: Partially concur. The testing of highly-complex, fully-integrated accounting systems will require an intensive effort and use of manpower and resources. To accomplish the task of testing, DLA has established the Financial Systems Evaluation Office which is testing systems in operation. However, it may not be possible to complete the full extent of testing that GAO is advocating before the end of the current reporting cycle. Under such circumstances, the DLA must continue to rely upon its total management process to provide reasonable assurance of compliance reporting.

- o **RECOMMENDATION 3:** GAO recommended that the Director, DLA establish a panel of cognizant managers to develop a coordinated approach for evaluating controls within the ADP systems and that the panel use the DoD's ADP Internal Control guidelines to develop its approach. (Page 13-14)

DoD Response: Partially concur. DLA is using the ADP Internal Control Guideline to review its ADP systems. DoD does not agree that a panel is required or that the review be centrally controlled across organizational lines. DLA has designated an ADP focal point and has taken a decentralized approach. Each staff element and field activity has a responsibility to review the design and/or operation of a system. The staff element, in conjunction with the DLA Systems Automation Center, is responsible for identifying, reporting, and correcting systemic problems.

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