

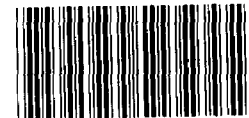
BY THE US GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Defense

Department Of Defense'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 DOD'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

The Honorable Caspar W. Weinberger  
The Secretary of Defense

Dear Mr. Secretary:

We have completed our review of the Department of Defense's (DOD'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)]. The act is aimed at strengthening management controls and accounting systems, thus helping to detect and deter fraud, waste, abuse, and mismanagement.

This report summarizes the results of our work. Our review included work at the Departments of the Army, Navy, and Air Force; the Defense Logistics Agency; and the Defense Mapping Agency--5 of the 24 DOD FIA reporting centers. Additional data on our objectives, scope, and methodology are contained in appendix I. We are issuing separate reports to the five reporting centers (see app. II) and are providing copies to your office.

We are pleased with actions taken to strengthen DOD's management controls and accounting systems evaluation program. This report discusses these actions. It also discusses some improvements that we believe are needed to further enhance DOD's implementation of the act.

Overall, the basic framework has been established to allow for full implementation of the act. However, DOD's management controls evaluation program has not matured to the point that it provides an adequate basis for determining the status of its controls and that DOD's internal controls, taken as a whole, comply with the requirements of the act. For example, some reporting centers have not evaluated some of their important systems of management control, DOD managers are having difficulty identifying and correcting systemic control weaknesses on a DOD-wide basis, and some reporting centers have not yet established effective systems to track and follow-up on corrections of control weaknesses.

With respect to DOD's efforts to evaluate accounting systems, we believe much more needs to be done before determinations of conformance can be made and before DOD can

report that it has "basic accountability" over resources entrusted to its care, such as controls over appropriations made by the Congress. Many systems have not been evaluated at all and for those that have been, either adequate time was not available to perform all the necessary tasks, and/or little testing of the systems was done to see if they were operating as intended and were in conformance with the Comptroller General's principles, standards, and related requirements.

#### REQUIREMENTS OF THE FIA

The FIA requires that internal accounting and administrative management controls be established in accordance with standards prescribed by the Comptroller General 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. Agency heads are required to annually evaluate and report to the President and the Congress whether the agency's systems of internal accounting and administrative controls fully comply with the act's requirements. If systems are not in full compliance, agency heads are required to identify any material control weaknesses and the plans and schedules for correcting them.

The act also requires a separate report on 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).

Our report on DOD's first-year implementation of the FIA<sup>1</sup> pointed out that DOD had made progress in complying with the act, but that some problems and delays were encountered which affected the full implementation of satisfactory evaluation programs, DOD-wide. Our report also noted that DOD planned to make program improvements which would enhance efforts to comply with the act and provide a better basis for more meaningful statements on internal controls in the future.

This year, we found that DOD managers had identified and corrected thousands of control weaknesses at lower levels. Although many of these problems were not sizeable, early detection and correction will help prevent them from reaching component-wide significance. Also, the five reporting centers we examined have taken positive action to address most of the

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<sup>1</sup>Department of Defense's First-Year Implementation of the Federal Managers' Financial Integrity Act (GAO/NSIAD-84-98, May 1, 1984).

evaluation program problem areas we reported. (See app. III for more details.)

Although progress was evident, some essential improvements still need to be made to form an adequate basis for future statements of reasonable assurance.

FORMING AN ADEQUATE BASIS FOR  
DETERMINING THE STATUS OF  
INTERNAL CONTROLS

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) comprehensiveness and quality of the internal management control evaluation work performed, (2) significance of the weaknesses disclosed, (3) status of corrective actions, and (4) extent to which accounting systems conform with the Comptroller General's requirements.

As mentioned earlier, we believe DOD's implementation program needs further improvement before DOD will have an adequate basis for deciding that its systems provide reasonable assurance. In our opinion, such a basis can be developed in the future if DOD (1) fully implements the evaluation program, (2) identifies the extent to which DOD components' material internal control weaknesses are systemic to DOD, and (3) takes action to conform accounting systems with the Comptroller General's requirements.

The evaluation program  
is not fully operational

Our individual reports to the five components show that progress has continued towards implementing adequate management control evaluation programs. However, much more must be done before these programs can be considered fully operational throughout DOD. For example:

- The Army redesigned its program in 1984 to help eliminate problems with evaluation inconsistencies and duplication of effort that existed in 1983. This new approach has experienced some difficulties and additional guidance is needed to clarify definitions of assessable units and what kinds of data are required for supporting documentation. Also, managers need to emphasize the evaluation of automated data processing (ADP) general and application controls. A number of Army components still need to establish control weakness tracking and follow-up systems.

--The Navy needs to develop tracking and follow-up systems at many components to monitor and assure that internal control deficiencies are corrected.

--The Air Force needs to (1) improve its quality assurance reviews of evaluations to ensure they are adequately performed and documented, (2) give more training to managers on how to conduct vulnerability assessments and management control reviews, and (3) better cover ADP general and application controls during evaluations.

The DOD Inspector General (IG) and the Auditors General have independently reviewed all the components' FIA programs, and their findings are in general agreement with ours. Overall, the IG reported that 21 of 29 DOD components had not yet fully implemented FIA evaluation programs.

DOD needs to assure systemic weaknesses are identified and corrected

DOD did not identify and report some control weaknesses as DOD-wide even though it is likely that they are systemic in nature. Without recognizing the true nature of such problems, actions which will correct the weaknesses on a DOD-wide basis may not be taken.

For example, in 1984 you reported significant material weaknesses in property management and cited corrective actions taken to improve controls. One weakness involved controls over the use of government vehicles. Our review of the three specific corrective actions cited, however, found that they were limited to three different Air Force commands. DOD reports on government vehicle usage indicate that control problems similar to those reported exist throughout DOD. We found a number of other similar instances where corrective actions cited in your report were limited to a few components or organizations.

We believe two factors were most important in causing some weaknesses not to be treated as systemic. These are (1) a variance in the degree of specificity with which DOD components reported material management control weaknesses to you and (2) a lack of a mechanism at the Office of the Secretary of Defense (OSD) level to enhance recognition of systemic weaknesses in the FIA program.

Wide variance in specificity of component reported weaknesses

The OSD FIA program manager recognized a variance in component reporting specificity when briefing senior DOD officials in February 1985. The manager noted that components had reported

unevenly and that many functional areas were not well represented in reports. The medical, research and development, and reserve affairs functions were cited as examples.

We also found a wide variance in the degree of specificity with which DOD components reported material management control weaknesses and corrective actions to you. For example, the Army reported problems in very specific detail, whereas, the Navy and especially the Air Force, tended to more highly summarize and "roll up" weaknesses into fewer problem areas. This condition could result in some problems not being recognized as systemic and in a failure to take needed corrective actions on a DOD-wide basis.

While DOD's 24 reporting centers identified 97 material control problems for consideration in your overall report, 62 were reported by the Army. This does not necessarily mean that the Army has weaker internal controls, but rather that Army managers have been more forthright in identifying control problems and necessary corrective actions.

OSD officials are aware of our concerns about the difficulty in identifying systemic, material weaknesses and the need for more specific and consistent problem identification from most of the 24 reporting centers. New DOD reporting instructions were issued in June 1985 which require more specific data on the sources and the impact of weaknesses, expand the definitions of material weaknesses, and provide examples for each of four reporting levels--DOD, components, major commands/field activities, and installations/activities.

We believe an increased willingness on the part of the other reporting centers to be as specific and forthright as the Army in identifying control problems and corrective actions, would also go a long way toward giving OSD managers better assurance that they understand the nature and extent of control problems throughout DOD.

A mechanism is needed to enhance OSD's  
ability to identify systemic weaknesses

As already noted, OSD managers had difficulty in recognizing some problems as being systemic weaknesses in DOD. A mechanism is needed to enhance their ability to treat such weaknesses as systemic. Mechanisms used by the Army, the Air Force, and the Assistant Secretary of Defense (Comptroller) offer examples OSD managers could follow to enhance systemic weakness recognition.

Army and Air Force officials came to the conclusion that the only way to be assured that management controls were working

as intended, was to structure their evaluation programs to first look at systemic vulnerabilities in functional areas across organizational lines and then test controls at operating levels to see if problems existed.

The Army program, currently being implemented, will rely on the Deputy Chief of Staff, Logistics, to identify key controls in his functional area and then prepare guidelines for managers throughout the Army to test selected controls in operation. Evaluation results will be provided to the Deputy at the end of the year who, in turn, will issue an opinion to the Secretary of the Army on the overall operational adequacy of functional controls (and identify any significant weaknesses) within the Logistics area. The Air Force has different procedures, but relies on staff offices to identify service-wide control problems in functional areas.

The Assistant Secretary of Defense (Comptroller), earlier this year selected four control problem areas of particular interest within his functional area of responsibility, and formed study groups to follow up on corrective actions taken by the DOD components. These study groups could become a good vehicle for exchanging information among the components. The four problem areas selected for emphasis--foreign military sales, accounting systems, ADP, and cash management/debt collection--are each an area which contain systemic DOD-wide management control and accounting systems problems. We endorse the Comptroller's efforts to focus attention on these areas of systemic weaknesses. In our opinion, you should encourage other OSD officials to also identify systemic problems within their areas of responsibility and to direct increased attention toward corrective actions.

Actions needed to conform  
accounting systems with the  
Comptroller General's requirements

The Army, Navy, Air Force, and the Defense Logistics Agency have reported widespread problems in most accounting systems and that long-term actions are needed before all systems will conform to the Comptroller General's requirements. For example, one of several current DOD-wide material weaknesses pertains to a need for better accounting control over government furnished material in the hands of contractors. We recently testified that the military services lack basic management and accounting systems control over about \$22 billion in government furnished property--a condition that has existed for many years. DOD is working to bring more accounting systems into conformance. As more systems achieve conformance, a more adequate basis for determining the overall status of DOD's internal management controls can be achieved.



DOD ACCOUNTING SYSTEMS CONFORMANCE  
EVALUATIONS AND REPORTING

Your 1984 statement on the status of DOD's internal accounting and administrative controls reported that 64 of DOD's 150 accounting systems are substantially in conformance with the Comptroller General's requirements and that DOD has systems in place which assure basic accountability over the resources entrusted to its care. Major problem areas noted in some of the 86 nonconforming systems included property accounting, including government furnished material; collections; cost accounting; accrual accounting; disbursements; general ledger control; military and civilian pay; systems documentation; in-transit property accountability; interfaces between systems; and the accuracy and reliability of information. (See app. IV for a discussion of some of the more important problems.) The report also noted actions already taken and those planned to bring accounting systems into conformance.

Our review of DOD's second-year implementation of the act shows that DOD has made progress in implementing it and has generally reported all known accounting systems conformance problems and plans for correcting them. Progress was marked by components improving their inventories of accounting systems, and implementing other more specific improvements. However, DOD should continue to improve its efforts, in that it

- performed limited transaction testing for only 10 of 150 accounting systems and therefore did not have an adequate basis for reporting that (1) 64 of the systems substantially conform with the Comptroller General's requirements and (2) it has systems in place which assure basic accountability over the resources entrusted to DOD's care,
- has not issued either an accounting systems evaluation policy directive or timely reporting instructions to its organizations and components, and
- does not have a tracking and follow-up system in place to assure corrective actions are taken in a timely manner.

Basis for reporting systems'  
conformance was inadequate

DOD reported in 1984 that 64 out of 150 accounting systems or system segments substantially conformed with the Comptroller General's requirements. In our view, DOD's basis for reporting conformance was inadequate because the components evaluations generally did not contain enough work to determine whether the systems were operating as intended. The following summarizes

the deficiencies in the evaluations conducted by the Air Force, Navy, Army, and Defense Logistics Agency:

- Although the Air Force instructed its personnel to test transactions as part of their evaluations of accounting systems' designs, we found that managers had not performed, nor were they instructed to perform any transaction testing on their accounting systems in operation.
- The Navy reported that 5 of 14 accounting systems substantially conformed. The primary basis for the Navy's report was a questionnaire. Although the questionnaire was intended to be used to evaluate the actual operation of the system, the questionnaire responses were based on evaluations of the system design manuals.
- The Army did not permit sufficient time for a comprehensive evaluation of its 67 operating systems. It distributed evaluation instructions and checklists in late July and required responses were due by October 1, 1984.
- The Defense Logistics Agency did not perform any evaluations of its 28 accounting systems in 1984. Headquarters staff made visits to some field activity accounting offices to observe manual controls over the systems in operation.

The lack of adequate testing was a common weakness in the evaluation process conducted by DOD components. Only 10 of DOD's 150 accounting systems were subjected to limited transaction testing. DOD has recognized the importance of testing and stated in its 1984 report that transaction testing will be emphasized as a basis for determining if a system is in conformance in the future.

Testing of the systems in operation is critical because, although agency managers may have extensive system knowledge, we have found in the past that systems are frequently operating differently than responsible managers believe them to be. Therefore, we believe testing should be conducted on all critical system areas. The glossary (app.V, p. 24) identifies what we consider to be adequate testing of accounting systems in operation.

Policy and timely reporting  
guidelines need to be issued

The DOD components independently took action to establish their own guidelines for performing accounting systems evaluations because a DOD policy had not been issued. In addition, DOD did not issue timely instructions to its components for

reporting the results of the evaluation process. The absence of a policy directive, coupled with the late reporting instructions, produced inconsistent and varied responses by DOD components.

Comprehensive DOD policy guidelines on the accounting systems evaluation process are needed to ensure that the components' efforts are properly coordinated. In a memorandum dated December 21, 1984, to you, the IG noted the absence of DOD policy for evaluating accounting systems. The IG stated that while DOD had completed the second year of accounting systems evaluations, it had not yet issued a directive for accounting systems reviews similar to those issued for the internal management control program. Further, we found that DOD did not issue reporting instructions until September 5, 1984, and set a November 15, 1984, deadline for the component's statements. In view of the complexity of DOD's worldwide operations and the required chain of command reporting, sufficient time was not provided.

In our view, policy guidelines are needed to clearly establish objectives, criteria, methodology, and system testing requirements for the evaluation of accounting systems. Such a directive should also provide procedures to help ensure that the internal accounting control weaknesses identified in management controls are considered when accounting systems are evaluated. If properly implemented, it would help assure that DOD components are carrying out the evaluations in a consistent and effective manner. Additionally, DOD needs to issue instructions for the annual reports from components, on a more timely basis.

Progress being made in correcting conformance problems

DOD recognizes that upgrading its accounting systems is a continuing process. It plans to bring deficient operating accounting systems into conformance with the Comptroller General's requirements by taking short- and long-term actions. However, DOD components have experienced slippages in implementing many of their long-term corrective measures. As a result, DOD is planning to develop a tracking system to monitor corrective action to ensure that slippages are minimized.

Some examples of short-term actions taken by DOD components are:

- During 1984, the Navy reported that it completed implementing the Pay Enhancement Program at shore activities in the United States and continued to implement the Uniform Micro Computer Disbursing System aboard ships and at overseas activities. Both of these systems should

reduce the amount of time to transmit pay data to the Navy's military pay accounting system, which processes about 1 million pay records. The total military personnel appropriation for the Navy is estimated at \$15.9 billion in fiscal year 1985.

- The Air Force reported that its departmental level stock fund accounting system was brought into conformance with the necessary Comptroller General's requirements by developing and implementing procedures for recording accounts receivable estimates. The fund finances the inventories for all commodities, including minor spares and repair parts, which are estimated to cost \$12.3 billion in fiscal year 1985. In 1984, the Air Force also reported that the Military Pay System was improved through better management and reporting of advance payments and accounts receivable. The total military personnel appropriation for the Air Force is estimated at \$17.8 billion for fiscal year 1985.

Some examples of the long-term corrective actions being taken by DOD components are:

- The Marine Corps is developing a standard budgeting, accounting, and reporting system which it says should be more responsive to users needs, provide more timely information, and provide better general ledger control over inventories. The Corps reported that the new system should be completed in 1989. When implemented, this system will account for all the Corps' appropriated funds which were estimated at \$9.7 billion in fiscal year 1985.
- The Defense Logistics Agency is planning to replace 19 of its 21 accounting systems which it reported as not being in conformance, with the financial management subsystem of the Automated Payroll, Cost, and Personnel System. The new subsystem is scheduled for 1986, and should eliminate reported deficiencies. This subsystem will account for the Agency's operations and maintenance appropriations, estimated to be \$1.7 billion in fiscal year 1985.

All three services and individual defense agencies are also planning to work on, or are currently working on, redesigns of major accounting systems. The new systems, which are scheduled to replace or modify current systems, will better conform with the Comptroller General's requirements. Forty-three systems are scheduled for upgrading and implementation in the field during the period 1986-1995. However, we noted that 35 of them had experienced schedule slippages during 1984. More details on these system projects are contained in our individual reports.

CONCLUSIONS

Overall, DOD has made progress towards fully implementing its management control evaluation program and has reported reasonable assurance that DOD's systems of internal control, taken as a whole, comply with the requirements of the FIA. Because of the magnitude of DOD's programs, activities, and functions, it can be expected that differing opinions would exist on the adequacy of the basis for determining the status of its internal controls. Certainly this judgment is difficult to make. Although the basic framework for an effective program has been established within DOD, more must be done before it will provide an adequate basis for determining that DOD's internal controls, taken as a whole, comply with the requirements of the act.

Our individual reports to the Secretaries of the Army, Navy, and Air Force, and to the Director of the Defense Logistics Agency contain specific recommendations and suggestions to help improve their evaluation programs. In these reports, we also endorse program improvement recommendations made by the DOD IG and the various Auditors General.

Currently, DOD's FIA internal management control evaluation program is not structured to assure systemic weaknesses are identified and treated as DOD-wide. We believe that to do so (1) the reporting components need to be as specific and forthright as the Army has been in identifying material control weaknesses and corrective actions and (2) OSD officials must assume greater responsibility for determining the status of internal management controls DOD-wide. OSD officials should consider either the Army or Air Force processes for assuring that key controls are working as intended. The focusing of the DOD Comptroller's attention on corrective actions being taken in four problem areas is a beneficial effort, and other OSD officials should follow the Comptroller's lead.

DOD recognizes it has major weaknesses in its accounting systems and is working to correct deficiencies by means of short- and long-range actions. DOD has generally reported all known accounting system deficiencies. However, because the systems were not adequately tested in operation, we do not believe DOD has an adequate basis for reporting that (1) 64 of its 150 accounting systems substantially conform with the Comptroller General's requirements and (2) it has systems which ensure basic accountability over the resources entrusted to its care. In addition, DOD did not give the components sufficient time to develop information to comply with prescribed compliance reports.

We believe that the problems of inadequate testing and insufficient time to do the accounting systems evaluation work can be minimized if DOD implements a policy directive which, at a minimum, establishes evaluation objectives, criteria, methodology, testing and documentation requirements, and reporting criteria and deadlines. DOD has already issued a similar directive for carrying out management control evaluations. Such a policy directive for accounting system evaluations would help ensure that these evaluations are more uniformly and consistently performed throughout DOD.

#### RECOMMENDATIONS

We recommend that the Secretary of Defense assign key OSD officials responsibility for certifying the adequacy of internal management controls within their functional areas. This would help assure that systemic material weaknesses were being identified and treated on a DOD-wide basis. Designated officials should then consider adopting either the Army or the Air Force process for functional managers to use in determining the operational adequacy of controls within their areas of responsibility.

We also recommend that your future annual statements on systems of internal and administrative controls not report that the systems, taken as a whole, provide reasonable assurance that the requirements of FIA have been met until such time as the revised FIA evaluation program provides an adequate basis to make such a determination.

We further recommend that you implement a policy directive for evaluating accounting systems' conformance with the Comptroller General's requirements. As a minimum, the directive should establish the objectives, criteria, methodology, testing and documentation requirements, and reporting deadlines for the DOD components' accounting systems evaluation programs. Finally, we recommend that systems not be reported (1) as in conformance with the Comptroller General's requirements and (2) as providing basic accountability over resources, until the necessary evaluations of systems have been performed.

#### AGENCY COMMENTS AND OUR ANALYSIS

DOD's official comments on our draft report are contained in appendix VI. DOD agreed with the facts in our report and with our recommendation to assign key OSD officials more responsibility for identifying and correcting internal control weaknesses within their areas of responsibility. DOD also agreed with the need to issue a new policy directive for evaluating accounting systems, although they advised us that the directive will allow each component to establish its own specific

evaluation methodology. We believe that to ensure that the component's methodologies are consistent with the DOD policy objectives, the OSD should formally review and approve each component's methodology before it is implemented.

As discussed more fully below, DOD did not agree with our conclusions and related recommendations concerning the adequacy of its basis for determining that its internal control systems, taken as a whole, meet the requirements of the act, and that accounting systems conformed with the Comptroller General's requirements.

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

Although DOD agreed that its internal control evaluation program needs to be improved, it pointed out that the 1984 FIA report was based on a combination of factors, including assurances given by DOD officials and information obtained from audit and investigative reports issued by the Inspector General, internal auditors, and by us.

DOD interpreted the criteria discussed in our report for determining that the requirements of the act have been met, as too narrow. It believes we did not adequately consider other sources that were employed by managers to determine the overall status of controls. DOD said there will continue to be a divergence of opinion over the adequacy of the basis for such determinations until we expand our criteria.

We agree that alternative sources of information on the effectiveness of controls are important. DOD's FIA evaluation program regulations require that managers consider data from all sources (particularly from the audit community) when determining vulnerabilities, and as alternatives to conducting detailed internal control reviews. In this respect, DOD regulations are in accordance with FIA guidelines that were established jointly by the Office of Management and Budget (OMB) and us in 1982. However, although audits and inspections may have detected particular instances of fraud, waste, and abuse, they rarely have the scope necessary to allow managers to determine the overall status of controls within entire functions or their organizations as a whole.

In order for DOD's systems, taken as a whole, to provide the reasonable assurance required by the act, we believe DOD must have a comprehensive evaluation program. DOD must essentially do two things to meet the requirements of the act. First, it must ensure that internal control systems meet the Comptroller General's standards which require that various

control techniques within programs, functions, and activities be designed to cost-effectively achieve all important control objectives, and that these systems provide the means for preventing fraud, waste, and abuse. Second, it must verify that key controls are being systemically implemented and are operating as intended. If not, corrective actions should be taken and then tested to determine whether the weaknesses have in fact been corrected.

As noted in our report, we found that DOD's internal control program had not matured enough to determine that control systems, taken as a whole, meet the requirements of the act. Although we did point out that DOD had done a good job of detecting individual instances of controls not working, we concluded that it needed to develop better ways for key OSD managers to identify systemic control weaknesses and thus to determine the overall adequacy of DOD's control systems. As discussed previously, DOD agreed with us and has taken action to assign greater internal control responsibilities to OSD managers.

Our report also noted that DOD's 1984 FIA report identified numerous internal control problems and accounting systems deficiencies that needed to be corrected. DOD also reported that 86 out of 150 of its accounting systems were not in conformance with the Comptroller General's requirements. We believe that the significance of the control problems that exist, and the extent to which accounting systems conform, are additional, important indicators of the overall status of controls.

In our report we recognize that because of the magnitude of DOD's programs, activities, and functions, differing opinions can exist on the adequacy of the basis for determining the overall status of internal controls. Certainly such a judgment is difficult to make. However, considering the sum of all the information available to us, we continue to believe that DOD did not yet have an adequate basis to determine that its systems, taken as a whole, meet the requirements of the act. We believe that the actions DOD has taken in response to our specific evaluation program recommendations, if properly implemented in the future, should provide DOD a better basis to determine the overall status of its internal controls and whether or not the requirements of the act have been met.

#### Disagreement on determining accounting systems conformance

DOD partially concurred in our recommendation that accounting systems not be reported as in conformance and as providing basic accountability over resources, until the necessary evaluations of systems have been performed.



DOD believes that the fiscal year 1984 accounting systems evaluations performed by the components, as well as other institutional procedures, were sufficient to determine conformity and basic accountability. We do not agree. As we have discussed in this report, we believe the evaluations performed by the military services and the Defense Logistics Agency generally do not provide a sufficient basis to adequately determine whether the systems were operating as intended.

However, for future determinations of conformance, DOD plans to have a sufficient basis for reporting conformance. For example, DOD states that "future certification statements signed by component heads must indicate that such certifications are based upon transaction testing of systems." Instructions will be issued recognizing the need to, among other things, test transactions of their operating accounting systems to provide this assurance of conformance. We believe these instructions, if implemented properly, will satisfy the intent of our recommendation.

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 Committees 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 Chairmen of the above Committees and to the Chairmen of the House and Senate Committees on Armed Services, and the Budget. Copies are also being sent to the Director, Office of Management and Budget; the Secretaries of the Army, Navy, and Air Force; and the Directors, Defense Logistics and Defense Mapping Agencies.

We appreciate the courtesy and cooperation Defense personnel extended to us during our reviews.

Sincerely yours,

  
Frank C. Conahan  
Director



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### ABBREVIATIONS

ADP	Automated Data Processing
DOD	Department of Defense
FIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense



OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to

- determine whether actions taken in response to the act have improved internal controls and accounting systems;
- evaluate progress made by selected DOD components in implementing their programs for evaluating systems of internal control and accounting; and
- assess the adequacy of the basis for the DOD's reporting that the objectives of the act had been met and that accounting systems do or do not conform with the Comptroller General's requirements.

Our review was conducted during the period June 1984 through May 1985. The major DOD components that are the basis for this report include the Army, Navy, Air Force, Defense Mapping Agency, and the Defense Logistics Agency. These components were selected because they provide broad coverage of operating and support activities in the DOD. We conducted our review at the offices of the Assistant Secretary of Defense (Comptroller) and at the headquarters elements of the DOD components in Washington, D.C.; at 25 major commands and 47 installations and field activities located throughout the United States, and in Korea and Japan. We also performed work at the Army, Navy, Air Force, and Marine Corps finance centers.

At these locations, we reviewed internal control program policies, procedures, directives, regulations, and correspondence. We reviewed a small sample of vulnerability assessments and internal control reviews to determine if they were adequate for reporting under the act. Officials and other key personnel responsible for implementing the program were interviewed. The status of corrective actions on selected material weaknesses identified last year by the various components was evaluated. We reviewed the progress made toward increasing the consideration of ADP application and general controls during evaluations. In addition, we reviewed the progress being made in evaluating accounting systems and fixing nonconformances with the Comptroller General's requirements.

We coordinated our work closely with the audit agencies of DOD, using the results of their work when possible. Our review was limited to an evaluation of the progress made by the selected DOD components in implementing their FIA programs. We did not independently determine the extent to which the DOD's internal controls, taken as a whole, provide reasonable assurance that the objectives of the act had been met, or whether or not all of the DOD's accounting systems conformed to the Comptroller General's requirements.

During the course of our review we regularly informed FIA program officials of our views on DOD's implementation of the act so they could consider this information in conducting their 1985 evaluation program. Our work was conducted in accordance with generally accepted government auditing standards.

GAO REPORTS ON DOD COMPONENTS' IMPLEMENTATION  
OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

<u>Title</u>	<u>Date</u>	<u>Report Number</u>
Defense Mapping Agency's Implementation of the Federal Managers' Financial Integrity Act	July 26, 1985	GAO/NSIAD-85-116
Defense Logistics Agency's Progress in Implementing the Federal Managers' Financial Integrity Act	Sept. 27, 1985	GAO/NSIAD-85-148
Army's Progress in Implementing the Federal Managers' Financial Integrity Act	Sept. 27, 1985	GAO/NSIAD-85-149
Navy's Progress in Implementing the Federal Managers' Financial Integrity Act	Sept. 27, 1985	GAO/NSIAD-85-150
Air Force's Progress in Imple- menting the Federal Managers' Financial Integrity Act	Sept. 27, 1985	GAO/NSIAD-85-151

ACTIONS TAKEN BY DOD COMPONENTSTO ADDRESS EVALUATION PROGRAM PROBLEMSREPORTED BY GAO IN 1984

<u>REPORTED PROBLEM</u>	<u>ACTIONS TAKEN</u>
<u>Guidance</u> --did not include all factors considered necessary for adequate assessment of the potential for fraud, waste, and abuse.	OSD revised DOD Directive 7040.6 to incorporate all of the suggested criteria.
<u>Training</u> --little or no how-to training was provided. Practical, hands-on training materials could help improve evaluation consistency and documentation problems.	DOD developed a self-study course for lower level DOD managers which is currently being distributed. It is expected to help improve evaluation quality and improve standardization.
<u>Quality Control</u> --procedures were lacking in most programs which resulted in differences in coverage and poor documentation of evaluations.	Progress was made in some components; however, much more must be done to assure better quality evaluations. See our individual reports for specifics.
<u>ADP Controls</u> --all components we reviewed failed to adequately review ADP general and application controls during evaluations. Guidance was needed.	A DOD work group was formed and it developed a comprehensive ADP Internal Control Guideline, which was issued early in fiscal year 1985.
<u>Follow-up Systems</u> --were not fully developed in most of the components we audited.	A DOD tracking system has been designed and a semi-annual reporting requirement established.
<u>Accounting Systems</u> --were not evaluated specifically to assess how well they operated. DOD guidance was needed on assigning responsibility for documenting system designs, testing operations, and tracking reported problems.	More evaluations were conducted, but DOD guidance was not provided. Testing still remains inadequate.

Our individual component reports contain additional details on actions taken to address FIA evaluation problems.



EXAMPLES OF DOD ACCOUNTINGSYSTEMS' CONFORMANCE PROBLEMS

DOD's reported deficiencies cover a wide range of accounting problems that preclude 86 systems from being in conformance with the Comptroller General's requirements. Examples of some of the most important problems are given below.

The Air Force's General Accounting and Finance System accounts for approximately \$114 billion in appropriations at more than 120 field locations, and also supports more than 50 non-Air Force federal agencies. Reported problems include a need for depreciation accounting and total costing, accounting for and reporting contingent liabilities, and property accounting. Also, the general ledger is deficient, in that it lacks a coding structure to ensure that entries are made to the proper accounts based on source documents. The need for accurate balances is especially important, in that they serve as a high-level of control over the integrity of data in the systems and subsystems and the reliability of financial reports.

The Defense Logistics Agency pays contractors for various items before the material is received. Payments may be made based on an invoice or notification that items have been shipped. In 1984, the Agency identified losses of over \$22.6 million for items which were paid for but could not be verified as received. In addition, agency personnel are attempting to determine whether items valued at \$53 million, and that are more than 90 days past scheduled delivery dates, have been received. The large loss, coupled with the uncertain location of items, clearly shows that accounting system procedures are not being adequately followed in monitoring and controlling millions of dollars of government assets.

The Navy stated that its military pay accounting system, which processes about 1 million active, retired, and reserve military pay records, does not produce accurate, consistent, and timely information. As a result, the Navy advised that incorrect amounts are paid to active military personnel; duplicate payments are made to retirees or annuitants; and incorrect amounts are remitted to the Internal Revenue Service for federal income tax withheld.

The Army reported that its present military accounting system is comprised of 66 subsystems. The known major deficiencies in the overall system included inadequate general ledger control and reporting, incomplete property and cost accounting, inadequate documentation, and poor control over pay entitlements.

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, using transaction testing as the key, more than one of the above techniques are needed to test all important 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.



## ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

COMPTROLLER

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 JULY 29, 1985  
(GAO CODE 390017 - OSD CASE 6809)

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

DOD COMMENTS

\* \* \* \*

FINDINGS

- o **FINDING A: A Basic Evaluation Framework Is Set, More Improvement Still Needed.** GAO found that, overall, the DoD has established the basic framework to allow full implementation of the FMFIA. GAO also found that DoD managers identified and corrected thousands of control weaknesses at lower levels, aiding in preventing them from reaching Component-wide significance. Additionally, GAO found the 5 reporting centers that it examined have taken positive action to address most of the evaluation program problem areas GAO reported. GAO concluded, however, that DoD's management controls evaluation program has not matured to the point where it provides an adequate basis for determining the status of the internal controls, or that the internal controls, taken as a whole, comply with the requirements of the FMFIA. Many DoD accounting systems, GAO found, have not been evaluated and for those that have been, either adequate time was not available to perform all the necessary tasks and/or little testing of the systems was done to see if they were operating as intended and were in conformance with the Comptroller General's principles, standards and related requirements. GAO concluded that much more needs to be done to DoD's accounting systems before determinations of conformance can be made and before DoD can report that it has "basis accountability" over its resources. GAO finally concluded that, although progress was evident, some essential improvements still need to be made to form an adequate basis for future statements of reasonable assurance. (Pages 1-3)

**DoD Response: Partially concur.** The DoD Internal Management Control (IMC) Program is a maturing program and the objective for 1984 was to establish the basic framework for the program. That objective was accomplished. However, when GAO concludes that DoD has not established an adequate basis for determining the status of the internal controls, or that the internal controls, taken as a whole, do not comply with the requirements of the FMFIA, that conclusion may be attributed to the narrowness of the criteria employed by GAO. Since internal control is a managerial tool, managers are not restricted to, nor should they rely solely

Note: Where applicable the page numbers have been changed to correspond with this report.

on the mechanisms of one program to be assured of its existence. Yet GAO's criteria suggest that the only means by which one can be assured of internal control is by relying solely on the procedures of the IMC Program. Taken as a whole, DoD has several key managerial methods which provide assurance that appropriate internal controls are in place. GAO should have expanded its criteria so as to note the assurances of internal control provided by existing instructions and guidance published by the OSD and DoD Components; the activities of the IG, DoD; agency audit results; internal review organizations, and GAO findings. It is this DoD expanded view of internal control safeguards that provides management with reasonable assurance.

DoD is not aware of any published GAO guidance stating that transaction testing is the sole basis for determining compliance with the GAO accounting principles, standards, and related requirements. In a meeting held June 18, 1984, co-hosted by GAO and OMB, GAO stated that the questionnaire approach to system review was an acceptable method. However, this method should be enhanced by performing some "transaction sampling." The questionnaire methods developed by two civilian agencies were cited as examples to follow. Not being totally satisfied with the questionnaire approach to evaluating operating accounting systems, Office of the Assistant Secretary of Defense (Comptroller) (OASD(C)), issued instructions, dated August 27, 1984, to the Military Departments specifying that testing of systems should be performed.

DoD provided GAO representatives a copy of the proposed requirements for evaluating accounting systems. GAO's response, dated August 31, 1984, recommended that the guidance emphasize periodic testing by the Components; however, GAO did not offer any testing guidance.

Additional guidance, dated May 23, 1985, was provided to the DoD Components emphasizing the need to include transaction testing of their operating accounting systems in determining conformance with GAO accounting principles, standards, and related requirements. The guidance also emphasized the need to evaluate all operating accounting systems which are not scheduled to be replaced in the near future. We do not expect the Components to perform tests on accounting systems which are scheduled to be replaced in a few years. This guidance will be included in Chapter 12 of the DoD Accounting Manual, 7220.9-M. The DoD expects to finalize and issue this guidance during September 1985.

- o **FINDING B: A Mechanism Is Needed To Identify Control Weaknesses Not Identified As DoD-wide Even Though They Likely Are Systemic In Nature.** GAO found a wide variance in the degree of specificity with which DoD Components reported material management control weaknesses and corrective



actions. GAO noted that the OSD FMFIA program manager, in a February 1985 briefing, recognized a variance in Component reporting specificity and pointed out that the Components had reported unevenly and many functional areas were not well represented. GAO found that the Army reported problems in very specific detail, while the Navy and Air Force summarized weaknesses into fewer problem areas. This condition could result, GAO concluded, in some problems not being recognized as systemic and a failure to take needed corrective actions on a DoD-wide basis. GAO reported that OSD officials, being aware of these possibilities, issued new reporting instructions in July 1985. The new instructions, according to GAO, require more data on sources and the impact of weaknesses and provide examples for reporting. GAO, however, concluded that OSD managers also need a mechanism to help identify and treat weaknesses as systemic. GAO suggested that the mechanism used by the Army, Air Force, or Assistant Secretary of Defense (Comptroller) would enhance the recognition of systemic weaknesses. (Pages 4-6)

**DoD Response: Concur.** On June 18, 1985, the ASD(C) issued guidelines and suggestions for use by DoD Components in preparing their fiscal year 1985 Annual Statement of Assurance. At that time, DoD guidance was provided which closely parallels the essence of this finding. An itemization of 15 individual standardized categories for identifying material weaknesses, with a cross indexing to the 34 categories employed by the IG, DoD, was provided as a common basis of classification for all DoD Components. Contained with this itemization were written specifications for each of the 15 categories. These 15 categories were also incorporated into the DoD automated IMC tracking system. The tracking system had been established earlier in 1985 as another means of standardizing program activity reporting and the correction of material weaknesses. The system also provides enhancements to the analytical aspects of the IMC process. Another section of the guidance contains an instruction providing for a commonality of source inputs for the identification of material weaknesses. In that context, Components were advised to review and identify those inspection, investigative, internal review, and audit reports or studies (including the results of GAO, IG, or agency audit, investigation, or inspection reports), as well as the mechanisms of the DoD IMC process, for material weaknesses that should be included in Component annual statements of assurance. This guidance also provided the DoD Components with an expanded definition of material weakness as a common basis for reporting.

- o **FINDING C: Accounting Systems Require Testing To Show Conformance With The Comptroller General's Requirements.** GAO noted that in 1984, DoD reported 64 of its 150 accounting systems were substantially in conformance with

the Comptroller General's requirements, and that the systems assured basic accountability over DoD resources. GAO found that DoD, in its second-year implementation of the FMFIA, has made progress in implementation and has generally reported all known accounting systems conformance problems and the plans for correction. GAO concluded that DoD's basis for reporting conformance was inadequate because the Components' evaluations generally did not contain enough work to determine whether the systems were operating as intended. GAO found that the lack of testing was a common weakness, and concluded that testing should be conducted on all critical system areas. GAO pointed out that DoD has recognized the importance of testing, stating in its 1984 report that transaction testing will be a basis for determining if a system is in conformance in the future. (Pages 7-8, and 11)

**DoD Response: Concur.** The revised Chapter 12 to the DoD Accounting Manual, 7220.9-M, specifically requires testing of operating accounting systems as part of the evaluation process. Future certification statements signed by Component heads must indicate that such certifications are based upon transaction testing of systems.

It is not clear that the GAO recognized the full extent of system testing performed by the DoD Components. GAO's definition of testing systems in operation states: "Testing 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 followup procedures." Many, if not all, of these procedures were performed to some degree. For example, the Army examined the system documentation for all 66 of its operating systems. DoD reported in its 1984 report that limited transaction testing was performed on sensitive areas in 10 systems or system segments. Such limited transaction testing should produce results similar to GAO's testing live transactions, comparing results, and direct testing of computer-based systems.

- o **FINDING D: DoD Policy On Accounting Systems Evaluation And More Timely Reporting Instructions Needed.** GAO found that DoD progress in implementing the FMFIA was marked by improved Component inventorying of accounting systems and other more specific improvements. GAO also found, however, that there is no DoD policy on accounting systems evaluations. GAO further found that DoD did not issue timely reporting instructions to the Components -- instructions were issued on September 5, 1984, with a response deadline of November 15, 1984. GAO concluded that, in view of the complexity of DoD's worldwide operations and the required chain of command reporting, sufficient time was

not provided. GAO cited a December 21, 1984, Defense Inspector General memorandum that stated DoD had completed the second year accounting systems evaluations, and had yet to issue a directive for accounting systems reviews similar to those issued for the Internal Management Control Program. GAO concluded that the absence of the policy directive, coupled with the late reporting instructions, resulted in inconsistencies and varied responses from the Components. GAO further concluded that accounting systems evaluation policy guidelines should, at a minimum, clearly establish evaluation objectives, criteria, methodology, system testing and documentation requirements, reporting criteria and deadlines, as well as provide for identified control weaknesses to be considered when accounting systems are evaluated. GAO finally concluded that DoD needs to issue instructions for the annual reports from the Components on a more timely basis. (Pages 8-9, and 11)

**DoD Response: Concur.** The DoD agrees that, to ensure Components comply with the FMFIA Act, guidance must be issued in a timely manner. This should not be a problem once the guidance is issued and implemented. DoD is planning to issue final guidance in September 1985.

#### RECOMMENDATIONS

- o **RECOMMENDATION 1:** GAO recommended that the Secretary of Defense assign key OSD officials responsibility for certifying the adequacy of internal management controls within their functional areas. This would help assure that systemic material weaknesses were being identified and treated on a DoD-wide basis. Designated officials should then consider adopting either the Army or the Air Force process for functional managers to use in determining the operational adequacy of controls within their areas of responsibility. (Page 12)

**DoD Response: Concur.** Both the Deputy Secretary of Defense (DepSecDef) and the Assistant Secretary of Defense (Comptroller) (ASD(C)) have already taken action consistent with the intent of this recommendation. On February 13, 1985, the ASD(C) briefed the Defense Council on Integrity and Management Improvement (DCIMI) on the status of Component-wide material weaknesses. The DCIMI is chaired by the DepSecDef and comprised of senior level OSD managers. Following that briefing, by memorandum on March 1, 1985, the DepSecDef directed the Under Secretaries of Defense, and the Assistant Secretaries of Defense for Health Affairs, Manpower, Installations & Logistics, and Reserve Affairs to work with the ASD(C) on corrective actions for material weaknesses in their functional areas. As a result of these actions, there currently exists a monitoring and reporting system at the levels described by the GAO recommendation.

OSD functional managers are requested to review material weaknesses and suggest other areas for inclusion and validate already identified problems. During fiscal year 1986, it is intended that OSD functional managers will become more involved with problem identification as well as correction of Component identified problems.

- o **RECOMMENDATION 2:** GAO recommended the future DoD annual statements on systems of internal and administrative controls not report reasonable assurance that the requirements of FMFIA have been met until such time as the revised FMFIA evaluation program provides an adequate basis to make such a determination. (Page 12)

**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 3:** GAO recommended that the Secretary of Defense implement a policy directive for evaluating accounting systems' conformance with the Comptroller General's requirements. As a minimum, the directive should establish the objectives, criteria, methodology, testing and documentation requirements, and reporting deadlines for the DoD Components' accounting systems evaluation programs. (Page 12)

**DoD Response: Partially Concur.** The DoD policy for evaluating operating accounting systems is included in the revised Chapter 12 of the DoD Accounting Manual, 7220.9-M, which is planned for issuance during September 1985. Each of GAO's concerns are addressed in the Chapter, but specific methodology is not established. Each DoD Component will be responsible for developing and implementing a specific evaluation methodology that is in accordance with the policies stated in Chapter 12. In addition, the revised Chapter 12 will contain suggested evaluation methods and procedures.

- o **RECOMMENDATION 4:** GAO recommended that accounting systems not be reported (1) as in conformance with the Comptroller General's requirements and (2) as providing basic accountability over resources, until the necessary evaluations of systems have been performed. (Page 12) Draft Report)

**DoD Response: Partially Concur.** DoD believes the evaluations performed by the Components, as well as other institutionalized procedures, were adequate to provide reasonable assurance that the systems reported were in compliance with GAO requirements and that adequate control and accountability over resources exist.

Instructions have been issued to the DoD Components recognizing the need to transaction test their operating accounting systems to provide assurance that the systems are operating as designed and in accordance with prescribed accounting principles, standards and related requirements. The DoD anticipates that the results of system testing will be reflected more strongly in the 1985 FMFIA report.





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