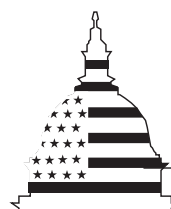


July 2001

FINANCIAL MANAGEMENT

Improvements in Air Force Fund Balance With Treasury Reconciliation Process



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United States General Accounting Office
Washington, DC 20548

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Mr. Thomas R. Bloom
Director
Defense Finance and Accounting Service

Mr. Zack E. Gaddy
Director
Defense Finance and Accounting Service—Denver Center

The Department of Defense (DOD) and its components have had long-standing problems in reconciling the transaction activity in their Fund Balance with Treasury accounts. These reconciliations continue to be a significant challenge facing DOD and contribute to DOD's inability to prepare auditable financial statements and to DOD financial management being a high-risk area.¹ We recently testified² that DOD could not reconcile billions of dollars of differences between its available fund balances and the amounts reported by the Department of the Treasury for those accounts. Until DOD and its components can reconcile the receipt and disbursement activity and demonstrate the validity of their Fund Balance with Treasury accounts, the amount of DOD funds available to them for expenditure in each appropriation account will remain questionable.

Federal agencies record their budget spending authorization in Fund Balance with Treasury accounts, and increase or decrease these accounts as they collect or disburse funds. Routinely reconciling the receipt and disbursement activity, as Treasury guidance requires, helps to ensure that all transactions are included in the agencies' Fund Balance with Treasury accounts. Agencies reconcile differences between their records and Treasury's by either recording the transactions that make up the differences or by correcting errors. In general, the reconciliation process can be described as consisting of two distinct parts. First, Treasury compares the payments and collections processed by the Federal Reserve and commercial banks to the amounts federal agencies reported to Treasury themselves or amounts reported for them by other agencies.

¹*Major Management Challenges and Program Risks: Department of Defense* (GAO-01-244, January 2001).

²*DOD Financial Management: Integrated Approach, Accountability, and Incentives Are Keys to Effective Reform* (GAO-01-681T, May 8, 2001).

Second, agencies must ensure that the disbursements and receipts reported to Treasury agree with their own data. For DOD components, this second part of the process is complicated by the fact that DOD components process disbursements for each other and because DOD components allow certain other federal agencies to make disbursements on their behalf. As a result, timing differences often occur between the reporting of DOD transactions to Treasury and the recording of transactions in DOD components' books.

In August 1998, DOD developed a strategic plan to improve the reconciliation process for the activity in its Fund Balance with Treasury accounts. DOD told us that the Defense Finance and Accounting Service's (DFAS) Denver Center, which provides support for the Air Force, has made the most progress in implementing this plan, and that its process for reconciling the activity in the Air Force General Funds³ is more comprehensive than that of the other DOD components. Consequently, we chose to review DFAS Denver's reconciliation processes. Our objectives were to determine (1) the progress DFAS Denver has made in improving its processes for reconciling the transaction activity in the Air Force General Funds and (2) whether the DFAS Denver reconciliation concepts, policies, and practices could be used in reconciling the Fund Balance with Treasury activity of other DOD components. The scope of our review focused solely on evaluating the processes used by DFAS Denver to reconcile Air Force's General Funds activity. However, we did not perform detailed testing of the transaction data used in the reconciliation process.

Results in Brief

DFAS Denver has made progress in developing a comprehensive reconciliation process for the Air Force General Funds' transaction activity in the Fund Balance with Treasury accounts, primarily by increasing management attention. However, the process needs some refinements.

DFAS Denver's two-part process includes reconciling (1) Treasury-identified cash differences and (2) DFAS Denver-identified differences between its and Treasury's records. To improve the first part, DFAS

³General funds are used to record financial transactions arising under congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts. The Air Force manages 16 general fund accounts, consisting of 7 funded by annual 1-year appropriations and 9 funded by multiyear appropriations.

Denver has developed additional guidance, provided training to its staff, and improved oversight to address an Air Force Audit Agency finding that DFAS Denver was not promptly researching and correcting differences. DFAS Denver's records show that this increased management attention has reduced the reported unreconciled net cash transaction differences that are from 2 months to 1 year old from \$26 million as of September 30, 1998, to less than \$400,000 as of September 30, 2000.

Prior to 1998, DFAS Denver was not performing part two of the reconciliation. Since then, DFAS Denver management has made a concerted effort to develop a comprehensive reconciliation process. DFAS Denver now (1) compares Treasury reports to Air Force accounting records to identify the total difference between the two sets of data, (2) attempts to identify the transactions that make up the unreconciled difference and categorizes them by type, and (3) tracks the identified transactions until they are recorded or corrected by field-level Air Force accounting stations. With these new procedures and increased management attention, DFAS Denver reports that it has been able to significantly reduce the amounts for which it has not been able to identify transactions that make up the unreconciled differences. DFAS Denver also reported improved ability to reconcile transactions within DFAS time frame performance metrics.

Although DFAS Denver has reduced the outstanding unreconciled differences from both parts of its reconciliation process, it has not yet documented the entire process to ensure that all necessary activities will continue to be performed if the personnel who currently know the processes leave. Further, the second part of the process needs additional refinement. For example, DFAS Denver has not yet developed the capability to identify all the transactions making up the unreconciled difference between its and Treasury's records. In addition, DFAS Denver has not prepared specific desk procedures for some of the individual activities within the second part of the process. Without such documentation, the process depends on the creativity and knowledge of a few individuals and is vulnerable to loss of momentum should one or more of these individuals no longer work in the area.

The concepts and policies developed thus far by DFAS Denver to identify and resolve transaction differences could improve the reconciliation processes of the other DFAS centers that have not made as much progress. The increased management attention devoted to identifying transactions making up the differences and reconciling those transactions that has been instrumental in DFAS Denver's reported success would

likely prove successful at the other DFAS centers. With increased management attention, each DFAS center could tailor the concepts and processes used at DFAS Denver to its individual environment even though each center has its own legacy system, which causes them to operate differently.

Once all of the DOD components are able to establish a comprehensive and routine reconciliation of the transaction activity in each of their appropriation accounts, DOD will be closer to establishing accountability over its unexpended balances. Reconciling and auditing the current activity can, over time, result in having a verifiable beginning balance in the Fund Balance with Treasury accounts.

We are making recommendations that address the need for DFAS Denver to continue its efforts to refine the reconciliation process. We are also recommending that DFAS headquarters direct and facilitate the other DFAS centers' adaptation of DFAS Denver's reconciliation concepts and policies to improve their Fund Balance with Treasury account reconciliations. DOD agreed with our recommendations, described completed and ongoing actions to address these issues, and provided estimated completion dates.

Background

Federal agencies record their budget spending authority in fund accounts called Fund Balance with Treasury (FBWT), and increase or decrease these accounts as they collect or disburse funds. In the federal government, an agency's FBWT account is the closest thing an agency has to a corporate bank account. The difference is that instead of a cash balance, FBWT represents unexpended spending authority in appropriations.⁴ In enacting appropriations, Congress authorizes agencies to spend from the various FBWT accounts to meet their missions. These fund accounts serve as a control mechanism to help ensure that agencies' disbursements do not exceed the appropriated amounts.

Reconciling FBWT activity is an important internal control in ensuring that all receipt and disbursement transactions have been recorded in the accounting records of government agencies. Reconciling agency FBWT

⁴An appropriation provides an agency with two authorities—the authority to incur obligations and the authority to disburse funds from the Treasury to liquidate those obligations.

activity records with Treasury activity records is important to establish the completeness of transactions reported and can be used to determine unexpended fund balances. Reconciliation is a necessary step in achieving funds control. A reconciliation consists of comparing two or more sets of records, researching and resolving any differences, and recording adjustments if necessary. Reconciliations are to be performed routinely so that any problems are detected and corrected promptly and differences are not allowed to age, thereby becoming increasingly difficult to research.

DFAS, a component of DOD, has responsibility for providing finance and accounting services to all other DOD components, including the Air Force, Army, Navy, and Marine Corps. DFAS' headquarters unit and five DFAS centers are responsible for accounting, disbursing, collecting, and financial reporting for DOD components. DFAS Denver, with support from its field locations, is specifically responsible for Air Force accounting functions. Air Force and other components' personnel are responsible for funds control and purchasing the goods and services necessary to meet their missions. The Office of the Under Secretary of Defense (Comptroller) issues the *DOD Financial Management Regulation* containing DOD's policies and procedures in the area of financial management.

The DFAS centers and their field locations process cash, interagency, and intra-DOD transactions based on requests from military service personnel. Cash transactions primarily consist of paper checks issued, electronic funds transfers, and deposits. Interagency and intra-DOD transactions are primarily transfers of funds between federal entities and do not involve cash; however, they affect the FBWT accounts the same way cash transactions do. DFAS increases or decreases DOD's individual FBWT account balances during the year as funds are collected or disbursed. DFAS is responsible for maintaining transaction-level details and a record of the unexpended balance for each of DOD's appropriation accounts. Treasury also maintains accounting information on the Air Force's and other federal agencies' FBWT activity to prepare governmentwide financial reports. In an effort to ensure the integrity of these reports, Treasury directs agencies to reconcile their reported FBWT activity on a regular and recurring basis.⁵

⁵*Department of the Treasury Financial Manual*, Vol. 1, part 2, chap. 5100 on Reconciling Fund Balance with Treasury Accounts, <http://fms.treas.gov/fundbalance>.

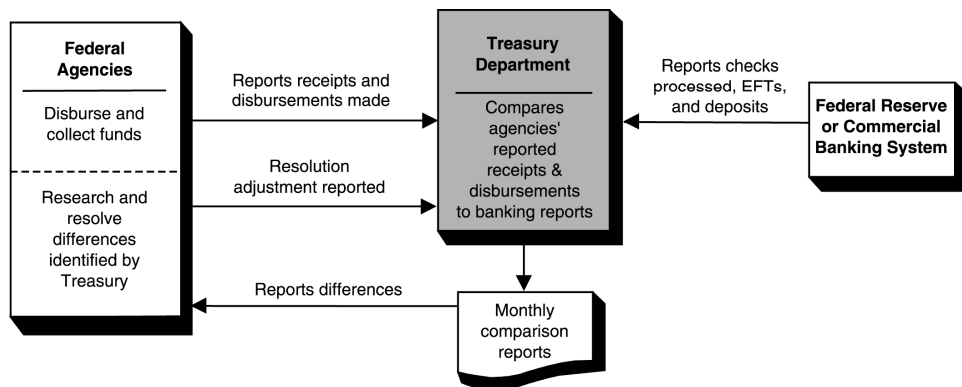
Many disbursements from Air Force General Funds are made and reported to Treasury by other DOD services and federal agencies in accordance with pre-arranged agreements. These other DOD components and agencies process disbursements from Air Force General Funds for obligations that were established by Air Force personnel responsible for buying goods and services and then transmit information on their disbursements for Air Force to Treasury and separately to DFAS Denver. Federal agencies and the other DOD components disburse the funds first, and DFAS Denver field locations receive the detailed accounting transaction data from them later. This process is different from both normal bookkeeping operations in the private sector and keeping one's personal checkbook. This DOD system is similar to having more than one person writing checks on the same bank account, which would create uncertainty in knowing the balance in the account. Increasing the difficulty in knowing the balance is DOD's long-standing problem of not having integrated accounting systems, which routinely causes accounting data to be processed at different times.

The following example illustrates the interagency disbursement system. Assume the Air Force authorizes the State Department to disburse Air Force funds. The State Department pays a bill for the Air Force and sends the information to Treasury. Treasury then subtracts the funds from the Air Force's FBWT. Treasury reports the disbursement to DFAS Denver. However, DFAS Denver cannot record the related expense transaction or subtract the already disbursed funds from the FBWT account balance on its books until it receives sufficient details from the State Department. These details can come after the month-end Treasury report. When DFAS Denver receives the transaction data from the State Department, DFAS Denver sends the information to the Air Force field activity that authorized the disbursement. The Air Force field activity matches the disbursement to the original obligation and records the transaction. Each month, DFAS Denver compares the activity recorded in the Air Force FBWT account to the activity reported in the account by Treasury. Because multiple federal agencies and other DOD components can affect the Air Force's fund balance accounts at Treasury, DFAS Denver's recorded transaction activity routinely differs from Treasury's, creating reconciling items at any point in time. These multiple participants in the disbursing and collecting process make the reconciliation process more complex than reconciling one's personal checkbook.

The reconciliation process consists of two parts. First, Treasury compares agency-reported receipts and disbursements to amounts reported by the Federal Reserve or commercial banking system. Treasury then provides

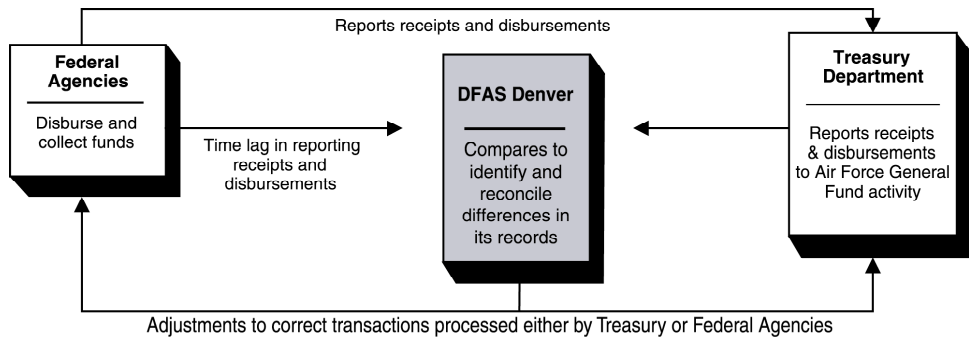
agencies the details of any identified discrepancies in monthly comparison reports. Each agency is responsible for researching the differences between its and Treasury's records. Once differences are resolved, agencies record any necessary adjustments to their FBWT accounts and report these adjustments to Treasury. To correct bank errors, agencies contact the bank or Treasury for assistance. Figure 1 summarizes this first part of the FBWT reconciliation process.

Figure 1: Treasury Comparison of Agency and Bank Reported Activity



For the second part of the reconciliation process, DFAS Denver compares the disbursement and collection transaction activity for each appropriation account in its records for the Air Force General Funds to another monthly report from Treasury that shows the activity reported by all agencies for each fund account. Since, as previously explained, Treasury receives some of the disbursement and collection activity directly from other entities before DFAS Denver, timing differences often occur. DFAS Denver then identifies and reconciles any timing differences or errors. Timing differences are resolved through the normal course of DFAS Denver's staff recording transactions in Air Force records. To correct errors, including those made by other agencies in reporting Air Force fund account transactions to Treasury, DFAS Denver's staff records adjustments to Air Force records and reports them to Treasury and the other agencies as appropriate. Figure 2 summarizes the second part of the FBWT reconciliation process.

Figure 2: Comparison of Air Force Records and Treasury Activity Reports



The reconciliation process at DFAS Denver and the other DOD components is complicated by the long-standing problem of a lack of integrated systems within and among the components. DFAS Denver currently depends on file extracts from multiple systems for its reconciliations. DFAS Denver’s staff analyzes the numerous extracts and determines the causes of the differences in the multiple systems. To be effective, this reconciliation process must be comprehensive to overcome and compensate for the lack of integration among its systems.

Objectives, Scope, and Methodology

Our objectives were to determine (1) the progress DFAS Denver has made in improving its processes for reconciling the transaction activity in the Air Force General Funds and (2) whether any of DFAS Denver’s reconciliation concepts or policies could be used in reconciling the Fund Balance with Treasury activity of the other DOD components. Our review focused on the General Funds reconciliations and did not include Air Force Working Capital Funds⁶ reconciliations.

To determine the extent of progress DFAS Denver has made in improving the reconciliation of the transaction activity in the Air Force General Funds, we met with DFAS Denver officials and observed DFAS Denver procedures for monitoring the field reconciliation efforts. We obtained reports of outstanding differences for the Air Force General Funds from DFAS Denver and Treasury. We determined whether existing DFAS

⁶Working capital funds are revolving funds that receive their initial working capital through an appropriation or a transfer of resources. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders.

Denver policies, procedures, and practices reflected the need for improvements outlined in prior year audit reports issued by GAO, DOD's Inspector General, and the Air Force Audit Agency.

To determine whether the DFAS Denver reconciliation concepts, policies, and practices could be used across DOD, we met with DFAS headquarters, Denver, Cleveland, and Indianapolis officials to identify the similarities and differences among DFAS centers and the FBWT reconciliation initiatives in place at each center. To determine the progress other centers had reported in reconciling their FBWT accounts, we obtained reports of outstanding differences from DFAS headquarters and Treasury.

The scope of our review at DFAS Denver focused solely on evaluating the processes used to reconcile the Air Force General Funds activity and did not include detailed testing of its reconciliations or of data provided by Treasury or the Air Force Audit Agency. Also, we did not determine whether DFAS Denver's policies and processes are uniformly in place throughout all of its field locations. We did not audit the Air Force's FBWT reconciliation and thus provide no conclusions as to whether the processes discussed in this report are being effectively performed.

We performed our work from August 2000 through April 2001 in accordance with generally accepted government auditing standards.

Written comments on a draft of this report were received from the Director of Accounting, DFAS, and have been reprinted in appendix I.

Reconciliation Process Improved but Further Refinement Is Necessary

DFAS Denver has developed a two-part process for reconciling its FBWT receipt and disbursement activity that reconciles differences in (1) cash transactions identified by Treasury and (2) Air Force transaction records compared to transaction activity reported to Treasury. Over the past few years, by increasing management attention on the reconciliation process, DFAS Denver has made improvements in both parts of the process and has reported a corresponding reduction in its unreconciled differences. However, its reconciliation processes are not yet fully refined.

Improvements in Tracking and Resolving Cash Differences Identified by Treasury

In prior years, auditors identified and reported weaknesses in DFAS Denver's ability to effectively reconcile the cash activity part of its FBWT reconciliation. For example, in reporting on the results of its audit of the Air Force's fiscal year 1997 financial statements, the Air Force Audit Agency noted that DFAS Denver field personnel did not promptly research

and correct deposit and disbursement differences identified by Treasury.⁷ In addition, the Air Force Audit Agency identified internal control weaknesses for fiscal year 1998 related to the (1) monitoring and reconciliation of check totals, (2) timely reporting of checks, and (3) prompt resolution of check amount discrepancies.⁸

In recent years, DFAS Denver has increased the management attention given to resolving cash differences identified by Treasury, which is part one of the FBWT reconciliation process. At the heart of its efforts are several initiatives to improve its processes for identifying, researching, and resolving the differences. For example, DFAS Denver has implemented new procedures for reconciling deposit and electronic funds transfer transactions. Each month, DFAS Denver produces exception reports containing specific transactions that have been reported to Treasury (1) by the Federal Reserve but not by DFAS field personnel, (2) by DFAS field personnel but not the Federal Reserve, and (3) in different months, for different amounts, or otherwise reported differently by DFAS field personnel and the Federal Reserve. DFAS Denver provides these lists each month to field accounting personnel to aid them in resolving differences. DFAS Denver personnel monitor the timeliness of field resolution of these differences and contact field personnel regarding aged unresolved amounts.

In addition to improving its reconciliation processes for deposits and electronic funds transfers, DFAS Denver also has improved its methods of monitoring differences related to paper checks. DFAS Denver receives a Treasury notification of individual paper check errors throughout the month as Treasury identifies discrepancies between the check amount reported by DFAS Denver and the amount paid by the bank. In addition, Treasury also reports these check discrepancies in a summary comparison report sent to DFAS Denver after month-end. DFAS Denver has added a procedure to monitor and correct the individual check errors prior to receiving the monthly summary comparison reports from Treasury.

Other initiatives DFAS Denver has undertaken include

⁷ *Air Force Audit Agency Report of Audit: Accounting for Selected Assets and Liabilities, Fiscal Year 1997 Air Force Consolidated Financial Statements* (September 1998, Project 97053001).

⁸ *Air Force Audit Agency Report of Audit: Accounting for Selected Assets and Liabilities - Fund Balance with Treasury, Fiscal Year 1998* (January 2000, Project 98053001).

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- adding a new section to the mandatory training class for new disbursing officers describing procedures for clearing differences reported by Treasury;
 - adding a section to the DFAS Web page providing detailed instructions for DFAS Denver and field accounting personnel for resolving cash transaction differences;
 - increasing the use of electronic funds transfers rather than paper checks (issuing electronic funds transfers is a more automated process than issuing paper checks, and, since the transaction occurs immediately, timing differences are virtually eliminated); and
 - issuing memorandums requiring field personnel to increase the priority given to resolving FBWT differences identified by Treasury.

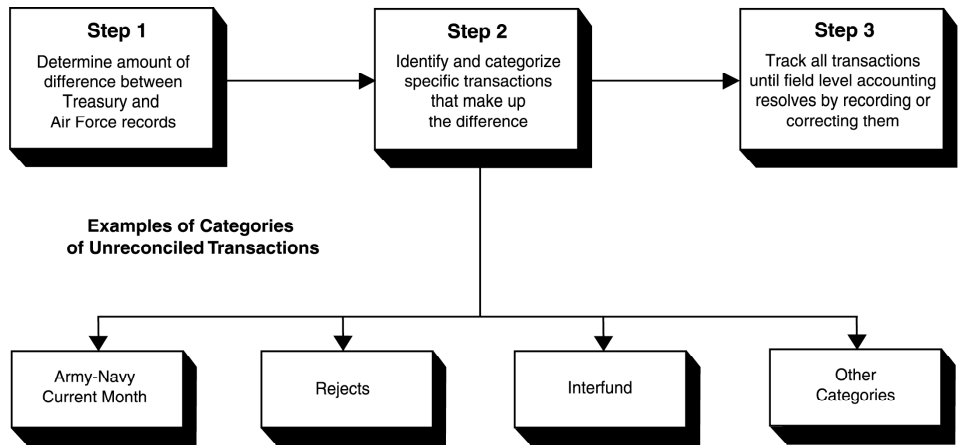
These proactive initiatives have been a major factor in DFAS Denver's reported reduction in cash transaction discrepancies. For example, according to Treasury reports as of September 30, 2000, the current net unresolved cash differences from 2 months to 1 year totaled less than \$400,000 compared to \$26 million as of September 30, 1998.

DFAS Denver's experience also provides evidence that not performing routine reconciliation can result in differences getting so old that they become difficult to reconcile. Treasury records as of September 30, 2000, show \$56 million still outstanding in net unreconciled cash differences that occurred over 5 years ago before the new reconciliation procedures were in place. DFAS Denver has found it difficult to locate supporting documentation to determine the causes of these old differences. The records also show that DFAS Denver has only \$260,000 net unreconciled differences that are from 1 to 5 years old.

Improvements in Reconciliation of Air Force Records to Transaction Activity Reported to Treasury

Every month, timing differences occur between when Treasury and Air Force receive and record transactions. These differences are caused by the lack of integrated accounting systems and routine business processing. Consequently, DFAS Denver must routinely reconcile its transaction records to those at Treasury. Prior to fiscal year 1998, DFAS Denver was not reconciling these monthly differences in the two sets of records. Over the past 3 years, DFAS Denver developed the second part of the overall reconciliation process to reconcile the difference between its records and those at Treasury as shown in figure 3. DFAS Denver's goal for this process is to identify the transactions that make up the difference, categorize them to facilitate reconciliation, and track them until they are reconciled.

Figure 3: Reconciliation of Difference Between Air Force Records and Treasury Records



The first step is to determine the difference between Treasury and Air Force records each month. DFAS Denver does this by comparing the total Air Force disbursement and receipt transactions in Treasury’s records to the comparable transactions in Air Force accounting records and calculating the difference. This is the amount that has to be reconciled, which was \$1.6 billion at September 30, 2000.

Step two is a monthly data analysis process to identify the specific transactions making up the difference calculated in step one. DFAS Denver refers to the calculated difference in the two sets of records as the undistributed difference. The term “undistributed” applies to those transactions that have not yet been reconciled—recorded or corrected in the accounting records.

To identify the transactions, DFAS Denver uses data retrieval and analysis tools to extract the transactions in DFAS Denver’s Merged Accounting and Fund Reporting system. The function of this system is to track transactions from the time DFAS Denver receives them from either Treasury or the originators of the transactions until Air Force personnel reconcile them. Once DFAS Denver identifies the transactions that make up the unreconciled difference, it sorts them by appropriation into various categories to help speed and simplify the reconciliation process. Sorting the transactions into categories with common elements facilitates tracking the transactions until the field-level accounting staff fully reconciles them by either recording them in Air Force accounting records, making

corrections to the records, or submitting adjustments or corrections to the originators of the transactions. DFAS Denver has developed 11 categories that reflect the nature of transactions. For example, the categories into which the unreconciled transactions are sorted include the following.

- **Army-Navy Current Month.** The Army and the Navy, which make payments on behalf of the Air Force, cite Air Force appropriations when they submit the payment information to Treasury. Since Air Force field locations often have not yet received the detailed accounting transactions for these payments, these transactions are placed in this category awaiting reconciliation.
- **Rejects.** This category is used when Air Force field locations cannot verify payments made by someone else on their behalf. This can happen when they determine that they have not been provided sufficient supporting documentation to post the transaction or the payment belongs to another accounting station. The field locations “reject” the individual payment back to DFAS Denver for transmission either back to the originator of the payment or to another field location.
- **Interfund.**⁹ DOD components sometimes use the interfund system to sell materials to each other. If the seller and buyer do not record the transactions in the same month, which often occurs, it automatically appears as a reconciling difference between DFAS Denver’s records and Treasury’s records and would be placed in this category for reconciliation purposes.

Reducing the total undistributed amount is important because fewer transactions will have to be tracked until reconciled. However, the use of nonintegrated systems and routine business processes does not permit the simultaneous processing of transactions and affects when transactions are recorded. Therefore, eliminating the undistributed amount entirely is not possible because timing differences will continue to cause a difference between DFAS Denver’s and Treasury’s records that will need to be identified and reconciled.

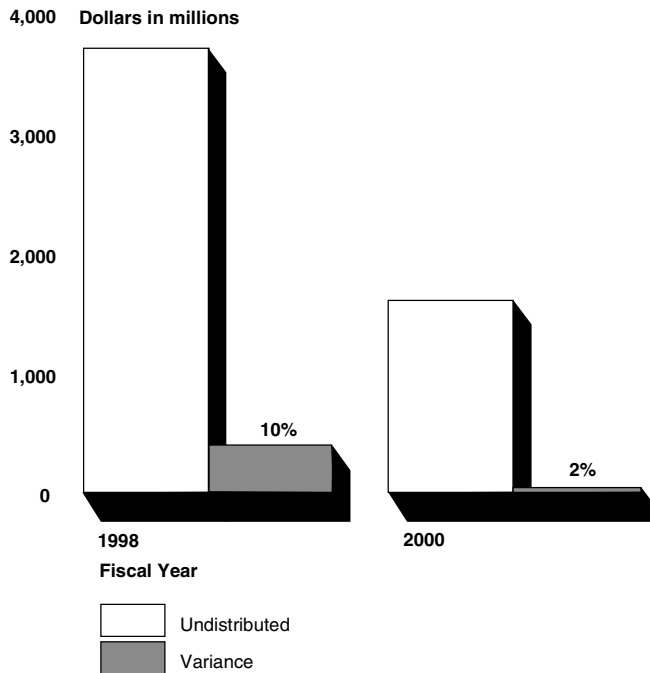
DFAS Denver’s analysis cannot yet identify all the transactions that make up the total undistributed difference. The amount that is not identified is referred to as the “variance.” Eliminating the variance is important

⁹Interfund is a system of billing and collecting for sales of material between activities of different DOD components, or between DOD components and the General Services Administration.

because the variance constitutes the amount of receipt and disbursement activity for which DFAS Denver cannot identify transactions. Without first identifying the transactions, DFAS Denver cannot reconcile the activity.

As figure 4 shows, DFAS Denver has reported progress in reducing both the variance and the total undistributed amount. As of September 30, 2000, the reported variance for all appropriations totaled \$35 million, or about 2 percent, of the \$1.6 billion in total difference in Treasury's and DFAS Denver's records. As of September 30, 1998, the reported variance was \$386 million, or almost 10 percent, of the \$3.7 billion in total difference. At the time of our review, DFAS Denver had additional efforts under way to refine its methodology for identifying transactions for the remaining variance. DFAS Denver officials told us that by April 2001 they had identified causes and potential explanations for all but \$2 million of the \$35 million variance as of September 30, 2000. However, they will not be able to prevent the variance from continuing until they have learned how to consistently identify the types of transactions that were causing the variance.

Figure 4: Reported Reduction in Undistributed Transactions and Variance



Source: Based on DFAS Denver data.

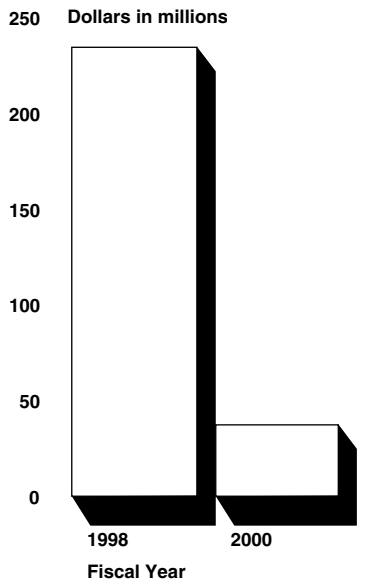
DFAS Denver’s analysis of undistributed transactions is crucial to part two of the overall reconciliation process, and the progress DFAS Denver has made in reducing the reported variance is commendable. However, the undistributed analysis is incomplete because two types of transactions are not subject to the analysis. As discussed in the following section, adding these transactions to the analysis is one of the needed refinements to the reconciliation process.

Step three is the tracking process. DFAS Denver tracks all undistributed transactions until its field-level accounting staff fully reconciles them by either recording them in Air Force accounting records or making corrections to Air Force or Treasury records. In this step, DFAS Denver transmits lists of undistributed transactions in aging categories to the field-level accounting stations each month and requires them to return the lists annotated with a proposed resolution for each transaction. To complete the loop, DFAS Denver personnel are to monitor that the annotated

resolution does, in fact, take place by examining subsequent accounting cycles for evidence of the action.

DFAS Denver measures the success of its tracking efforts against performance metrics for reconciling transactions established by DFAS headquarters. These time frame performance metrics range from 60 to 180 days, depending on the type of transaction. DFAS Denver data indicate that about 85 percent of the total undistributed transactions are reconciled within 60 days, so DFAS Denver's primary focus is on the other 15 percent, although it tracks all undistributed transactions until they are reconciled. DFAS Denver has reported progress in reducing the volume of transactions that fall outside the established time frame performance metrics for reconciling identified transactions. As figure 5 shows, according to DFAS Denver reports, it reduced the portion of the undistributed transactions shown in figure 4 that were not reconciled within the performance time frame metrics from \$234 million at the end of fiscal year 1998 to \$37 million at the end of 2000.

Figure 5: Reported Reduction in Transactions Identified but Not Reconciled Within Established DFAS Time Frame Performance Metrics



Source: Based on DFAS Denver data.

Refinements to Reconciliation Process Are Necessary

Although DFAS Denver has made progress in developing its reconciliation process to fully reconcile the differences between Treasury's and its own FBWT records for the Air Force General Funds, it has not yet achieved that goal. First, DFAS Denver has not documented the overall reconciliation process with explanations of the individual steps, their objectives, and their associated comparisons and reconciliations. Such a description could provide both a road map for the entire process and a means for ensuring that the FBWT activity reconciliation is complete and thorough. In addition to potentially omitting important activities without a complete description of the process, a loss of one or more of the few key people who understand the entire process, especially part two, would jeopardize DFAS Denver's ability to maintain its reconciliation progress and to continue needed refinements.

Second, in addition to the need to document the overall reconciliation process, we identified three refinements to part two of the process that are necessary.

- **Identification of Transactions for Remaining Variance.** As discussed above, DFAS Denver has not yet determined the causes of the remaining difference between its and Treasury's receipt and disbursement activity or the transactions that make it up. Because all transactions have not been identified and because the variance fluctuates somewhat from month to month, further analysis is necessary. Until DFAS Denver can identify all of the transactions that make up the variance, it will not be able to fully reconcile the difference.
- **Undistributed Analysis Incomplete.** DFAS Denver has not included two types of unreconciled transactions in its analysis of the undistributed transactions because they are not in the Merged Accounting and Fund Reporting system. The first type consists of the transactions that field-level personnel have accepted, processed, and entered into the Air Force accounting records but not yet matched to obligations. Field-level accounting staffs recorded these transactions even though DFAS does not consider transactions ready to be recorded in Air Force's official accounting records until they have been matched with their obligations. The second type consists of the transactions recorded temporarily in Treasury suspense accounts. DFAS Denver and Treasury use these suspense accounts to record receipt or disbursement transactions pending identification of the fund holders.¹⁰ DFAS Denver includes these

¹⁰ A fund holder is a unit or individual responsible for incurring obligations against an appropriation and for managing the use of the appropriation's funds.

transactions in the undistributed analysis at fiscal year-end but not routinely every month. Until both types of transactions are routinely identified by appropriate data extracts and included in the monthly analysis of undistributed transactions, DFAS Denver will not have assurance that it has identified the complete universe of transactions that must be reconciled. During our review, DFAS Denver agreed to begin including both types of transactions in the monthly undistributed analysis.

- **Lack of Documentation for Specific Desk Procedures.** DFAS Denver has not fully documented, with how-to desk procedures, some of the steps and activities within the second part of the reconciliation process. For example, the various categories of transactions displayed in the Undistributed Report and the Merged Accounting and Fund Reporting system files from which they are extracted are defined and documented, but the techniques and specific procedures for performing the analysis and developing the report are not. DFAS Denver began a project to document these techniques and procedures during our review. Recreating these management tools without documentation would be difficult for someone who was not familiar with the process. How-to procedures can ensure that the process can be replicated over time. Furthermore, in some instances, only one or two key individuals developed these and other procedures and know how to perform them. Without complete documentation, the loss of a few key people could put DFAS Denver at risk of losing its momentum in reconciling its FBWT activity.

DFAS Denver's Process Improvements Transferable to Other DFAS Centers

The FBWT reconciliation concepts, policies, and procedures developed at DFAS Denver could be used by other DFAS centers, which have not made as much progress in reconciling their FBWT activity, according to DFAS reports and officials. The other centers have not been as successful as DFAS Denver has in identifying transactions that constitute the undistributed difference between their DOD components' accounting records and Treasury's. For example, even though their overall General Funds operating expenditures are comparable to Air Force's, the Army and Navy variances—the amounts for which they cannot determine specific transactions—are substantially larger. As stated previously, DFAS Denver reported a \$35 million variance as of September 30, 2000, for the Air Force. In comparison, DFAS Cleveland reported a \$5.8 billion variance for the Navy, and DFAS Indianapolis reported \$664 million for the Army.

DOD's legacy accounting systems complicate the FBWT reconciliation process. These systems are not integrated, which causes timing differences in processing receipts and transactions since all DOD

components pay bills for each other. In addition, the systems were not designed to facilitate the reconciliation process. Although DOD has had plans under way for years to create integrated systems, it is likely many years away from implementing fully integrated financial management systems.

Nevertheless, the DFAS centers must reconcile their FBWT activity. Each DFAS center processes billions of dollars of transactions each month that must be accounted for and reconciled. Consequently, the centers must create auditable FBWT activity reconciliation processes. To facilitate its efforts, DFAS Denver has designed interim workaround measures, such as its data extracts, to identify undistributed transactions to create useful reconciliation data. DFAS Denver's efforts have demonstrated that current DOD systems can be adapted for routine financial reconciliations if used creatively and with perseverance.

Transferring DFAS Denver's experiences to the other centers is reasonable even though each center relies on different legacy systems, which cause them to operate differently to accomplish the same tasks. Since each center's systems are different, it is the concepts and general approach to developing processes and practices developed at DFAS Denver that can be adapted and utilized, rather than the specific steps in the processes. An example is DFAS Denver's concept of identifying, categorizing, and tracking undistributed transactions as illustrated in figure 3. After comparing their records to Treasury's, the other DFAS centers could first identify the individual transactions that make up the difference between their records and Treasury's. After identifying the individual transactions, they could categorize them by type to facilitate reconciliation. Finally, they could track and monitor the transactions until they are reconciled at the field level.

DFAS Denver has demonstrated that increased management attention can, indeed, result in positive change. Reconciliation of FBWT—a key step in DOD's ability to establish adequate funds control and financial accountability—will only be achieved if the other centers follow DFAS Denver's lead and provide the needed attention to this area.

Other Issues Affecting Fund Balance With Treasury Reconciliation

Increased attention, improved monitoring, and adaptation of the concepts used by DFAS Denver will help all of the DOD components to reconcile their FBWT transaction activity. In addition, a comprehensive reconciliation process can facilitate achieving a successful audit of only that year's FBWT transaction activity. However, one year's successful audit of the reconciliation of FBWT activity will not result in an auditable FBWT financial statement balance because the issue of verifying and auditing the beginning balances will remain. The balances in each FBWT account roll forward from year to year until the account is closed, which can be 5 years or more, depending on the type of appropriation.¹¹ For example, the DOD-wide financial statement reported a FBWT balance of \$178 billion as of September 30, 2000. Some portion of this can be attributed to the beginning balance of \$175 billion in FBWT brought forward on October 1, 1999. Although one year's audit of current activity will not resolve this issue, a series of successful audits can. After a number of years, if current activity is routinely reconciled and audited, the balances from prior years when reconciliations were not routinely being performed will ultimately be immaterial.

One other issue that affects the reliability of the amount of DOD funds available for expenditure in each appropriated fund is DOD's practice of making large amounts of adjustments to closed accounts. For example, as we discussed in our May 2001 testimony on DOD financial management,¹² DOD reported \$2.7 billion of adjustments to closed appropriation accounts in fiscal year 2000. Although closed accounts are not included in FBWT balances, we reported that DOD made frequent adjustments to move transactions from current accounts and charge them to closed accounts. Until all of DOD's transactions are accurately recorded, the reliability of FBWT amounts will remain questionable.

Conclusions

DFAS Denver has made progress in developing an auditable process capable of fully reconciling its FBWT activity, but it has more to do to finish the job. For example, DFAS Denver has not yet identified all of the transactions that make up the difference between its and Treasury's

¹¹Although there can be activity in an expired account until it is closed, only open appropriation accounts are the subject of FBWT activity reconciliation.

¹²*DOD Financial Management: Integrated Approach, Accountability, and Incentives Are Keys to Effective Reform* (GAO-01-681T, May 8, 2001).

receipt and disbursement activity. Finally, a significant amount of the progress has been highly dependent upon the work of a few key people, but their efforts have not been captured in detailed documented procedures. Consequently, if these people were lost, DFAS Denver would risk being unable to institutionalize these processes and losing the momentum it has gained.

The reconciliation process is convoluted in that it involves extracting and comparing data from several DOD systems, which are not fully integrated. However, other DOD components do not have to wait for future system enhancements to institute good financial management practices. DFAS Denver's experience demonstrates that an effective combination of people, policies, procedures, and controls can serve as a short-term solution to the larger and longer term problem of overhauling inadequate systems. The concepts used at DFAS Denver can be adapted by other DFAS centers. However, each center will have to develop its own procedures, data extracts, comparisons, and reconciliations based on the systems it uses.

Recommendations for Executive Action

To further improve the reconciliation of the activity in Air Force Fund Balance with Treasury General Fund accounts and to ensure that the process is comprehensive and institutionalized with continuity of effort, we recommend that the Director, DFAS, direct the Director, DFAS Denver, to

- further refine the reconciliation process to identify and include all transactions that make up the differences between Air Force and Treasury records and resolve these differences within established time frames; and
- document the entire Fund Balance with Treasury General Funds activity reconciliation process, including specific procedures for the various reconciliations within the overall process.

To improve and expedite the reconciliation processes at other DOD components, we recommend that the Director, DFAS, require the other DFAS centers to adapt DFAS Denver's reconciliation concepts and practices to their own environments. To ensure that each center's adaptations are consistent and in accordance with DFAS policies, we further recommend that the Director, DFAS, provide leadership and assistance in transferring knowledge from DFAS Denver to the other centers.

Agency Comments

In written comments on a draft of this report, DOD concurred with our recommendations. DOD's response described the actions that DFAS has underway to address each recommendation and provided estimated completion dates.

We are sending copies of this report to the Under Secretary of Defense (Comptroller and Chief Financial Officer); the Commissioner of the Financial Management Service, Department of the Treasury; and the directors of the four other DFAS Centers: DFAS Cleveland, DFAS Columbus, DFAS Indianapolis, and DFAS Kansas City. Copies will be made available to others upon request.

Please contact Linda Garrison at (404) 679-1902 or by e-mail at garrisonl@gao.gov if you or your staffs have any questions about this report. GAO staff making key contributions to this report were Ray Bush, Francine DelVecchio, David Shoemaker, and Carolyn Voltz.

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive style with a large, stylized initial "G".

Gregory D. Kutz
Director
Financial Management and Assurance

Appendix I: Comments From the Department of Defense



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291
WWW.DFAS.MIL

JUL - 6 2001



Mr. Gregory D. Kutz
Director, Financial Management and Assurance
U.S. General Accounting Office
Washington, DC 20548

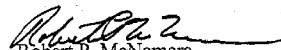
Dear Mr. Kutz:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "FINANCIAL MANAGEMENT: Improvements in Air Force Fund Balances With Treasury Reconciliation Process," dated June 12, 2001 (GAO Code 924053/OSD Case 4015) (enclosure).

While the Defense Finance and Accounting Service (DFAS) has improved its Fund Balance with Treasury (FBWT) reconciliation processes, much remains to be done. We will continue to place management's attention on FBWT reconciliation processes throughout the DFAS network. The DFAS will integrate payment and accounting systems to ensure future disbursements are recorded and reported timely and accurately.

My point of contact is Mr. David Arvin who may be reached by electronic mail at david.a.arvin@dfas.mil or by telephone at (703) 607-2857.

Sincerely,


Robert P. McNamara
Director for Accounting

Enclosure:
As stated

cc:
ODCFO(AP)
DODIG

GAO DRAFT REPORT DATED JUNE 12, 2001
(GAO CODE 924053) OSD CASE 4015

"FINANCIAL MANAGEMENT: IMPROVEMENTS IN AIR
FORCE FUND BALANCES WITH TREASURY
RECONCILIATION PROCESS"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Director, DFAS, direct the Director, DFAS Denver to further refine the reconciliation process to identify and include all transactions that make up the differences between Air Force and Treasury records and resolve these differences within established time frames. (p. 31/GAO Draft Report)

DOD RESPONSE: Concur. DFAS Denver (DFAS-DE) has taken action to move the reconciliation of budget clearing accounts and suspense accounts to Treasury's trial balance. (Completed Date: May 31, 2001) In addition, DFAS-DE fielded a comparison tool at its field sites that will reconcile differences between expenditure records and those reported in the status of funds. A preliminary analysis indicates that the bulk of the remaining variance can be attributed to these differences. Procedures are being drafted for the sites to perform reconciliations and make adjustments. The action for the sites is to identify and clear remaining differences.

Estimated Completion Date: December 31, 2001.

RECOMMENDATION 2: The GAO recommended that the Director, DFAS, direct the Director, DFAS Denver to document the entire Fund Balance with Treasury General Fund activity reconciliation process, including specific procedures for the various reconciliations within the overall process. (p. 31/GAO Draft Report)

DOD RESPONSE: DFAS-DE is reviewing and revising its standard operating procedures (SOPs). It agrees the SOPs do not address the various reconciliations and analyses performed by staff accountants, which will be the focus in revising the procedures.

Estimated Completion Date: July 30, 2001.

RECOMMENDATION 3: The GAO recommended that the Director, DFAS, require the other DFAS centers to adapt DFAS Denver's reconciliation concepts and practices to their own environments. (p. 32/GAO Draft Report)

DOD RESPONSE: Concur. During the start-up of the DFAS Fund Balance with Treasury reconciliation project in the spring of 1999, peer reviews of processes in use by all centralized sites were conducted. The centralized sites that did not have a complete process in place were introduced to DFAS-DE's process. All centralized sites are using DFAS-DE concepts and

**Appendix I: Comments From the Department
of Defense**

practices, but the sites' processes and reconciliations are not as developed. Further exportation of the refined concepts and practices will be accomplished.

Estimated Completion Date: March 31, 2002.

RECOMMENDATION 4: The GAO recommended that the Director, DFAS, provide leadership and assistance in transferring knowledge from DFAS Denver to the other centers. (p. 32/GAO Draft Report)

DOD RESPONSE: Concur. The Director, DFAS, will ensure knowledge is transferred to all centralized sites to ensure reconciliation of the Fund Balance with Treasury accounts.

Estimated Completion Date: March 31, 2002.

Related Products

General Accounting Office Reports

Financial Audit: Issues Regarding Reconciliations of Fund Balances With Treasury Accounts ([GAO/AIMD-99-271](#), September 17, 1999).

Financial Audit: Issues Regarding Reconciliations of Fund Balances With Treasury Accounts ([GAO/AIMD-99-3](#), October 14, 1998).

Financial Audit: Reconciliation of Fund Balances With Treasury ([GAO/AIMD-97-104R](#), June 24, 1997).

Department of Defense Inspector General Reports

Performance Measures for Disbursing Stations (Report No. D-2001-024, December 22, 2000).

Disclosure of Differences in Deposits, Interagency Transfers, and Checks Issued in the FY 1999 DOD Agency-Wide Financial Statements (Report No. D-2000-123, May 18, 2000).

Air Force Audit Agency Reports

Accounting for Selected Assets and Liabilities – Fund Balance With Treasury, Fiscal Year 1999 (99053001, August 28, 2000).

Accounting for Selected Assets and Liabilities – Fund Balance With Treasury, Fiscal Year 1998 (98053001, January 6, 2000).

Accounting for Selected Assets and Liabilities, Fiscal Year 1997 Air Force Consolidated Financial Statements (97053001, September 3, 1998).

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