



SECRETARY OF THE ARMY
WASHINGTON

29-08-2006 P01:30

INFO MEMO

MEMORANDUM FOR SECRETARY OF DEFENSE

FROM: Francis J. Harvey, Secretary of the Army

SUBJECT: Fiscal Year (FY) 2006 Statement of Assurance on Management Controls as Required under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

- The Army met the FMFIA objectives except for the five material weaknesses identified in TAB B. Excluding the noted weaknesses, the internal controls are operating effectively.
- The weaknesses were found in the internal controls over quarterly and annual financial statement reporting. We are addressing these identified weaknesses as areas of concern.
- This statement of assurance was reviewed and approved by the Army's Senior Level Steering Group, independently validated by the US Army Audit Agency (USAAA), and supported by major command feeder statements.
- Although the above reviews identified the five material weaknesses as well as opportunities for improvement, USAAA concluded that the Army's management control process is effective.

COORDINATION: NONE

Attachments:

TAB A 1. USAAA Assessments; 2. Army Assessment; 3. Program's Significant Accomplishment

TAB B 1. List of Weaknesses; 2. Uncorrected; 3. Corrected; 4. Financial Reporting Assurance

TAB C 1. Under Secretary of Defense (USD) Memorandum, dated November 8, 2005

Prepared by: LTC Douglas L. Flohr, (703) 695-1717

ARMY AUDIT AGENCY ASSESSMENT



DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
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17 July 2006

MEMORANDUM FOR Secretary of the Army

SUBJECT: Independent Assessment of the Army's Compliance With the Federal Managers Financial Integrity Act

1. U.S. Army Audit Agency performed a review to provide you with an independent assessment of the Army's actions to comply with the requirements of the Federal Managers Financial Integrity Act of 1982; DOD Directive 5010.38 (Management Control Program [MCP]); and DOD Instruction 5010.40 (Management Control Program Procedures).

2. Based on our review I have concluded that the Army, as an entity, has continued its efforts to ensure that a system of management controls exists in accordance with the Integrity Act, DOD Directive 5010.38, and DOD Instruction 5010.40. During FY 06 the Army remained committed to ensuring that the management control process was effective. Here are some of the actions taken:

- The Army continued to emphasize leadership, training, and process execution in its day-to-day operations.
- A Senior Level Steering Group met twice during the fiscal year to review Army-level material weaknesses.

In addition, under the direction of the Management Services and Internal Review Directorate, the overall program:

- Provided functional guidance, and education and training programs during FY 06.
- Operated a Web site with information on the management control process.

These actions had a positive effect on the process.

3. Again this year our review of the program paralleled the Army's emphasis on leadership, training, and execution of the management control process. We also concentrated on support for your statement, the identification and correction of material weaknesses, audit recommendations, and the publication of key management controls in Army regulations. From our review of 28 assessable units at 6 activities, we concluded that:

SUBJECT: Independent Assessment of the Army's Compliance With the Federal Managers Financial Integrity Act

- Leadership has generally continued its emphasis on the process. Senior-level managers at Headquarters, DA and Army commands have directly participated, and their feeder statements were generally a fair representation of the effectiveness of the process.
- Senior leaders at each level generally evaluated weaknesses identified by external inspection and audit activities and reported those weaknesses they considered to be material.
- Management levels identifying material weaknesses corrected the weaknesses or scheduled them for correction.
- Headquarters, DA activities and major commands had reasonably effective systems for monitoring actions to correct material weaknesses.
- Education and training efforts generally resulted in increased awareness of feeder statement requirements.
- Activity managers prepared feeder statements that organizations consolidated into an annual assurance statement the commander or equivalent signed.

The Army continues to provide senior-level emphasis on the importance of a system of management controls. For example:

- The Internal Review Office at U.S. Army Reserve Command established a Senior Leadership Council (known as the War Council) that discusses the management control process.
- U.S. Military Academy designated management control coordinators in addition to management control administrators and assessable unit managers. The Academy provided training to 100 percent of the management control personnel.
- U.S. Army Developmental Test Command incorporated the Command Inspection Program into its 5-year management control plan and did risk assessments of functional areas not addressed in the inspection or management control programs.

However, some local commands could improve their management control program. Improvements such as ensuring that all personnel involved in completing management control evaluation certification statements are trained on how to complete and support the statements and documenting management control training would strengthen the program. Although improvements were needed, the issues we identified were not significant enough to change our overall conclusion on the effectiveness of the Army's management control process.

SUBJECT: Independent Assessment of the Army's Compliance With the Federal Managers Financial Integrity Act

4. AR 11-2 (Management Control) requires DA functional proponents to identify the areas that should have evaluations of key management controls. The regulation also requires the functional proponent to publish key controls, usually in the form of evaluation checklists, in its Army regulations. During FY 06 we found that the functional proponents we reviewed generally had included management control provisions in their Army regulations.

5. In addition to the specific review of the management control program, I based my conclusion on evaluations of individual management controls during each of our audits. As of 30 June 2006, Army Audit Agency had issued 110 reports during FY 06. Those reports included evaluations of 238 specific key controls related to the audit subjects. We determined that 113 of the 238 controls were in place and operating, 58 were in place but not operating, and 67 were not in place. Of the 12 standards for internal controls shown in Appendix B of AR 11-2, 3 (documentation, recording of transactions, and supervision) accounted for 52 percent of the controls that were either not operating or not in place. Additional focus in these areas would further strengthen the MCP.

6. Although our reviews identified opportunities for improvement, they did not identify any undisclosed material problem areas that affect your annual assurance statement for the Secretary of Defense on the status of internal accounting and administrative controls in the Army.



PATRICK J. FITZGERALD
The Auditor General

(TAB A-2)
**DESCRIPTION OF THE CONCEPT OF REASONABLE ASSURANCE
AND HOW THE EVALUTATION WAS CONDUCTED**

The Army is able to provide a qualified statement of reasonable assurance that the Army's internal controls in effect for the FY ending September 30, 2006, met FMFIA objectives except for the five material weaknesses described in TAB B. These material weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2006. Other than the material weaknesses noted in TAB B, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.

Guidelines for the Evaluation

The Army's senior management evaluated the system of internal accounting and administrative control, in effect during the fiscal year ending September 30, 2006, in accordance with the guidance provided in Office of Management and Budget (OMB) Circular A-123, "Management Accountability and Control," as implemented by DoD Directive 5010.38, "Management Control Program," and DoD instruction 5010.40, "Management Control Program Procedures." The OMB guidelines were issued in consultation with the Comptroller General of the United States, as required by the "Federal Managers' Financial Integrity Act of 1982." Included is an evaluation of whether the system of internal accounting and administrative control for the Army is in compliance with standards prescribed by the Comptroller General.

Objectives of Reasonable Assurance

The objectives of the system of internal accounting and administrative control of the Army are to provide reasonable assurance that:

- Obligations and costs comply with applicable law;
- Programs achieve their intended results;
- Assets are safeguarded against waste, loss, unauthorized use, and misappropriation;
- Revenues and expenditures applicable to agency operations are recorded and accounted for properly. This ensures accounts and reliable financial and statistical reports are prepared and accountability of the assets is maintained; and
- Programs are efficiently and effectively carried out in accordance with applicable law and management policy.

Concept of Reasonable Assurance

The evaluation of internal controls extends to every responsibility and activity undertaken by the Army and applies to financial, administrative, and operational controls. The concept of reasonable assurance recognizes that the cost of internal controls should not exceed the expected benefits. The expected benefits and related costs of internal control measures are addressed using managerial judgment. Internal control problems may occur due to inherent limitations, such as resource constraints, congressional restrictions, and other similar factors. Future projections made as a result of any evaluation may be affected by changes in conditions or deterioration of procedural compliance over time. The Army's statement of reasonable assurance is provided within these limitations.

Evaluation

The overall evaluation was performed in accordance with the guidelines above as well as information provided by external sources such as the Government Accountability Office (GAO), Department of Defense Inspector General (DODIG), Army Inspector General, and the U.S. Army Audit Agency (USAAA). The results indicate that the Army's system of internal accounting and administrative controls, in effect during fiscal year 2006, complies with the requirement to provide reasonable assurance that the objectives mentioned above were achieved, except as identified in the listed weaknesses.

Determination of Reasonableness

The Army's approach to internal controls is based on the fundamental philosophy that all commanders and managers have an inherent internal control responsibility. All Army headquarters officials and functional proponents are responsible for establishing sound internal controls in their policy directives and for exercising effective oversight to ensure compliance with these policies. Commanders and managers throughout the Army are responsible for establishing and maintaining effective internal controls over their operations and resources. This philosophy is soundly rooted in FMFIA, OMB, Department of Defense (DoD), and Army policies. The Army's internal control process supports commanders and managers in meeting their inherent responsibilities by providing a process for periodically conducting detailed evaluations of key internal controls, and a process for developing and supporting an objective annual statement of assurance that fully discloses known material weaknesses.

Detailed evaluations of key internal controls are identified by the Army's Internal Control Steering Group. Composed of senior Managers' Internal Control Administrators (MICAs) from throughout the Army, the Steering Group provides advice and feedback on HQDA internal control initiatives. The Steering Group also identifies areas needing improvement and assists in implementing improvements in the internal control process. During fiscal year 2006, the Steering Group reviewed risk management processes, and recommended use of the Army's many corporate metrics vehicles (performance warehouse) to assess risk.

The process for developing and supporting an objective assurance statement is accomplished through three key components. First is leadership emphasis. Second is the education and training of commanders and managers in their internal control responsibilities. Third is an evaluation process that clearly defines fundamental requirements, establishes accountability, and enables an effective method to detect, report, and correct recurring internal control deficiencies. In addition to these three key components, the Army increased emphasis on internal control over financial reporting in compliance with Office of Management and Budget (OMB), Circular A-123, Appendix A. A summary of each key component follows:

Leadership Emphasis:

Senior Army leadership has consistently demonstrated strong support for the managers' internal control process by:

-- Using the Senior Level Steering Group (SLSG) as a "senior management council" as recommended by OMB Circular A-123, to review, discuss, and resolve internal control issues. This executive body is composed of general officers and senior executive service members representing all areas of Army operations. As part of their oversight duties, the SLSG reviews on-going internal control issues, and works towards correcting previously reported material weaknesses. The SLSG considers additional internal control deficiencies that merit reporting as Army material weaknesses.

Education and Training

Educating Army commanders and managers at all levels on the principles and practices of sound internal control is central to achieving the objectives of the FMFIA. The Army's internal control staff implemented an Army-wide education and training effort to achieve a basic understanding of internal controls. This training is provided to the HQDA staff, commanders, managers, and MICAs at all levels. The following is a summary of the education and training efforts:

Direct Training Assistance: The Army's internal control staff embeds internal control instruction in the Army's education and training structure. This training approach is proven to be cost-effective and provides for more comprehensive internal control training. It also reaches a wider student population, and increases management's understanding of, and commitment to, effective internal controls.

Education of Army Leadership: In an effort to make the managers' internal control process a part of the professional development of every Army commander and manager, the internal control staff ensures that the managers' internal control message is included in the curricula of the Army's primary leadership schools. The following leadership schools include management control instruction in their curriculum:

-- Command and General Staff College. The Command and General Staff Officer Course Intermediate Level Education consists of common core and career field phases to prepare all field

grade officers for leadership positions in the Army, joint, multinational, and interagency organizations executing full spectrum operations. It annually prepares approximately 1,200 officers.

-- Garrison Commanders' Course. Designed for colonels assigned to command Army garrisons and their civilian executive assistants, this course is presented four times a year.

-- General Officer Installation Command Course. Designed for major generals assigned to command Army installations; this course is taught four times a year and addresses the topic of internal controls.

-- Defense Comptrollership Program (DCP) and Professional Resources Management Course (PRMC). The DCP is a 14-month graduate level program for Army military and civilian resource managers at Syracuse University. The PRMC is a four-week professional development course taught at the University for mid-level Army managers. Internal control processes are integrated into these educational activities.

-- Defense Financial Managers Course. This is a four-week course for mid-career and senior resource managers in DoD. This course is taught six times a year to over 200 students and develops the student's capacity to adapt the comptroller's role to the economic, political, and social environment of military organizations.

Training of Army Managers: In addition to direct training assistance to MICAs and efforts to improve leadership education, internal control instruction is incorporated into courses designed to train Army managers. These include:

-- Army Soldier Schools. The officer and warrant officer basic/advanced courses, the advanced non-commissioned officer and first sergeant courses, and the Combined Arms and Services Staff School.

-- Army Management Staff College. The Sustaining Base Leadership and Management Program is a 12-week course designed to provide advanced professional education to approximately 600 military and civilian managers across a wide range of functional areas who will advance to fill key positions.

-- Government Audit Training Institute (GATI). The internal control staff has worked with GATI (a part of the U.S. Department of Agriculture's Graduate School) to develop two courses that are tailored specifically to the Army's managers' internal control process. First, there is a basic one-day on-site course for managers on their roles and responsibilities in the internal control process. During FY 2006, GATI taught three classes reaching 195 students. Second, there is a two-day course specifically designed to train MICAs on how to effectively perform their duties. During FY 2006, this course was offered 15 times reaching 384 Army students. This represents an increase of 87 students taught in FY 2006 over FY 2005.

-- Auditor Training. The USAAA has incorporated instruction on the Army's managers' internal control process into training courses for both USAAA and Army Internal Review evaluators, with separate courses provided for basic, intermediate, and senior auditor levels.

Evaluation Process:

-- A sound evaluation process is key in detecting, reporting, and correcting internal control weaknesses. The foundation of the Army's evaluation process is the 512 internal control administrators responsible for evaluating and testing the effectiveness of internal controls. The cadre of internal control professionals evaluated and tested internal controls across the entire spectrum of Army operations. Additionally, the Army internal review, reviewed four focus areas:

1. Contracting Support. This review determined if sufficient actions are being taken to reduce or eliminate unneeded contracting support. This review focused on controls associated with improper use of reimbursable orders to bypass local contracting authority, training provided to quality assurance evaluators, proper evaluation of contractor performance, and validation of contractor invoices. Results of this review disclosed improvement is needed in the areas of requirements validation, surveillance plan development, and training for contracting officer representatives.

2. Defense Travel System (DTS). This review identified technical, functional, and training problems impeding maximum use of DTS. This review focused on effectiveness of support provided by DTS System Administrators, adequacy of training provided to travelers, and effectiveness of controls designed to mitigate waste, fraud, and abuse. Results of this review disclosed improvements in training provided to lead Defense travel administrators, improvements to traveler related training, and the need for improved controls in the preparation and approval of travel documentation.

3. Unique Local Information Technology (IT) Systems. This review tested the effectiveness of controls over the purchase, development, modification, and documentation of local unique IT systems. This review focused on the effectiveness of inventories used to identify and classify systems, spending controls—particularly compliance with development and modernization costs exceeding \$1 million, and compliance with the department's enterprise architecture. Results of this review disclosed the need for more detailed guidance regarding the management of IT systems.

4. Property Inventory Accountability and Reporting. This review tested the effectiveness of controls over the accountability and reporting of accountable items reported in the Defense Property Accountability System (DPAS). This review focused on compliance with inventory management supply policies, and the effectiveness of controls to ensure the accuracy of inventory data contained in DPAS. Results of this review were not available in time to include in the fiscal year 2006 annual assurance statement.

The Army's Special Review Office (SRO) is responsible for reviewing financial management controls supporting sensitive and classified operations. During fiscal year 2006, the SRO conducted six complete operational reviews, two follow-up reviews, four special funding reviews, and four special reviews of DA waivers. Findings were noted, and corrective actions were initiated, in the areas of cash management, quality assurance programs, obligation management, credit card management, and operational voucher processing.

DoD Systemic Material Weaknesses

For FY 2006, OSD is reporting eleven DoD systemic internal control material weaknesses. DoD weaknesses include:

- Financial Management Systems and Process
- Information Technology and Assurance
- Environmental Liabilities
- Personnel Security Investigations Program
- Property Infrastructure
- Government Card Program Management
- Valuation of Plant, Property and Equipment on Financial Reports
- Valuation of Inventory on Financial Reports
- Improper Use of Non-Department of Defense Contracting Vehicles
- Contracting Services
- Inaccuracy of Contracting Federal Procurement Data Reporting Army material weaknesses and areas of concern

Areas of Concern

Our process detected two new material weaknesses during the fiscal year 2006, and discloses the following areas of concern that are monitored by the Army's Senior-Level Steering Group:

- Over an 18-month period, Army units purchased approximately \$2.3 billion in supply items through several "off-line" purchasing systems. The off-line systems enable ordering activities to circumvent supply discipline, funds control, and property accountability. The Army issued guidance restricting use of off-line systems and is working with the Defense Logistics Agency and the General Services Administration to establish permanent, systemic controls.
- Several high-dollar accounting adjustments were processed into the Army's financial records without appropriate documentation or approvals. The Army and Defense Finance and Accounting Service (DFAS) developed "as-is" business process flows identifying control points and highlighting areas of risks. Additional controls have been established requiring appropriate documentation and approvals.
- Review of real property financial data at one installation in support of General Funds Enterprise Business System (GFEBs) Release 1.1 disclosed an 86 percent error rate. Corrective actions were identified, documented, and processed into the real property system of record. The Army is assessing the condition of real property records on a broader scale to determine the magnitude of the problem and to develop the appropriate corrective actions.
- Within the Military Personnel Army appropriation, the Army lacks a reliable cost model to forecast pay and non-pay obligations, a formal funds distribution process that enables

proponents to manage obligations based on funding allocations, and an automated system that records obligations at the time subsistence requisitions are accepted by the source of supply. As a result of this situation, disbursements often post to the financial system without an obligation in place, and often times these disbursements occur months after fiscal year-end close. Army will develop models to accurately forecast obligations, implement a formal funds distribution process requiring proponents to manage execution within predetermined spending limits, and implement an electronic interface to enable the simultaneous recording of obligations when orders are received by the source of supply for subsistence items.

- The number of Army-wide Antideficiency Act cases (preliminary and formal) grew from 19 in fiscal year 2001 to 54 in fiscal year 2006. Increases in Antideficiency Act cases are a symptom of poor financial controls. The Army tracked each case monthly to ensure investigations are completed timely, emphasized to commanders the importance of administering disciplinary actions commensurate with investigation findings, and required all fund certifying officers attend fiscal law training. Antideficiency Act cases will be closely monitored to ensure investigations are timely closed, and effective actions are implemented to prevent the recurrence of future violations.
- The testing control environment for Nuclear, Biological, and Chemical Survivability for Army Systems was not adequate to ensure that systems were survivable in contaminated environments.

(TAB A-3)
MANAGERS' INTERNAL CONTROL PROGRAM AND RELATED
ACCOMPLISHMENTS

Description of the Issue: Assignment of Safety Officers to Brigade Combat Teams

Commander's combat power is eroded from losses of personnel and equipment due to accidents. As a control measure to mitigate the loss of personnel and equipment due to accidents, Army Regulation 385-10 requires brigade size units and smaller to appoint a safety officer. This control was not effective because safety officers typically have numerous other competing responsibilities limiting the amount of time available for safety related issues. A permanent, dedicated safety officer is needed to provide commanders with the expertise necessary to enforce standards, develop control measures, and continually evaluate the units' safety effectiveness.

Accomplishment

A Department of the Army civilian safety specialist (GS-11) was permanently assigned to the staff of each Brigade Combat Team in FY06. The safety officer is a deployable asset required to accompany assigned units at all times, including combat operations. Assignment of a full time safety specialist to each Brigade Combat Team enables a detailed focus on safety issues and a reduction in lost combat power due to the accidental loss of equipment and personnel. As a result, the fatality rate for Military Class A and negligent discharge accidents were significantly reduced between FY05 and FY06. Accident statistics show that there were 175 Military Class A accidents in FY06 compared to 219 in FY05, a reduction of 20 percent and that there were two negligent discharge accidents in FY 06 compared to five in FY 05.

Description of the Issue: Vehicle Rollovers

Wheeled vehicles rolled over when driven on uneven dirt roads that were close to the canal's edge. When a vehicle veers too close to a canal on a slight slope, it will roll on its side or completely over. For the first two years of Operation Iraqi Freedom, 419 soldiers were killed or injured in vehicle accidents.

Accomplishment

FORSCOM's Safety Division designed and built a prototype HMMWV Egress Assistance Trainer (HEAT) simulator. The simulator is a rotisserie type device that turns a HMMWV in various angles including upside down with soldiers inside. This device demonstrates the critical angle for HMMWVs at which no recovery is possible and the security of seatbelt mechanisms. This device also allows soldiers to egress without endangering life or limb. The 10th Mountain Division (Light) trained 2,000 soldiers in four weeks on the proper use of the simulator. Additionally, Coalition Forces Land Component Command Safety Division, embraced the technology and built a similar device. They trained approximately 1,000 soldiers. The device is being considered for worldwide use to include U.S. Army Europe, several CONUS installations, and U.S. Air Force tactical training schools. The Training and Doctrine Command is in the process of updating their Graphic Training Aide 55-30-030 and other training aides with material on how to prevent rollovers and what to do if a rollover can not be prevented.

HEAT saves lives - a success story published by Desert Voice, April 12, 2006. A gunner and his crew walked away from a HMMWV rollover accident with minor injuries April 1, 2006 at Udairi Range. These soldiers received training on the HEAT the day before the accident.

Description of the Issue: Property Book Unit Supply System Enhanced (PBUSE)

The Army's Standard Property Book System-Redesigned, and the Unit Level Logistics System (SPBS-R and ULLS-S4) have long outlived their effective use and ability to support the Army's logistical requirements and accountability needs. SPBS-R and ULLS-S4 were stand alone systems. They were not designed to interface with each other or the Army's retail and wholesale supply systems. Army leaders could not view all property held by units and therefore, the Army's ability to make good deployment decisions was hampered.

Accomplishment

The Department of the Army completed fielding the PBUSE in FY 2006. PBUSE consolidates two baseline systems SPBS-R and ULLS-S4 and operates in one common platform versus multiple platforms, thus, reducing the foot print. This system reduces processing time, increases accuracy; provides real-time visibility for fleet management/task force organization; supports fast-paced/split-based operations and readiness management; operates on any personal computer with web connection and serves as a bridge to Enterprise Resource Planning via state-of-the-art software and hardware with accurate data. PBUSE provides real-time total asset visibility at all levels of Army management, and an audit trail for unit transfers of equipment made by company commanders.

Description of the Issue: Systems Used In Pre-Deployment Planning

The Army used several automated systems with conflicting information for pre-deployment planning and to develop deployment equipment lists (DEL). Current systems include: Theater Provided Equipment Calculator (TPE-C), Theater Force Tracker (TFT), Battle Web (BW), Automated Battle Book System (ABS), and Deployment Asset Visibility System (DAVS).

Accomplishment

The Army merged a war fighter system, Equipment Common Operating Picture, and business system, Single Army Logistics Enterprise, into a single environment. Forces Command and Army Field Support Command are working with the Army on a phased approach to merge BW, ABS, and DAVS technologies into a single asset visibility product commonly called enhanced BW. The result of this merger will provide a single asset visibility tool to facilitate unit pre-deployment planning and DEL development. The baseline capabilities of enhanced BW include: visibility of pre-positioned stocks, theater provided equipment, theater based installation property and CONUS based pre-deployment unit training sets, and DEL development.

Description of the Issue: Equipment Survey Program

Army equipment requirements were not properly documented. Specifically, authorizations in the Table of Distribution and Allowance (TDA) weren't justified by mission requirements and excess equipment was not identified and returned to the supply system.

A-3-2

Accomplishment

The Department of the Army established the Army Equipment Survey Program to provide independent on-site reviews of equipment requirements. During fiscal year 2006, the teams provided support to 32 active component units. The teams surveyed equipment valued at \$1.3 billion resulting in decreased TDA requirements of \$368 million. The teams also identified 1,538 equipment items valued at \$376 million that were in excess of organizational requirements and were subsequently returned to the Army supply system. This program has enabled equipment survey teams to ensure authorizations are fully justified by mission requirements, equipment required to accomplish unit missions is properly documented, excess equipment is identified and returned to supply system and property accountability records are reconciled.

Description of the Issue: LEAN/Six Sigma (LSS) Initiative.

Army Materiel Command Major Subordinate Commands (MSC) selected LSS as a primary tool for continuous process improvement in the face of declining funding and steady workload. LSS offers tools for streamlining processes without sacrificing internal controls. It is a technique to review business processes, identify/reduce waste and improve not only critical efforts but all processes identified by management.

Accomplishment:

- At two MSCs, LSS Initiatives have resulted in over 138 projects in various states of completion and 96 “Do Its”, resulting in:
 - \$7.2M in cost savings/cost avoidances.
 - Improved targeted process lead times.
 - Improved targeted process quality.
 - Reduced Manual Cycle Time (MCT) in Letter of Offer and Acceptance (LOA) quality review process by 66 percent.
 - Improved internal USASAC First Pass Yield on LOAs by 32 percent.
 - Established a standard error coding system for LOA quality.
 - Reduced MCT in requisition management by 10 work-years.
 - Reduced MCT in case closure process by 3.5 work-years.
 - Converted hard-copy products to electronic products, reducing printing/shipping costs.
 - Reduced defects in J&A by 33 percent.
 - Reduced flow time in Capital Improvement Program (CIP) process by 35 percent.
 - Reduced touch time in CIP by 51 percent.
 - Reduced number of non-value added steps in CIP by 50 percent.

- The process improvements generated by LSS certainly offer cost avoidances, however, their positive impact on internal controls cannot be overlooked. Each step removed from a targeted process improves internal controls by enhancing timeliness, reducing opportunity for errors, and builds in quality controls from start to finish. LSS has become a major continuous improvement tool and has emerged as a major influence on Command Strategy.

(TAB B-1)
LISTS OF UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES

Uncorrected Weaknesses Identified During the Period:

<u>Title</u>	<u>Year First Reported</u>	<u>(Quarter and Fiscal Year) Targeted Correction Date</u>		<u>Page</u>
		<u>Per Last Annual Statement</u>	<u>Per This Annual Statement</u>	
<u>Contract Administration</u>				
Oversight of Service Contracts	FY 2006	N/A	4 th Qtr, FY 2010	B-2-1
<u>Comptroller and/or Resource Management:</u>				
Army General Equipment Data Integrity	FY 2006	N/A	4 th Qtr, FY 2009	B-2-3

Uncorrected Weaknesses Identified During Prior Periods:

<u>Title</u>	<u>Year First Reported</u>	<u>Correction QTR and FY Date</u>		<u>Page</u>
		<u>Per Last Annual Statement</u>	<u>Per This Annual Statement</u>	
<u>Supply Operations:</u>				
Logistics Asset Visibility and Accountability	FY 2004	4 th Qtr, FY 2008	4 th Qtr, FY 2011	B-2-5
Financial Reporting of Equipment In-Transit	FY 1996	3 rd Qtr, FY 2007	3 rd Qtr, FY 2007	B-2-7
<u>Personnel and/or Organizational Management:</u>				
Reserve Component Mobilization Accountability	FY 2003	4 th Qtr, FY 2006	2 nd Qtr, FY 2007	B-2-9

(TAB B-1)
LISTS OF UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES

Corrected Weaknesses Identified During All Periods

<u>Title</u>	<u>Year First Reported</u>	<u>Page</u>
<u>Personnel and/or Organizational Management</u>		
Line-of-Duty (LOD) and Incapacitation (Incap) Pay	FY 2002	B-3-1
Manpower Requirements Determination System	FY 1997	B-3-2
<u>Comptroller and/or Resource Management:</u>		
Financial Reporting of General Equipment	FY 1999	B-3-3

(TAB B-2)

UNCORRECTED MATERIAL WEAKNESSES STATUS OF CORRECTIVE ACTIONS

Title and Description of Issue: Oversight of Service Contracts. The Director of the Army Contracting Agency (ACA) identified the administration of contracting services as an area of concern in the ACA FY05 Annual Assurance Statement. Subsequent review by the Senior Level Steering Group in conjunction with the Army Audit Agency revealed that oversight of service contracts should be disclosed as an Army-wide material weakness. Specific elements of this weakness include poorly trained CORs, weak requirements justification, and improper use of contractor labor.

Functional Category: Contract/Procurement

Component: Army

Senior Official In Charge: Ms. Tina Ballard - Deputy Assistant Secretary of the Army (Policy and Procurement)

Pace of Corrective Action:

Year Identified: FY 2006

Targeted Correction Date: 4Qtr, FY 2010

Target Date in Last Year's Report: N/A

Current Target Date: 4th Qtr, FY 2010

Reason for Change in Date(s): N/A

Validation Process: Major Commands (MACOMs) verify acceptable implementation at their levels using Internal Review (IR) Assets. AAA validates results after IR verifies acceptable implementation.

Results Indicators: Review contract files to verify compliance with current policy: CORs are trained and appointed, surveillance plans developed and used to support receipt and acceptance of services. The acceptable accuracy rate for COR training and oversight execution is 90 percent (where potential fraud exists 95%).

For MACOM level ASSP reviews, success is defined as data reflecting that internal controls over service contracts imposed by the ASSP are in place and working effectively.

Additional indicators of positive or negative implementation would include:

- Review of recent audit organization reports and the conclusions found related to contract administration of service contracts.
- Annual review results by DA/MACOM Contracting Operations Review (COR) teams. (the old Procurement Management Assistance Program (PMAP) review process).

Source(s) Identifying Weakness:

- ACA Director's FY05 Annual Assurance Statement
- DoDIG Report 2006-010, Contract Surveillance for Service Contracts, dated October 28, 2005

- GAO, Report GAO-05-274, Opportunities to Improve Surveillance on Department of Defense Service Contracts, dated March 2005
- AAA Report A-2005-0296-ALT, Contract Administration for Contracts Resulting from A-76 Commercial Activities Study Decisions, dated 15 September 2005

Major Milestones to Include Progress to Date:

A. Completed Milestones:

<u>Date:</u>	<u>Milestone:</u>
None	

B. Planned Milestones for FY 2007:

<u>Date:</u>	<u>Milestones:</u>
1 st Qtr, FY 2007	DASA (P&P) coordinate/develop a partnership with US Army IR, AAA where review approach, analytical procedures and documentation requirements are determined. This will ensure consistency throughout.
1 st Qtr, FY 2007	DASA (P&P) alerts US Army Contracting Community that the previous guidance issued on COR training and execution will be reviewed.
1 st Qtr, FY 2007	DASA (P&P) publishes Army Regulation on Management and Oversight of Service Contracts
2 nd Qtr, FY2007	Concurrently with the FY07 Principal Assistant Responsible for Contracting (PARC) Conference (on or about April 07), assess data from annual reports to the MACOM ASSP level decision authority on progress of meeting service contract metrics to establish a baseline
3 rd Qtr, FY 2007	US Army IR begins review of COR compliance with previously issued guidance
3 rd Qtr, FY2007	ICW AAA and US Army IR, set goals toward progress of meeting MACOM ASSP level review service contract metrics
4 th Qtr, FY2007	US Army IR reports results of COR compliance with previously issued guidance to ASA(ALT)

C. Planned Milestones (Beyond FY06):

<u>Date:</u>	<u>Milestones:</u>
4 th Qtr, FY 2008	Issue additional guidance/take corrective action or request AAA verification ref: COR reviews.
2 nd Qtr, FY2009	ASA(ALT) and US Army IR verify that goals toward progress of meeting MACOM ASSP level review service contract metrics are being met.
4 th Qtr, FY2010	AAA review and validate administration of contract services.

Title and Description of Issue: Army General Equipment Data Integrity. Army installations do not systemically comply with DoD and Army regulations that require periodic comprehensive (wall-to-wall) inventories of Property, Plant and Equipment (PP&E). This failure to properly perform accountability functions has led to breakdowns in reporting acquisitions, improvements, transfers and disposals of PP&E; all of which may have an impact on Army financial statements. Army installations are also unable to present adequate documentation to support information in property accountability systems. Absence of supporting documentation for property records will prohibit Army from achieving goals of reliable financial statements.

Functional Category: Logistics, Installation Management, and Comptroller

Component: Army

Senior Official In Charge: Mr. John J. Argodale, Deputy Assistant Secretary of the Army (Financial Operations)

Pace of Corrective Action:

Year Identified: FY 2006

Original Targeted Correction Date: 4th Qtr, FY 2009

Targeted Correction Date in Last Year's Report: N/A

Current Target Date: 4th Qtr, FY 2009

Reason for Change in Date(s): N/A

Validation Process: Army Audit Agency will validate review plans and the effectiveness of corrective actions.

Results Indicators: The Army will have better financial information for its general equipment assets. A by-product of this effort will be that the Army will be substantially closer toward receiving a favorable audit opinion on its financial statements. Additionally, Army must retain records to support accountability system information.

Source(s) Identifying Weakness:

- Army Audit Agency Report: A-2005-XXX-FFG Real Property – Ft. Jackson
- IG, DOD report: Internal Controls over Real Property (D2006-072, April 6, 2006)

Major Milestones to Include Progress to Date:

A. Completed Milestones:

Date:

Completed

Milestone:

Conduct initial pilot site assistance visit -- Fort Jackson (includes accountability analysis, data validation, source documentation validation and creation, and other required actions to create auditable records).

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B. Planned Milestones for Fiscal Year 2007:

<u>Date:</u>	<u>Milestone:</u>
1 st Qtr, FY 2007	Conduct second pilot site assistance visit -- Fort Hood (includes accountability analysis, data validation, source documentation validation and creation, and other required actions to create auditable records; also includes development of preliminary site review plan).
2 nd Qtr, FY 2007	Distribute OASA(FM&C), G4, IMA signed memo to Army installations directing comprehensive 100 percent (wall-to-wall) inventories of PP&E, and identifying supporting documentation requirements.
3 rd Qtr, FY 2007	Produce scorecard style performance measurement tool to track Army progress. Include a completeness indicator which will trigger either a AAA or IR site validation.
4 th Qtr, FY 2007	Develop/Refine site assistance review plan for IR use. Request AAA validation of plan

C. Planned Milestones Beyond Fiscal Year 2007:

<u>Date:</u>	<u>Milestone:</u>
1 st Qtr, FY 2008	Implement the scorecard
4 th Qtr, FY 2008	Using validation plan, conduct site assistance visits Army-wide (includes accountability analysis, data validation, source documentation validation and creation, and other required actions to create auditable records).
2 nd Qtr, FY 2009	Scorecard indicates that all sites are compliant. AAA notified to begin validation
4 th Qtr, FY 2009	Army Audit Agency validates closure of Army general equipment data integrity material weakness.

Title and Description of Issue: Logistics Asset Visibility and Accountability. The Army does not have adequate visibility over all requisitions, equipment, and supplies transported to, from, and within theaters of operation. The supply chain does not effectively support asset visibility and distribution capability.

Functional Category: Supply Operations

Component: Army

Senior Official In Charge: Ms. Modell Plummer, Director of Supply and Maintenance

Pace of Correction:

Year Identified: 2nd Qtr, FY 2004

Original Targeted Correction Date: 4th Qtr, FY 2008

Targeted Correction Date in Last Year's Report: 4th Qtr, FY 2008

Current Target: 2nd Qtr, FY 2011

Reason for Change in Date: Funding decrements impacted the fielding of Combat Service Support (CSS) Very Small Aperture Terminal (VSAT) and Global Combat Service Support-Army (GCSS-A).

Validation Indicator: Validation will be conducted by the Office of the Deputy Chief of Staff (ODSC), G-4 and USAAA.

Results Indicator: Corrective actions will reduce the error rate of in-transit asset data to an acceptable level and will improve asset data accuracy in Logistics Integrated Data Base (LIDB), thus improving asset reporting and document closure procedures.

Source(s) Identifying Weakness: GAO letter dated December 18, 2003, Subject: Defense Logistics Observations on The Effectiveness of Logistics Activities during Operation Iraqi Freedom, (GAO-04-305R).

Major Milestones to include Progress to Date:

A. Completed Milestones:

<u>Date:</u>	<u>Milestone:</u>
Completed	Army Radio Frequency Identification (RFID) Strategy. Combat Service Support Very Small Aperture Terminal Phase One – SSA/Log Nodes (Connect Focus Area IPT).
Completed	Established Army Reserve/Retrograde Logistics Reverse Pipeline Committee

B. Planned Milestones for Fiscal Year 2007:

<u>Date</u>	<u>Milestone:</u>
On-Going	GCSS-A Initial Operating Capability (IOC) and Fielding
On-Going	Property Book Unit Supply Enhanced (PBUSE) fielding

C. Planned Milestones Beyond Fiscal Year 2007:

<u>Date</u>	<u>Milestone:</u>
4 th Qtr, FY2008	Battle Command Support System fielding
4 th Qtr, FY 2009	CSS VSAT fielding.
2 nd Qtr, FY2010	GCSS-A IOC fielding.
4 th Qtr, FY 2011	USAAA review and validation.

Title and Description of Issue: Financial Reporting of Equipment In-Transit. Systems interface and logistics process problems cause a significant portion of the in-transit records displayed by the Continuing Balance System-Expanded (CBS-X) to be invalid. The receipt transactions did not close out the shipment (in-transit) records. As a result, the Army did not have reliable data on the value of equipment in-transit, and the value on in-transits reported on the Army's financial statements was misstated by a significant but unknown amount.

Functional Category: OSD Supply Operations

Component: Army

Senior Official In Charge: Ms. Modell Plummer, Director of Supply and Maintenance,

Pace of Corrective Action:

Year Identified: FY 1996

Original Targeted Date: FY 1999

Targeted Corrections Date in Last Year's Report: 3rd Qtr, FY 2007

Current Target Date: 3rd Qtr, FY 2007

Reason for Change In Date: N/A

Validation Indicator: Validation will be conducted by the Deputy Chief of Staff (ODSC), G-4 and USAAA.

Results Indicator: Corrective actions will reduce the error rate of in-transit asset data to an acceptable level and will improve asset data accuracy in Logistics Integrated Data Base (LIDB), thus improving asset reporting and document closure procedures.

Source(s) Identifying Weakness: General Accounting Office (GAO), "FINANCIAL MANAGEMENT: Army Lacks Accountability and Control Over Equipment", September 1993; USAAA Audit AA 96-156, Financial Reporting of Equipment In Transit", June 1996.

Major Milestones to include Progress to Date:

A. Completed Milestones:

<u>Date</u>	<u>Milestone:</u>
Completed	Property Book Unit Supply Enhanced (PBUSE) complete unit fielding
Completed	Property Book Unit Supply-Enhanced (PBUS-E) Web based Property Book projected completion

Completed

LMP (based on HQDA decision) to undergo a strategic pause (shifting from HQAMC to PEO EIS),

B. Planned Milestones for Fiscal Year 2007:

Date

Milestone:

1st Qtr, FY 2007

Army G-4 record scrub prior to requesting USAAA validation.

3rd Qtr, FY 2007

USAAA review and validation.

Title and Description of Issue: Reserve Component (RC) Mobilization Accountability. RC mobilization accountability must provide better-integrated internal controls for tracking RC personnel in the “mobilization pipeline.” Currently, available automated management tools lack synchronization/integration for tracking RC personnel.

Functional Category: OSD - Personnel and/or Organization Management

Component: Army

Senior Official In-Charge: Kathryn A. Condon, Army, G-3/5/7

Pace of Corrective Action:

Year Identified: FY 2003

Original Target Date: 4th Qtr FY 2004

Target Date in Last Year’s Report: 4th Qtr FY 2006

Current Target Date: 2nd Qtr FY 2007

Reason for Change in Date: Not Applicable

Source(s) Identifying Weakness: Assistant Secretary of the Army (Manpower and Reserve Affairs); Assistant Secretary of the Army (Financial Management and Comptroller); Office of the Deputy Chief of Staff (ODCS), G-3/5/7; ODCS G-1; Defense Finance and Accounting Service; Army National Guard; National Guard Bureau; U.S. Army Reserve Command; Office of the Chief, Army Reserve; U.S. Army Forces Command; First Army.

Major Milestones to include Progress to Date:

A. Completed Milestones:

<u>Date:</u>	<u>Milestones:</u>
Completed	Data feed established from National Guard Bureau individual orders system (AFCOS) through ITAP to DAMPS. Data feeds established from DAMPS to RLAS/AORS/AFCOS.
Completed	AFCOS incorporates DAMPS data in the generation of NGB individual orders.
Completed	RLAS incorporates DAMPS data in the generation of USARC TPU individual orders.
Completed	Validation of RLAS/AFCOS data within DAMPS.

B. Planned Milestones for Fiscal Year 2007:

<u>Date</u>	<u>Milestone:</u>
2 nd Qtr FY 2007	USAAA review and validation.

(TAB B-3)
MATERIAL WEAKNESSES CORRECTED THIS PERIOD

Title and Description of Issue Line-of –Duty and Incapacitation (Incap) Pay. Neither DoD nor the Army has established policy guidance, including effective internal controls, for the processing of LOD and Incap pay. As a result, Army continues to have problems in the processing of LOD and Incap pay; an increased number of Soldiers dunned by medical care providers; and more frequent Inspector General investigations and congressional inquiries into late payment/unpaid medical bills.

Functional Category Personnel and/or Organizational Management

Component: Army

Pace of Corrective Action:

Year Identified: FY 2002

Original Targeted Correction Date: 4th Qtr, FY 2004

Targeted Correction Date in Last Year's Report: 4th Qtr, FY 2005

Current Target: Completed

Reason for Change in Dates: Validation was not completed in time for results to be reported in the FY 2005 assurance statement.

Source(s) Identifying Weakness: Army National Guard staff, state assessments, and Internal Review audits.

Major Milestones to include Progress to Date:

USAAA review and validation completed.
Completed all milestones in FY06

Title and Description of Issue: Manpower Requirements Determination System. The Army had not established effective manpower programs for managing and controlling Tables of Distribution and Allowances (TDAs) workload, organizations and manpower staffing, including reductions in force. The current system for manpower requirements determination lacks the ability to link workload, manpower requirements, and dollars. Thus, the Army is not capable of rationally predicting future manpower requirements based on workload.

Functional Category: Personnel and/or Organization Management

Component: Army

Pace of Corrective Action:

Year Identified: FY 1997

Original Targeted Correction Date: FY 2000

Targeted Correction Date in Last Year's Report: 4th Qtr, FY 2005

Current Target: Completed

Reason for Correction: Validation was not completed in time for results to be reported in FY 2005 assurance statement.

Validation Indicator: The Office of the Deputy Chief of Staff (ODCS), G-1, and USAAA will validate corrective actions.

Results Indicators: Staffing levels of Army organizations will be based on workload associated with valid prioritized missions. Manpower requests contained in Army budget submissions and the dollars required to support the requested level of manpower will be logically developed from specific workload requirements that are derived from missions directed or approved by higher headquarters and approved by HQDA.

Source(s) Identifying Weakness: Numerous USAAA audits and General Accounting Office audit reports published between 1992 and 1997.

Major Milestones to Include Progress to Date:

USAAA review and validation completed.
Completed all milestones in FY06

Title and Description of Issue: Financial Reporting of General Equipment. The Army does not currently meet Federal Accounting Standards for the financial reporting of real property and general equipment. In November 1995, the Federal Accounting Standards Board issued Federal Accounting Standard Number 6, Accounting for Property, Plant, and Equipment (PP&E) requiring Federal agencies to present fairly the cost and depreciation of equipment assets in their financial statements.

Functional Category: Comptroller and/or Resource Management

Component: Army

Senior Official In Charge: Mr. John Argodale, Deputy Assistant Secretary of the Army (Financial Operations)

Pace of Corrective Action:

Year Identified: FY 1999

Original Targeted Correction Date: FY 2001

Targeted Correction Date in Last Year's Report: 1st Qtr, FY 2006

Current Target: Completed

Reason For Change in Date(s): Army is evaluating the reliability and quality of property book data to ensure data is ready for closing validation.

Validation Indicator: USAAA will validate the effectiveness of corrective actions.

Results Indicators: The Army is substantially closer to receiving an unqualified audit opinion on its annual financial statements by fielding a Chief Financial Officers' Act compliant property system. In addition, the Army benefited from Defense Property Accountability System (DPAS) implementation through: improved management oversight and visibility of PP&E; improved management access to PP&E information and operating results; and standardized property book accounting throughout the Army.

Source(s) Identifying Weakness: Management Review (Army Equipment Working Group and Army Integrated Process Team for Real Property). Audits of Army financial statements performed by USAAA (USAAA 97-149), Army's Principal Financial Statements for Fiscal Year 1996 -- Financial Reporting of Real Property and USAAA 99-192, Army's Principal Financial Statements for Fiscal Year 1998 -- Financial Reporting of Army General Equipment Financial Statements.

Major Milestones to include Progress to Date:

Completed all milestones in FY 2006.

USAAA review and validation. USAAA closed out current weakness as it relates to DPAS system fielding. (DPAS will replace or interface with existing non-compliant systems.)

DESCRIPTION OF THE CONCEPT OF REASONABLE ASSURANCE OVER QUARTERLY FINANCIAL STATEMENT REPORTING AND HOW THE EVALUATION WAS CONDUCTED

The Army conducted an internal control assessment of the effectiveness of internal controls over quarterly and annual financial statement reporting related to fund balance with Treasury, investments, real property, military equipment, Federal Employees Compensation Act, environmental liabilities, and appropriations received. The assessment was conducted in compliance with OMB Circular A-123, Appendix A, under the oversight of the Senior Assessment Team, which is maintaining complete records of the assessment documentation. Based on the results of the assessment, the number of unresolved problems that cannot be assessed, and audit disclaimers, The Army provides no assurance that the internal controls over quarterly and annual financial statement reporting in these areas as of June 30, 2006 were operating effectively. The Army can provide no assurance on those areas outside the focus areas because they were not assessed.

Guidelines for the Evaluation

The Army's Senior Assessment Team (SAT) evaluated the system of internal controls over quarterly and annual financial statement reporting in the focus areas of fund balance with Treasury, investments, real property, military equipment, Federal Employees Compensation Act, environmental liabilities, and appropriations received. The Army's decision to report no reasonable assurance is manifested in the pervasive number of unresolved reporting problems identified in the general fund and working capital fund. These problems are summarized as areas of concern in this TAB. Neither the general funds, nor the working capital fund are supported by accounting systems capable of meeting basic accounting standards such as transaction based general ledger accounting, accrual accounting, and transaction based elimination of intra-governmental transactions. The systems deficiencies result in billions of dollars in unsubstantiated accounting adjustments and more than a trillion dollars in abnormal general ledger account balances.

Determination of Reasonableness

The Army is responsible for financial statement balances and the end-to-end processes from which the balances result. The Army's Financial Improvement Plan contains 1,482 tasks, including 374 tasks assigned to entities outside the Army. The tasks correct known control weaknesses in financial statement reporting. These tasks are based on audit findings and recommendations, FMFIA requirements, pronouncements of the Federal Accounting Standards Advisory Board (FASAB), and the Senior Assessment Team's (SAT) evaluation of financial statement controls.

The SAT and the Audit Committee Executives (ACE) are two senior oversight bodies responsible for the Army's financial statements. The SAT convened twice during FY 2006 to assess financial statement internal controls, while the ACE conducted three meetings to assess progress in completing Financial Improvement Plan tasks and audit status. The SAT and ACE will continue to provide oversight of the Army's end-to-end financial statement process to ensure

financial statement controls are in place and working effectively, and corrective actions are implemented to enable an unqualified audit opinion.

The SAT documented business process flows, process risks, process controls, and developed an extensive test plan for use in determining the reasonableness of internal controls in support of financial statement reporting. As a consequence of control testing and the existence of extensive, uncorrected deficiencies identified in financial statement audits that cannot be tested, the SAT determined that no assurance of internal control over quarterly and annual financial statement reporting can be provided for FY 2006.

The Audit Committee Executives led the execution of the Army's Financial Improvement Plan (FIP). During the first three quarters of FY 2006, the Army completed 28 FIP tasks, with an additional 124 tasks scheduled for completion in the 4th quarter. Completion of these tasks corrects several deficiencies in financial statement reporting and positions the Army to produce timely and accurate financial statements needed for a favorable audit.

FY 2006 Results

General Fund Enterprise Business System:

In compliance with our Financial Improvement Plan, the Army completed the first successful technology demonstration of a FMFIA compliant, commercial off the shelf (COTS) enterprise resource planning (ERP) financial management system within the Department of Defense. The General Fund Enterprise Business System (GFEBS) technology demonstration resulted in the successful configuration of the US Government Standard General Ledger (USGSGL) and the Department's 180 Real Property Inventory Requirements (RPIR). Transactions demonstrating a full array of financial processes including funds execution, real property inventory, and financial reporting were successfully tested during the demonstration. Having demonstrated basic financial processes in a FMFIA compliant financial management system, the Army is now positioned to complete the next GFEBS release—full financial processing within a garrison environment. At full operational capability, GFEBS will be the single financial system of record for all Army general fund appropriations.

Real Property Inventory Valuation:

In support of the GFEBS technology demonstration, the Army reconciled real property financial data at Fort Jackson. The reconciliation disclosed deficiencies in internal controls including the completion of required physical inventories and retention of substantiating documentation. Results of the reconciliation enabled correct financial reporting of real property at Fort Jackson. In July 2006, the Army began a real property reconciliation at Fort Hood. The reconciliation will ensure real property values and RPIR data at Fort Hood are correctly reported, provide the Army a repeatable, auditable process for Army-wide real property reconciliation, and provide a feasibility analysis for a reduction of the real property capitalization threshold to \$20 thousand. Completion of the repeatable, auditable process will enable the launch of a systematic Army-wide real property reconciliation in FY 2007.

Funds Control Module:

During FY 2005, the Army obligated approximately \$20 billion for supplies and equipment, with the majority ordered through the Army's supply system. The interface between the supply and financial systems was not compliant with Federal Financial Management Improvement Act (FMFIA) requirements, causing material financial misstatements. During FY 2006 the Army implemented the supply/finance Funds Control Module (FCM) to ensure obligations, disbursements, and other financial transactions generated in the supply systems are posted correctly to the financial systems. The Army Audit Agency performed a FMFIA compliancy review of FCM and determined that FCM substantially complied with all 111 applicable FMFIA requirements. The Army now has a FMFIA compliant process to ensure reliable financial reporting of the \$20 billion in supply obligations and disbursements processed annually. FCM fielding will be completed in October 2006 enabling Army-wide operation in FY 2007.

Procurement and Vendor Pay Process Review:

The Army and Defense Finance and Accounting Service (DFAS) jointly engaged in a study of the end-to-end procurement and vendor pay process. The objective is to identify key control points in the end-to-end process, assess their effectiveness, and implement business process changes to improve the efficiency and effectiveness of the procurement and vendor payment processes. Procurement and vendor pay processes have a significant financial statement impact with respect to Funds Balance with Treasury (FBWT) and Statement of Budgetary Resources. The study will be completed in FY 2006 and recommendations implemented in FY 2007.

Army-Wide Joint Reconciliation Program:

The Army-Wide Joint Reconciliation Program ensures the timely and accurate posting of financial transactions to accounting systems at the detail transaction level through the reconciliation of unliquidated obligations and other accounting transactions. The program improved the reliability of financial reports by reducing problem disbursements to less than \$200 million, consistently liquidating delinquent accounts receivable by 10 percent, reducing prior year travel advances by 77 percent, eliminating \$400 million in canceled account liabilities, and reducing contract interest penalties from \$89 to \$79 per million dollars disbursed.

Areas of Concern

We detected a pervasive number of unresolved reporting problems in the general fund and working capital fund. These problems are summarized as areas of concern as follows:

Army General Fund

1. Defense Finance and Accounting Service (DFAS) accounting systems lacked a single standard transaction-driven general ledger. The Army also acknowledges that the financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the financial systems, non-financial feeder systems, and processes were designed and implemented prior to the issuance of generally accepted accounting principles and therefore, were not designed to

collect and record financial information on an accrual basis. Until such time as systems and processes are updated in accordance with generally accepted accounting principles, the Army's financial data will be based on budgetary transactions, non-financial feeder system transactions, and adjustments for known accruals of major items.

2. The Army General Fund financial statements are prepared using inadequate financial management systems and processes. General ledger adjustments are processed to make the summary proprietary balances match budgetary status appropriation balances when preparing Army's financial statements. In addition, DFAS did not adequately support \$241.5 billion in journal voucher adjustments used to prepare the FY 2005 Army General Fund financial statements.

3. DoD is unable to collect, exchange, and reconcile buyer and seller intra-governmental transactions, resulting in adjustments that cannot be verified. This is primarily because of systems limitations, as the majority of the systems currently used within DoD do not allow for the capture of buyer-side information for use in reconciliations and eliminations. DoD and Army accounting systems were unable to capture trading partner data at the transaction level in a manner that facilitated required trading partner eliminations, and DoD guidance did not require adequate support for eliminations. In addition, DoD procedures required that buyer-side transaction data be forced to agree with seller-side transaction data without performing proper reconciliations. Therefore, DFAS made \$26.2 billion in unsupported adjustments to the FY 2005 financial statements to intragovernmental accounts to force the accounts to agree with the records of Army's trading partners.

4. DFAS did not detect, report, or take effective action to eliminate abnormal balances included in the Army General Fund accounting records. The abnormal balances were included on trial balances submitted to DFAS during FY 2005. The FY 2005 trial balance data for the Army General Fund included 224 general ledger accounts with \$1.2 trillion of unresolved abnormal balances. Abnormal balances not only distort the Army General Fund financial statements, but also indicate internal control and operational deficiencies. The existence of abnormal balances may also conceal instances of fraud. There is also the potential for the errors causing abnormal balances to be perpetuated in the Defense Departmental Reporting System-Budgetary Module, when it is implemented.

5. DoD and its Components, including the Army, have long-standing problems in reconciling transaction activity in their Fund Balance with Treasury accounts. Appropriation balances recorded in the accounting records do not agree with balances held at Treasury. Therefore, DFAS made unsupported adjustments that had a net effect of \$44.0 billion on the financial statements. In addition, material uncertainties exist in Fund Balance with Treasury, especially with regards to suspense accounts.

6. DoD has acknowledged weaknesses in its accounts receivable management. The weaknesses are considered to be DoD-wide and apply to both public and intragovernmental receivables at the Army General Fund level. Weaknesses include:

- Noncompliance with policies and procedures regarding referrals to Debt Management and Treasury and for write-offs of two year old debt,

- Lack of controls to ensure all entitlement system receivables (vendor pay, civilian pay, and interest) are recorded in the accounting systems, and
- Lack of control to ensure that accounts receivable balances are supportable at the transaction level.

7. Inventories are reported at approximate historical cost using Latest Acquisition Cost adjusted for holding gains and losses. The systems do not maintain historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." The systems are also unable to produce financial transactions using the U.S. Government Standard General Ledger. SFFAS No. 3 states that Operating Materials and Supplies shall be expensed when the items are consumed. However, DoD has acknowledged that significant amounts of Operating Materials and Supplies were expensed when they were purchased instead of when they were consumed.

8. Statements of Federal Financial Accounting Standards (SFFAS) No. 6, "Accounting for Property, Plant, and Equipment," requires the recording of all General Property, Plant, and Equipment at cost, and the recognition of depreciation expense on all General Property, Plant, and Equipment. The Army has acknowledged that real property was not recorded at acquisition or historical cost and did not include all costs needed to bring the real property to a form and location suitable for its intended use. Also, the Army could not support the reported cost of Military Equipment in accordance with SFFAS No. 6. Military Equipment was not recorded at acquisition or historical cost and did not include all costs needed to bring the equipment to a form and location suitable for its intended use. The Army also lacks FMFIA-compliant property accountability systems for all its Military Table of Equipment unit property books.

9. The Army is unable to properly account for and report Accounts Payable. DFAS made \$14.4 billion in unsupported adjustments for FY 2005 that increased Accounts Payable by \$9.6 billion. In addition, the DFAS accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations for intra-agency sales. Therefore, the Army has acknowledged that it was unable to reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable generating the payables.

10. The Army has not properly estimated and reported its environmental liabilities. For example, the data and processes used to report Defense Environmental Restoration Program, Base Realignment and Closure, and non-Defense Environmental Restoration Program environmental liabilities on the financial statements did not have adequate documentation and audit trails. Although estimators were properly qualified to perform estimates, the Army did not document supervisory reviews of estimates, and adequate quality control programs were not in place to ensure the reliability of data.

11. The Statement of Net Cost is not presented by programs that align with major goals and outputs described in the DoD strategic and performance plans required by the Government Performance and Results Act. In addition, revenues and expenses are reported by appropriation categories because financial processes and systems do not collect costs in line with performance measures. The amounts presented in the Statement of Net Cost are based on funding, obligation, accrual and disbursing transactions, which are not always recorded using accrual accounting.

DFAS accounting systems do not always record the transactions on an accrual basis as is required by generally accepted accounting principles. The information presented also includes data from non-financial feeder systems to capture all cost and financing sources for the Army. Also, Army General Fund budgetary and proprietary information does not correlate.

12. DFAS accounting systems do not provide or capture data needed for obligations incurred and recoveries of prior year obligations in accordance with Office of Management and Budget Circular A 11, "Preparation, Submission, and Execution of the Budget Requirements." The Statement of Budgetary Resources does not include eliminating entries and therefore a Disaggregated Statement of Budgetary Resources is included in the Required Supplementary Information section of the financial statements. The Army uses budget execution data, which is composed of transaction report codes, to prepare the monthly Standard Form 133 and the quarterly Federal Agencies Centralized Trial Balance System II budgetary general ledger accounts. DFAS personnel use the Federal Agencies Centralized Trial Balance System II data to prepare the Statement of Budgetary Resources. Since both the Standard Form 133 and the Statement of Budgetary Resources are prepared using budget execution data, there is no true reconciliation between the two reports.

13. The Office of Management and Budget requires a consolidated Statement of Financing, except for the budgetary information used to calculate net obligations, which must be presented on a combined basis. Also, because the differences between the Statement of Net Cost and the Statement of Financing were not reconciled, the Statement of Financing does not accurately present the relationship between budgetary obligations incurred by the Army General Fund and its Net Cost of Operations. This is evidenced by DFAS preparing \$9.2 billion in unsupported adjustments to force costs to agree with obligation information.

Army Working Capital Fund

1. The systems used for the Army Working Capital Fund are unable to meet all of the requirements for full accrual accounting because the systems were not designed to collect and record financial information, as required by generally accepted accounting principles. Financial and non-financial feeder systems are not integrated and do not contain an audit trail for the proprietary and budgetary accounts. The Army Working Capital Fund derives most of its financial information for major accounts from noncompliant financial systems, such as the Commodity Command Standard System. The Army Working Capital Fund began implementation of the Logistics Modernization Program during FY 2003.

2. DFAS did not adequately support about \$1.5 billion in adjustments processed to force amounts to agree with other sources of information and records used to prepare the FY 2005 Army Working Capital Fund Financial Statements. An additional \$78.5 million in adjustments did not have adequate documentation attached to the journal vouchers to support either the reason for the adjustments or the dollar values. The unsupported adjusting accounting entries presented a material uncertainty regarding the line item balances on the FY 2005 Army Working Capital Fund Financial Statements. DFAS did not always follow the established minimum requirements for documenting journal vouchers to support adjusting accounting entries made to the general ledger accounts.

3. The Army's inability to reconcile most intragovernmental transactions results in adjustments that cannot be verified. Army accounting systems are not capable of capturing trading partner data at the transaction level in a manner that facilitated trading partner reconciliations, and DoD guidance did not require adequate support for intragovernmental eliminations. Buyer-side transaction data was forced to agree with seller-side transaction data without performing proper reconciliations. In FY 2005, DFAS made \$10.8 billion in adjustments to intragovernmental accounts to force the accounts to agree with the records of Army Working Capital Fund trading partners.

4. The existing inventory valuation method does not produce an auditable approximation of historical cost. The Army Working Capital Fund uses the latest acquisition cost method for valuing inventory because legacy inventory systems were designed for materiel management rather than accounting. The systems provide accountability and visibility over inventory items, but do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." In addition, the systems are not able to produce financial transactions using the U.S. Government Standard General Ledger accounts and neither DFAS nor the Army reconciled all differences between the accounting records and the logistical records. Instead, they accepted the data from the logistical records and adjusted the accounting records by about \$3 billion. The Logistics Modernization Program uses the moving average cost method of valuing inventory and the U.S. Government Standard General Ledger accounts to record financial transactions. During the initial deployment phase, Army and DFAS users reported problems associated with duplicate and inaccurate posting of inventory and financial transactions. Further, the Army had not completed physical inventories or established adequate controls over items in transit.

5. The value of Army Working Capital Fund General Property, Plant, and Equipment is not reliably reported because of the lack of supporting documentation, failure to correctly compute depreciation, and the failure to fully report the value of property in the possession of contractors. Information on acquisition date and cost was not always available and was sometimes recorded incorrectly. In addition, the Integrated Facilities System, the system that provides real property information to the Defense Property Accountability System, was a noncompliant system. The Integrated Facilities System was not able to calculate depreciated values for real property, preserve previous values by handling both positive and negative numbers, and provide an audit trail of all real property.

6. DFAS made significant adjustments to the accounts payable balances to derive the reported balances. In FY 2005 DFAS adjusted accounts payable with the public upward by \$2.4 million for undistributed disbursements. Also, the Army Working Capital Fund was unable to reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable. As a result, in FY 2005 DFAS made \$123.3 million in unsupported adjustments to decrease intragovernmental accounts payable to force the amounts to agree with Army trading partners. In addition, accounts payable in the Supply Management activity group were not established in accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," which requires that an accounts payable be established when the entity accepts title to the goods or services. The Army Working Capital Fund recognized accounts payable based on the

physical receipt of the goods or services rather than when the Government accepted title to the goods or services. As a result, the Army Working Capital Fund could not ensure that its accounts payable were not materially misstated.

7. The Statement of Net Cost was not presented by responsibility segments that were consistent with DoD performance goals and measures. Accounting systems were unable to accurately capture costs for Army Working Capital Fund programs and properly account for intragovernmental transactions and related eliminations. In addition, some of the Army Working Capital Fund's financial data presented on the Statement of Net Cost were based on budgetary transactions.

8. The Army cannot reconcile budgetary obligations to net cost without making unsupported adjustments. The Statement of Financing was prepared on a combined basis, while the Statement of Net Cost was prepared on a consolidated basis.

