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Accounting and Information
Management Division

B-271042

February 12, 1996

Ms. Phyllis A. Hudson, Director,
Defense Finance and Accounting
Service, Cleveland Center
1240 East Ninth Street
Cleveland, Ohio 44199-2055

Dear Ms. Hudson:

As part of our broad review of the Navy's fiscal year 1994 financial operations, we examined appropriation balances reported for undelivered orders, along with related balances for accounts payable, for the approximately 200 appropriations reported by the Navy as of September 30, 1994. Our review was conducted in accordance with generally accepted government auditing standards. We identified two appropriations where Defense Finance and Accounting Service, Cleveland (DFAS-Cleveland) staff reduced undelivered orders with unsupported adjustments totaling about \$72 million. DFAS-Cleveland staff said they made these adjustments pursuant to their practice of routinely eliminating negative undelivered orders balances from the Report on Budget Execution (DD 1176) whenever such balances arose without first researching the transactions on which they were based. Your staff advised us that they have discontinued this practice as a result of our having brought it to their attention during our review.

The purpose of this letter is to bring to your attention the conditions we found regarding the handling of negative undelivered orders by DFAS-Cleveland and to request supporting documentation regarding process changes and accounting adjustments discussed below.

Eliminating Negative Undelivered
Orders Can Be Misleading

A negative balance for undelivered orders is a "red flag," signaling a problem that needs to be investigated and resolved.¹ It could indicate that (1) obligations

¹The situation where disbursements exceed obligations is part of a larger
(continued...)

were not properly recorded, (2) disbursements were charged to the wrong appropriation, (3) duplicate payments or overpayments occurred, or (4) the Navy actually spent more than it obligated and potentially more than its available budget authority, in violation of the Anti-Deficiency Act. Because DFAS-Cleveland's practice arbitrarily eliminated such balances, it removed from key reports one indicator that potential funding or accounting problems existed. Moreover, it compounded the problem by arbitrarily reducing a liability such as accounts payable and increasing an asset such as refunds due.

For example, in preparing the Navy's September 30, 1994, Report on Budget Execution for the 1988/1990 Aircraft Procurement, Navy appropriation, DFAS-Cleveland Center adjusted the Navy's negative undelivered orders balance (-\$71.7 million) to zero, applied the negative \$71.7 million to reduce the \$52.1 million accounts payable liability, and reclassified the difference (\$-19.6 million) to increase the asset refunds due. (See table 1.) The only footnote provided for this balance stated that the \$19.6 million was from refunds due, which is clearly misleading.

Table 1: DFAS-Cleveland's Accounting for Negative Undelivered Orders From September 30, 1994, Report on Budget Execution for 1988/1990 Aircraft Procurement, Navy Appropriation

(Dollars in millions)

DD 1176 line	Title	Unadjusted balances	Amounts reported
13A1	Undelivered orders	\$(71.7)	\$0
13A2	Accounts payable	\$52.1	\$0
13A3	Advances, prepayments, refunds	\$0	\$19.6

¹(...continued)

Defensewide issue referred to as problem disbursements that we reported on in the past. As of November 30, 1995, Defensewide problem disbursements totaled \$22.1 billion. Of this amount, the Navy accounted for \$13.5 billion. We testified on this issue in May 1995 before the Subcommittee on Defense, Committee on Appropriations, United States Senate (GAO/T-AIMD-95-146, May 23, 1995).

The adjustment also adversely affected other financial reports which use the Report on Budget Execution as source data. For example, the \$52.1 million was not included in the accounts payable balance on the Navy's Report on Financial Position for fiscal year 1994 or on the Navy's Year End Closing Statement to Treasury. According to a Treasury official, Treasury uses this information to prepare the Federal Government's Annual Report which is provided to the Congress and the general public.

Moreover, on September 30, 1994, the Treasury balance of the 1988/1990 Aircraft Procurement, Navy appropriation, was about \$11 million. Had the Navy reported the \$52.1 million in accounts payable, the reported Treasury balance would not have been enough to pay the Navy's liability for the goods and services it had received, a situation that indicates the potential for an Anti-Deficiency Act violation.

Draft Guidance Encouraged
Unsupported Adjustments

DFAS-Cleveland staff told us that when preparing the Navy's Report on Budget Execution, their practice was to automatically adjust negative undelivered orders balances to zero by reclassifying the balance first to reduce accounts payable and then, if a negative balance still existed, to increase the balance for refunds due. The automatic adjustments were made without any valid basis. The DFAS-Cleveland Center had prepared draft guidelines for preparing the Navy's Report on Budget Execution that would formalize its practice of routinely adjusting negative undelivered orders to zero. According to Defense Finance and Accounting Service headquarters officials, there is no DFAS guidance that suggests that negative undelivered orders balances should be routinely reclassified.

Moreover, DFAS-Cleveland's draft guidance was inconsistent with the reporting practices of other Defense agencies and Department of Defense (DOD) Comptroller guidance that stressed the correction of problem transactions. The budget execution reports from other Defense agencies included negative balances for undelivered orders and accounts payable. Moreover, such unusual (negative) balances were generally footnoted to indicate what the problem was and what was being done to resolve it. The DOD Comptroller's guidance stated that when disbursements exceeded obligations, accounting activities must perform substantial and intensive research to correct erroneous transactions. Thus, arbitrarily eliminating balances that identify such conditions would be

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inconsistent with the spirit of the DOD Comptroller's guidance to correct such problems.

Recently, your staff advised us that effective September 30, 1995, they discontinued the practice of arbitrarily eliminating negative undelivered orders balances as a result of our bringing this problem to their attention. Also, as we suggested, they provided a copy of revised draft guidance for preparing line 13A1 of the Report on Budget Execution that calls for reporting and footnoting negative balances for undelivered orders. Your staff pointed out that while they had not footnoted negative undelivered balances in the Reports on Budget Execution for October and November 1995, they would do so for any existing negative balances beginning with the December 1995 report. We would appreciate receiving a copy of your revised guidance when it is finalized and your December 1995 Report on Budget Execution showing how negative balances are footnoted.

Your staff also advised us that after September 30, 1994, DFAS made numerous accounting adjustments that alleviated the potential Anti-Deficiency Act violation prior to closing the 1988/1990 Aircraft Procurement, Navy appropriation as of September 30, 1995. Accordingly, we would also appreciate receiving the supporting documentation for these accounting adjustments.

We are sending copies of this letter to the Deputy Chief Financial Officer, Department of Defense; the Assistant Secretary of the Navy for Financial Management/Comptroller; and the Director, Defense Finance and Accounting Service. If you have questions or comments on matters discussed in this letter, please contact me at (202) 512-9542 or Ben Smith, Evaluator-in-Charge, at (202) 512-9196. Thank you for your continued cooperation during our audit.

Sincerely yours,



Lisa G. Jacobson
Director, Defense Financial Audits

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