

CHAPTER 3

ACCOUNTING SYSTEMS CONFORMANCE, EVALUATION, AND REPORTING

0301 PURPOSE. This chapter prescribes the procedures for determining whether DoD accounting systems are designed, documented, and operated in accordance with the provisions of this Regulation. It also establishes the procedures to be followed in evaluating operating accounting systems, reporting the status of actions to upgrade accounting systems to meet prescribed accounting principles, standards, and related requirements, and for preparing the annual report on accounting systems required by Section 4 of the Federal Managers' Financial Integrity Act (FMFIA), 31 U.S. Code 3512.

030101 Overview. The FMFIA places the responsibility for developing and maintaining adequate accounting systems on Federal agency managers. The Act requires that agency heads annually report to the President and the Congress whether agency accounting systems comply with the Comptroller General's standards, and holds managers responsible for correcting identified deficiencies. This statutory requirement for an annual report, as per OMB guidelines, is to be based on reviews conducted annually by system managers and users and on detailed evaluations conducted on a cyclical basis. This statutory requirement is implemented in DoD by this chapter. To satisfy this statutory requirement, DoD established the Accounting Systems Review and Evaluation Program. This program consists of the System Manager/User Review (SM/UR) process which supports and provides guidance to DoD managers in conducting annual reviews and the Consolidated Systems Evaluation (CSE) process which is the detailed, cyclical, independent evaluation as required by the Act. The results of these reviews and evaluations are used to prepare Section 4 of the annual FMFIA report and for reporting accounting system status in the DoD Five Year Financial Management Plan.

0302 POLICY

030201 Financial Management and Accounting System Structure. DoD is responsible for developing and maintaining an integrated financial management system structure. The financial management structure is the total of DoD's systems, both manual and automated, for planning, budget formulation and execution, and accounting. The accounting system structure is comprised of Primary (Core) accounting systems which provide full general ledger control over financial transactions and resource balances, and administrative accounting systems (i.e., subsidiary and accounting support systems) which provide data to the Primary accounting systems. Subsidiary accounting systems produce functional transactional data needed for the general ledger such as budget execution, payroll, travel, procurement, and real property. Accounting support systems must have full general ledger control and provide financial information on operations to the Primary accounting systems such as the Defense Business Operations and Foreign Military Sales. The accounting system structure falls within the scope of Section 4 of the FMFIA.

This accounting system structure shall:

- A. Be in reasonable compliance with the Comptroller General, OMB, Department of Treasury and DoD accounting principles, standards and policies.
- B. Provide maximum accounting and general ledger control through the use of the DoD Standard General Ledger.
- C. Maximize the use of standardization in data administration, data processing and data elements and minimize the number of individual accounting and financial applications.
- D. Maximize the most effective and economical use of data processing and telecommunications technology and accounting methodology and techniques.

E. Maximize the use of information systems architectures.

F. Produce auditable financial statements.

The accounting system structure is supplemented by feeder systems. Feeder systems provide purely nonfinancial information, or they are the initial record of financial data for processing by accounting systems. Feeder systems are recordation only and do not generate or compile financial information, and are not within the scope of Section 4 of the FMFIA. Examples of feeder systems are: logistics and inventory systems that provide acquisition cost, location, and quantity information; personnel systems providing grade and entitlements information; and timekeeping systems providing attendance and leave information. Feeder systems fall under the scope of Section 2 of the FMFIA.

0303 RESPONSIBILITIES

030301 The Comptroller of the Department of Defense (C, DoD):

A. Serve as the DoD senior official under OMB Circular No. A-127 for policy guidance, direction, and coordination with DoD Components and other Federal agencies on accounting system requirements.

B. Prescribe the principles, standards, and related requirements applicable to DoD accounting systems.

C. Approve, for signature by the Secretary of Defense, an annual consolidated accounting report and an inventory of operating accounting systems in accordance with Section 4 of the FMFIA.

D. Approve proposed development of or substantial revisions to accounting systems for adherence to the requirements of this chapter prior to providing DoD approval to proceed and to expend funds.

E. Approve and issue annually a Chief Financial Officers Five Year Financial Manage-

ment Plan for an integrated financial management system structure.

030302 The Defense Finance and Accounting Service shall:

A. Prescribe the procedures for conducting the annual evaluation of accounting systems required by Section 4 of the FMFIA, and prepare an accounting report for signature by Secretary of Defense.

B. Develop and maintain a Chief Financial Officers Five Year Financial Management Plan for an integrated financial management system structure which:

1. Describes the existing financial management structure and any changes needed to establish an integrated accounting system;

2. Is consistent with applicable accounting principles, standards, and requirements;

3. Provides a strategy for developing and integrating accounting and financial information to ensure adequacy, consistency, and timeliness of financial information;

4. Identifies and makes proposals to eliminate duplicative and unnecessary accounting systems, including sharing systems;

5. Identifies projects to bring existing accounting systems into compliance with the applicable standards and requirements;

6. Contains milestones for equipment acquisition and other actions necessary to implement the Five Year Financial Management Plan;

7. Identifies personnel needs and actions to ensure those needs are met;

8. Includes a plan for ensuring the annual audit of financial statements pursuant to the Chief Financial Officers Act; and

9. Estimates the cost of implementing the Five Year Financial Management Plan.

C. Develop and maintain an accounting systems planning process which monitors, coordinates and reports the compliance of the accounting systems with the requirements of the FMFIA and the status of developmental, enhancement and improvement initiatives and projects to improve accounting systems.

D. Develop and maintain a comprehensive accounting system inventory for accounting systems in operation and under development.

E. Assess the state of compliance of accounting systems with the Comptroller General, OMB, Department of the Treasury, and DoD accounting principles, standards and policies and report annually the results to the Secretary of Defense.

F. Develop, maintain, and issue the Key Accounting Requirements (KARs). KARs are a composite of GAO, OMB, and DoD regulations and are requirements with which all DoD accounting systems must comply.

G. Maintain and issue SM/UR guidance for annual compliancy reviews of the Primary and Administrative accounting systems conducted by managers of the accounting systems.

H. Perform CSEs on developmental and operational Primary and Administrative accounting systems in the DoD Accounting System inventory on a cyclical basis.

I. Ensure that the accounting systems provide complete, reliable, consistent, and timely information which is prepared on a uniform basis and is responsive to the financial information needs of management.

030303 The Managers of Accounting Systems shall:

A. Ensure that accounting systems are developed, maintained, reviewed, improved and reported on per the requirements of this chapter.

B. Conduct annual reviews of assigned accounting systems per the DoD SM/UR guide.

C. Monitor the progress of development, enhancement or improvement initiatives to accounting systems under their control.

030304 The Users of DoD Accounting Systems shall: Work with the system managers in conducting the annual reviews of these systems and in producing the documented management assessment of system compliance.

030305 The Inspector General, Department of Defense shall:

A. Provide technical assistance and advice on DoD efforts to review and improve accounting systems.

B. Perform accounting system audits to determine whether accounting system reviews and evaluations were conducted in accordance with prescribed guidelines and advise the DFAS. Performing such IG audits should not be interpreted as preventing the IG from providing technical assistance and advice.

C. Advise the Secretary of Defense annually as to the effectiveness of DoD compliance with this Regulation and the requirements of the FMFIA.

0304 LEGAL REQUIREMENTS

030401 Budgeting and Accounting Act. The Budget and Accounting Procedures Act of 1950 requires that the head of each executive agency establish and maintain systems of accounting and internal controls that provide:

A. Disclosure of the agency's financial results;

B. Integration of the agency accounting with the central accounting and reporting requirements of the Department of the Treasury;

C. Financial management information;

D. Control and accountability for agency assets; and

E. Accounting results that will be the basis for:

1. Preparing and supporting the agency budget;

2. Controlling the execution of the agency budget; and

3. Providing financial information the President requires under the budget and appropriations authority.

030402 Federal Managers Financial Integrity Act. The Federal Managers' Financial Integrity (FMFIA) Act, P.L. 97-255, was passed by Congress in September 1982 to enhance the Budget and Accounting Procedures Act, and provide management accountability by requiring ongoing evaluations and reports. For the first time, agency heads were required under this Act to report annually to the President and the Congress as to whether accounting systems (Section 4 of the Act) conform to the principles, standards, and related requirements prescribed by the Comptroller General.

030403 Chief Financial Officer's Act. The Chief Financial Officer's Act, as implemented by OMB, requires that the annual audit of an agency's financial statements contains a report on the Agency's implementation of the Federal Manager's Financial Integrity Act. Auditors are required to review and report on management's process for evaluating and reporting on accounting systems and internal controls, and compare the most recent Federal Manager's Financial Integrity Act reports with the results of their audit.

0305 REGULATORY REQUIREMENTS

030501 OMB Circular No. A-34. Provides instructions on budget execution, financial plans, apportionments, reappportionments, deferrals, proposed and enacted rescissions, systems for administrative control of funds, allotments,

operating budgets, reports on budget execution, and reports on violations of the Antideficiency Act.

030502 OMB Circular No. A-127. Prescribes policies and procedures to be followed in developing, operating, evaluating, and reporting on financial management systems.

030503 The Treasury Fiscal Manual. Provides instructions for the guidance of departments and agencies of the Federal Government in the areas of central accounting and reporting, payrolls, deductions and withholdings, disbursing, deposit regulations and other fiscal matters. DoD accounting systems must be capable of producing the reports required by the applicable sections of the Treasury Fiscal Manual. This includes the general purpose financial statements prescribed in I TFM 2-4100, the Report on Obligations (SF 225) prescribed in I TFM 2-4400, and the Year-End Closing Statement (TFS Form 2108) prescribed in I TFM 2-4200.

0306 GUIDELINES

030601 Review and Evaluation of Accounting Systems. Section 4 of the FMFIA as implemented by OMB Circular A-127 requires an annual self-appraisal of operating accounting systems by systems managers and users, and an independent detailed evaluation performed on a cyclical basis. These self-appraisals and independent detailed evaluations form the basis for determining the compliancy of accounting systems. The DoD FMFIA Section 4 program's two processes to satisfy these requirements are the SM/UR program and the CSE program.

A. SM/URs are self-evaluations performed annually by the owners and operators of the accounting systems using the DoD SM/UR guide. The guide consolidates all accounting policies and requirements reported in Section 4 of the FMFIA, and provides direction for completing the annual review and determining accounting systems compliancy. The guide is prepared, issued, and the results evaluated and consolidated by DFAS.

B. CSEs are independent detailed reviews performed by DFAS Headquarter's

evaluation teams on a cyclical bases using the DoD Accounting Systems Review and Evaluation Policies and Procedures Handbook. Reviews and evaluations determine whether accounting systems operate in compliance with prescribed accounting principles, standards, and related requirements.

030602 Methodology for Determining Compliance of Accounting Systems

A. Key Accounting Requirement (KAR). Accounting requirements made up of a composite of all GAO, OMB, Treasury, DoD requirements, with which an accounting system must reasonably comply. Addendum A provides a list of the current 13 KARs. KARs are used both by System Managers annually and by DFAS Headquarters cyclically to review the accounting systems. This process identifies system departures and determines whether the departures are of such materiality to prevent the system from being in reasonable compliance with accounting principles, standards, and related requirements. All departures from a KAR which are determined to be material are material deficiencies and require corrective action with a reasonable implementation date.

B. Material Deficiency. DoD uses the concept of materiality to determine the compliance of its accounting systems and to identify, where appropriate, needed corrective actions. A departure from a KAR is considered a material deficiency if it could result in:

1. Loss of control of over 5% or more of the measurable resources for which the accounting system is responsible. Examples include: (1) if more than 5% of the disbursements were undistributed, KAR 7; (2) if more than 5% of Class 3 and 4 plant property could not be located using the official accounting records, KAR 2; or (3) if more that 5% of materials and supplies were not in the custody of the accountable supply officer, KAR 2.

2. Impairment of the DoD mission. Examples include: (1) maintaining memorandum records because official records cannot be relied upon, KAR 12; (2) excessive overrides and work arounds to make the system work,

KAR 11; or (3) inefficient and unnecessary procedures that result in the reduction of operating forces readiness or effectiveness, KAR 12.

3. Fraud or other criminal activities go undetected. Examples include: (1) allowing controls to be bypassed without the knowledge of an authorizing official, KAR 7; (2) inadequate supervision, KAR 11; (3) lack of separation of duties, KAR 7; or (4) inadequate audit trails to trace transactions, KAR 8.

4. An event that would result in significant adverse publicity or embarrassment to the Department and diminish the credibility or reputation of DoD. Examples include: (1) procurements without valid requirements, KAR 2; (2) excessive or unauthorized charges, KAR 7; or (3) erroneous or duplicate payments, KAR 9.

5. Violations of statutory requirements, KAR 7. Examples include: (1) use of funds for purposes other than appropriated (31 U.S.C. 1301); (2) obligations or expenditures in excess of funds available (31 U.S.C. 1517); (3) obligations not supported by documentary evidence (31 U.S.C. 1501); (4) expenditure of funds beyond the period authorized by law (31 U.S.C. 1502).

C. System Manager/User Review

1. A SM/UR is a structured and objective method for system managers to review their accounting systems for compliance. The DoD SM/UR Guide provides direction to the system managers of DoD accounting systems for conducting annual reviews of these systems for compliance to accounting statutory and regulatory requirements. It represents management's self-evaluation of its accounting systems. As such, it is based on all available knowledge of the system from the day to day operations plus the results of prior reviews and evaluations. The Guide provides the accounting criteria or requirements with which all DoD accounting systems must comply; it provides review techniques and guidance to assist system managers in determining if their systems are in compliance with the KARs, and it provides them the opportunity to identify needed corrective actions. The Guide incorporates the accounting principle of

materiality; therefore, only material deficiencies, departures from KARs which are determined to be material, are used by the system managers in assessing the compliance of their systems.

2. System managers are responsible for conducting these reviews in accordance with the DoD SM/UR Guide and by the schedule provided by DFAS Headquarters. Each accounting system is to be reviewed annually unless it is scheduled to be replaced or has undergone a detailed CSE in the current fiscal year.

3. System managers, based upon the results of the SM/UR, are to certify the compliance or noncompliance of accounting system(s) and forward the SM/URs to DFAS for review, analysis, and coordination.

D. Consolidated Systems Evaluation

1. A CSE is an independent, comprehensive, systematic, and objective evaluation conducted by DFAS Headquarter's evaluation teams. It is used to provide reasonable assurance that accounting systems comply with statutory and regulatory requirements. It is a detailed evaluation to determine whether the accounting system's design, procedures, and control techniques satisfy accounting principles and standards. A CSE determines whether the accounting system captures, records, processes, and reports financial transactions in conformance with these same standards. This evaluation covers the full life cycle of the transaction from initiation of the accounting transaction, through system processing, and ultimate posting to the accounts for inclusion in output reports. This life cycle/transaction flow approach will often involve both manual and automated procedures and controls.

2. CSEs are performed on both operational and developmental accounting systems. An operational accounting system is to be covered by a CSE every three years unless it is scheduled for replacement in the near term. Developmental accounting systems are selected for CSEs based on their importance as a corrective action to the compliance determination of the applicable accounting system. CSEs of

operational accounting systems identify departures and material deficiencies with the KARs and provide a compliancy determination. CSEs of developmental accounting systems identify departures and provide recommendations to ensure that the accounting system will be compliant when implemented.

0307 ANNUAL REPORT ON OPERATING ACCOUNTING SYSTEMS

030701 General. DFAS will annually validate the inventory and status of DoD operating accounting systems as of September 30. The status will be based on SM/URs, CSEs, audits, and Inspections. DFAS will submit to the Secretary of Defense, after approval by the C,DoD, by November 15 of each year the Annual Statement of Assurance required by Section 4 of the FMFIA, and as illustrated at figure 3-1. Documentation supporting the compliancy call and the SM/UR will be the support for the Annual Statement of Assurance for Section 4. The SM/UR and supporting documentation should be maintained for audit purposes by the office responsible for performing the review. Under OMB guidelines for the Chief Financial Officers Act, auditors are required to review and report on the agency's FMFIA program when performing financial statement audits.

030702 Inventory Reporting.

A. Accounting systems shall be consolidated and reported at the highest level consistent with adequate system interfaces. Consolidated systems contain interfaces and have a virtual uninterrupted data flow. Adequately interfaced systems contain edit checks and internal controls on the initial transaction that ensure the proper processing throughout the entire accounting cycle. Any system that performs an accounting function and that does not adequately interface with another accounting system will be reported separately. Systems that do not adequately interface may require reentry of source data or partially processed data, significant controls and edit checks on the data exchanged, reprocessing of data, or data conversion because of incompatibility.

B. An entity that uses an unmodified accounting system of another activity designated as the System Manager, or submits its accounting source documents to another DoD organization for processing and receives outputs from the processing organization's system, does not have an operating accounting system subject to reporting.

030703 Enclosure to the Annual Accounting Systems Report. The report shall be accompanied by an inventory listing of each Primary and Administrative accounting system. DFAS will conduct an annual validation of the inventory of accounting systems by March 31 of each year through canvassing of the System Managers. The prior year annual inventory listing shall be the beginning point for preparing the current year's inventory. New systems will be added

and Primary and Administrative accounting systems no longer in operation will be eliminated. All changes shall be explained by footnotes to the listing. See figure 3-2 for an illustration of this inventory listing.

030704 Categorization of the Inventory. The status of accounting systems in the inventory will be reported in the following classifications:

A. Primary or Administrative accounting systems substantially in compliance with prescribed accounting principles, standards, and related requirements.

B. Primary or Administrative accounting systems not in compliance with prescribed accounting principles, standards, and related requirements.

**ANNUAL REPORT ON OPERATING ACCOUNTING
SYSTEMS FOR FISCAL YEAR 19XX**

Pursuant to Section 4 of the Federal Managers' Financial Integrity Act of 1982, we have reviewed the Primary and Administrative accounting systems, as defined by the General Accounting Office (GAO), during the fiscal year ending September 30, 19xx. The review of each system was performed by operating personnel and encompassed the accounting principles, standards and related requirements prescribed by the this Regulation. Various methods were used in performing the reviews. They included the use of system questionnaires, transaction testing of sensitive areas in (number) systems, and review of operations. An inventory of operating accounting systems is included as an appendix.

DoD/DFAS has (number) Primary and Administrative accounting systems that meet the GAO definition of accounting systems requiring approval or conditional approval. The results of the evaluations described in the first paragraph, the approval of accounting system design documentation already provided by the GAO for certain accounting systems, assurances given by system managers, and other information, show that (number) systems are substantially in compliance with DoD Financial Management Regulation requirements.

The remaining (number) accounting system, while containing many good internal and fund control features, do not meet all necessary requirements and cannot be certified as in substantial compliance. (Describe any material deficiencies in the remaining noncompliant systems).

FIGURE 3-1

DEFENSE FINANCE AND ACCOUNTING SERVICE
(NAME OF CENTER)
ANNUAL INVENTORY OF OPERATING
ACCOUNTING SYSTEMS
FISCAL YEAR 19XX

A. OPERATING ACCOUNTING SYSTEMS SUBSTANTIALLY IN COMPLIANCE WITH GAO ACCOUNTING PRINCIPLES, STANDARDS, AND RELATED REQUIREMENTS

System Name

ABC Accounting System
DEF Payroll System

B. OPERATING ACCOUNTING SYSTEMS NOT IN COMPLIANCE WITH GAO ACCOUNTING PRINCIPLES, STANDARDS, AND RELATED REQUIREMENTS

<u>System Name</u>	<u>Planned Date to be Brought into Compliance</u>
XYZ Installation System	Feb. 19XX

(Note: As a footnote, identify the name of the replacement accounting system if this is the action necessary to upgrade the accounting system.)

FIGURE 3-2

ADDENDUM
KEY ACCOUNTING REQUIREMENTS

KEY ACCOUNTING REQUIREMENT NUMBER 1**GENERAL LEDGER CONTROL AND FINANCIAL REPORTING****Description of Key Accounting Requirement**

The system must have general ledger control and maintain an appropriate account structure approved by DoD. The general ledger account structure must follow the general ledger accounts for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources. A double entry set of accounts must be maintained within the system to reflect budget authority, undelivered orders, obligations, expenditures and other necessary accounts. The system must list both control and subsidiary general ledger accounts by title and numbers with definition of each account. Subsidiary accounts shall be reconciled to the control accounts at least monthly.

Full financial disclosure, accountability, adequate financial information, and reports must be provided for management purposes, and for necessary external reporting to OMB and Treasury. General ledger control and financial reports apply to all DoD systems except pay delivery systems, including stock, industrial, and trust funds.

This key accounting requirement addresses the mandatory fiduciary general ledger and reporting for the departmental, claimant, and field level accounting. It does not address the requirements for management information. KAR 12 on user information needs addresses management information aspects of an accounting system.

KEY ACCOUNTING REQUIREMENT NUMBER 2**PROPERTY AND INVENTORY ACCOUNTING****Description of Key Accounting Requirement**

The system must account in quantitative and monetary terms for the procurement, receipt, issue, and control of plant property, equipment, inventory, and material. Most acquisitions are recorded upon receipt of goods.

All property and equipment including ADP software with an initial acquisition cost of \$15,000 and an estimated useful life of more than two years must be capitalized and reported at cost including amounts paid to install the assets in the proper form and place. If cost is unknown, the fair value of the fixed asset at the date of acquisition is estimated. Costs of additions, alterations, or replacements that extend the asset's useful life or service capacity are capitalized as fixed assets. Proper accounting controls exist for Government-owned property held and used by contractors.

Inventory accounting must entail accounting and control over the acquisition and issuance of materials, the comparison of physical inventories and records, the planning for procurement and utilization, and effective custody of the materials.

The property management system must include accounting controls over inventory ledgers that identify the item, its location, quantity, acquisition date, cost, and other information. Subsidiary

ADDENDUM
KEY ACCOUNTING REQUIREMENTS
(CONTINUED)

property records are reconciled periodically to general ledger accounts. Physical controls include assigning specific individuals to inventory, placing physical safeguards on inventory, and periodically reconciling physical inventories to the accounting records.

KEY ACCOUNTING REQUIREMENT NUMBER 3

ACCOUNTING FOR RECEIVABLES INCLUDING ADVANCES

Description of Key Accounting Requirement

The system must account for all accounts receivables (any public indebtedness to the U.S. Government). Accounts receivable shall be recorded accurately and promptly to provide timely and reliable financial status. Accounts receivable shall be reduced upon collection of funds or when offset by previously established collateral. Uncollectible amounts should be promptly written off according to DoD instructions and the accounts receivable reduced accordingly. An allowance for uncollectible accounts and corresponding expenses must be established to provide full financial disclosure. The process should document the efforts made to collect delinquent debts (this includes compliance to the Debt Collection Act).

All collections shall be under general ledger accounting control. Cash shall be deposited as expeditiously as possible and immediately recorded in the accounting records.

Advances shall be recorded as assets until receipt of the goods or services or until contract terms are met. Accounting control must be maintained over advances made to employees, contractors, and all others. Advances must be promptly recorded and reconciled to general ledger control accounts.

KEY ACCOUNTING REQUIREMENT NUMBER 4

COST ACCOUNTING

Description of Key Accounting Requirement

Cost accounting must involve accounting analysis and reporting on costs of production of goods or services, or operation of programs, activities, functions, or organizational units. Cost accounting shall be provided in the accounting system if it is required in such instances as pricing decisions, productivity improvement decisions or measurement of performance, efficiency comparisons of like activities, and in industrial fund activities. For industrial fund activities, there is a DoD requirement for working capital funds to provide capital for industrial type and commercial type activities. Industrial fund accounting shall provide an effective means for controlling the cost of goods and services produced or furnished by industrial and commercial type activities. Cost accounting should be used in job order and process cost and in determining operating results. The primary components of DoD costs are labor and materials. However, other costs such as depreciation, amortization, unfunded liabilities such as severance pay, labor, manufacturing overhead, unallocated costs, etc., should be accumulated in the accounting system when needed.

ADDENDUM
KEY ACCOUNTING REQUIREMENTS
(CONTINUED)

KEY ACCOUNTING REQUIREMENT NUMBER 5**ACCRUAL ACCOUNTING****Description of Key Accounting Requirement**

Accrual accounting must recognize the accountable aspects of financial transactions or events as they occur. Transactions may be recorded in accounting records as they occur or be adjusted to the accrual basis at each month end. Accrual accounting should be used to meet the specific needs of management and the Congress.

Amounts of accrued expenditures and revenues must be recorded only when supported by prescribed documentary evidence on the basis of initial documentation received. They are adjusted subsequently, if necessary, upon receipt of more accurate documentation. Examples of acceptable initial documentation received include receiving reports, bills of lading, job sheets, certified unpaid invoices and journal vouchers showing administrative estimates by responsible officials. This documentation shall represent a reflection of transactions and performance which actually occur.

When liabilities are incurred as work is performed rather than when deliveries are made, accruals must be recorded from performance reports for the affected accounting period. Unpaid personnel compensation and benefits which have been earned as of the end of the pay year must be accrued in full or in part, e.g., the accrual of annual leave is material and should be recognized annually in the financial statements. Accrued payroll for civilian and military for salaries and wages, employer's share of fringe benefits, allowances, foreign nationals, severance pay, unfunded annual leave, annual leave, and retirement must be recorded and reconciled with the actual payroll.

KEY ACCOUNTING REQUIREMENT NUMBER 6**MILITARY AND CIVILIAN PAYROLL PROCEDURES****Description of Key Accounting Requirement**

Wherever feasible, DoD will use modern technology in its computer systems to process payroll transactions. The payroll system will interface with the accounting system providing obligation and accrual data. The military and civilian payroll processes and procedures must be available to management, users, auditors, evaluators, etc.

Payroll systems must incorporate controls of both gross and net payroll amounts and payroll deductions to ensure smooth payroll processing action and to minimize incorrect payments. Procedures will be available to ensure that only authorized deductions are made from pay and all deductions are supported by proper documentation. Accounting entries for authorized deductions from pay must be verified. Timely, accurate, and complete individual and subsidiary records are maintained for leave accounts, employee benefits, compensated personnel absences, general benefits such as bonuses and cash allowances for quarters and subsistence, allotments by type and amount, and other balances. Reconciliations of the general ledger and personnel records to payroll records will be performed.

ADDENDUM
KEY ACCOUNTING REQUIREMENTS
(CONTINUED)

Unpaid personnel compensation and benefits, including annual leave, which have been earned by employees as of the end of the pay year must be accrued in full. Accrued payroll will be reconciled with actual payroll. Personal compensation and all employee benefit expenses (including federal contributions) shall be reported and disclosed separately in financial statements.

Automated controls will include predetermined limits on the computation of pay; accumulation and tests of zero balances; checks on sequence of records; counts of records; crossfoot balances; and other tests of the validity of the data or accuracy of the processing. Separation of duties is promoted by requiring vouchers authorizing payment to be certified before payment by a duly authorized certifying officer who does not compute amounts payable, maintain the payroll records, or distribute the paychecks.

KEY ACCOUNTING REQUIREMENT NUMBER 7

SYSTEM CONTROLS (FUND AND INTERNAL)

Description of Key Accounting Requirement

A. Fund Control. The system must ensure obligations and expenditures do not exceed the amount appropriated, apportioned, reapportioned, allocated and allotted (Anti-Deficiency Act 31 U.S.C.). The system must provide a process and procedures for control over errors to ensure that once errors are detected: (1) corrections are made in a timely manner and reentered into the appropriate processing cycle; (2) corrections are made only once; and, (3) the correction itself is validated. The system must show the appropriations and funds to be accounted for and a description of the accounting entity's proposed fund distribution and control process. The system must have good fund control procedures to prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements. Obligations must be recorded immediately. Fund control procedures must include fiscal year end Section 1311 Statement of Certification by a senior accounting official to ensure the validity of all obligations and unobligated balances. Administrative funds control must ensure that funds are used economically, efficiently, and only for properly authorized purposes.

B. Internal Controls. The system must have adequate internal controls to prevent, detect, and correct errors and irregularities that may occur throughout the system. Separation of duties and responsibilities must be maintained for initiating, authorizing, processing, recording, and reviewing transactions. Automated systems must have system security and integrity for authorized processing to include procedures and controls which protect hardware, software, and documentation from physical damage by accident, fire, flood, environmental hazards, and unauthorized access. Also, the system must have controls to prevent unauthorized use of confidential information.

KEY ACCOUNTING REQUIREMENT NUMBER 8

AUDIT TRAILS

Description of Key Accounting Requirement

Audit trails permit tracing transactions through a system. Audit trails allow auditors or evaluators to ensure transactions are properly accumulated and correctly classified, coded and recorded in all affected

ADDENDUM
KEY ACCOUNTING REQUIREMENTS
(CONTINUED)

accounts. Audit trails should allow a transaction to be traced from initiation through processing to final reports. In addition, good audit trails allow for the detection and tracing of rejected or suspended transactions, such as unmatched disbursements, for ultimate systematic correction in a reasonable timeframe.

A fundamental requirement for any compliant accounting system is that the financial transactions for which the system must account be adequately supported with pertinent documents and source records. All transactions, including those which are computer-generated and computer-processed, must be traceable to individual source records. Audit trails enable the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source. Items in source records necessary for audit-trail purposes include transaction type, record or account involved, amount, processing references, and identification of the preparer and approver of the transaction. A key test of the adequacy of an audit trail is whether tracing the transaction forward from the source or back from the result will permit verification of the amount recorded or reported.

KEY ACCOUNTING REQUIREMENT NUMBER 9

CASH PROCEDURES AND ACCOUNTS PAYABLE

Description of Key Accounting Requirement

The system shall be designed to ensure timely payments based on properly approved disbursement documents. Payment process and procedures must comply with the Prompt Payment Act. Cash discounts should be taken when determined to be financially advantageous to the DoD.

Accounts payable are liabilities which should be recorded when goods or services are received. The liability reported in the annual financial statements shall reflect amounts due for goods and services received. For items manufactured by a contractor to specifications, the accounting system shall reflect the appropriate payable, including contract retentions, for each accounting period based on requests for progress payments or on reasonable estimates of unbilled contractor performance. This shall be recorded in the proper accounting period.

Accounts payable for services performed by employees, contractors, and others shall be determined based on performance as evidenced by payroll records, progress billings, or other available data. Reasonable estimates of the cost of services performed before the end of a reporting period shall be made for annual financial reporting purposes in the absence of invoices or other available data. The system shall record the liability for goods and services purchased under a long-term contract in the period in which the goods or services are received or accepted.

KEY ACCOUNTING REQUIREMENT NUMBER 10

SYSTEM DOCUMENTATION

Description of Key Accounting Requirement

The accounting system must have adequate system documentation which must include interfaces between accounting system segments. The detailed accounting system design package shall adequately document

ADDENDUM
KEY ACCOUNTING REQUIREMENTS
(CONTINUED)

the functional user's accounting requirements. Such documentation must be available in users manuals, subsystem specifications, etc. The detailed documentation must be comprehensive and shall include a combination of descriptions of processes, flowcharts and narrative description, diagrams, basic accounting entries including adjusting and closing entries, illustrations or samples of source documents for input, and sample outputs and reports. It shall also include internal controls incorporated within the accounting system. The documentation must demonstrate conformance with the DoD Financial Management Regulation and other DoD requirements for adequate and reasonable documentation. The system documentation shall be in enough detail to be understood by computer personnel and system accountants assigned to develop applicable software. It shall demonstrate readily to users, auditors, and evaluators the system's conceptual processes and procedures. The documentation should be in good order to facilitate maintenance operations and transaction testing. Good documentation would permit transaction testing which is designed to disclose whether valid transactions are processed properly, and whether the system rejects invalid transactions. The documentation shall have enough detail that a testing of the system could cover an entire transaction, from initial authorization through processing, posting to the accounts, and reporting. The documentation should indicate the mission, organization, description, objectives, financial management requirements, and boundaries of the system.

KEY ACCOUNTING REQUIREMENT NUMBER 11

SYSTEM OPERATIONS

Description of Key Accounting Requirement

Adequate organization and planning shall exist regarding systems operations to assure that financial management and accounting objectives are met in an economical and efficient manner. It must satisfy legal requirements, laws, regulations, accounting principles and standards, and related requirements as prescribed in the DoD Financial Management Regulation and other related instructions. Financial systems shall contain all data required to achieve the purposes for which they were created and maintained. They shall also be as simple as possible, consistent with regulatory requirements and users' needs. The existing and planned hardware should be adequate to process efficiently current and projected future transaction volumes. There should be compatibility of existing and planned hardware to interface effectively with other systems. The system should conform to required DoD systems documentation requirements. The best of acceptably priced contemporary technology should be used. There should be detailed system operating and maintenance procedures. Also, there should be periodic system reviews to assure that the system is functioning as intended, required procedures are being followed, any operating problems are promptly identified and corrected, and possible state-of-the-art enhancements are incorporated as appropriate.

KEY ACCOUNTING REQUIREMENT NUMBER 12

USER INFORMATION NEEDS

Description of Key Accounting Requirement

User information needs and requirements as to quality, accuracy, timeliness, reliability, responsiveness of the system shall be adequate in response to program, financial managers, and other users. The system

ADDENDUM
KEY ACCOUNTING REQUIREMENTS
(CONTINUED)

shall satisfy users as to their reporting requirements particularly as it relates to month end reports. The system must also satisfy user needs to facilitate their management decision making process. In addition, if there are departures in other key accounting requirements that adversely impact the users of the system, the materiality of these departures will be determined under this key accounting requirement.

KEY ACCOUNTING REQUIREMENT NUMBER 13

BUDGETARY ACCOUNTING

Description of Key Accounting Requirement

The system shall support formulation of the budget, support budget requests, and control budget execution. Programming, budgeting, accounting, reporting classification, and coding structure should be uniform and consistent with each other and synchronized with the organizational structure so that actual activity reported within the accounting system can be compared with enacted budgets and support future budget formulation for each activity. Presidential, Congressional, and OMB decisions shall be recorded in the system, and financial management data and results shall be appropriately classified to track such decisions. The system shall record budget resources at the appropriate level and account for appropriations, reappropriations realized, apportionments, allocations, transfers, allotments of budget authority, customer orders accepted, reimbursables, and other appropriate accounts prescribed by DoD.