

CHAPTER 3

**FINANCIAL MANAGEMENT SYSTEMS:
POLICY, ROLES AND RESPONSIBILITIES FOR
CONFORMANCE, EVALUATION, AND REPORTING**

0301. **GENERAL.** By statute the head of a Federal agency is responsible for establishing and maintaining financial management systems and internal controls that provide for (1) complete disclosure of the financial results of the agency, (2) adequate financial information for managerial purposes, (3) effective control over and accountability for the agency's assets, and (4) reliable accounting and financial reporting. Various Federal entities, including the Congress, the Office of Management and Budget, the Department of the Treasury, the General Accounting Office, and the Joint Financial Management Improvement Program (JFMIP),¹ legislate or promulgate requirements that are applicable to DoD's financial management systems. Within DoD automated financial management systems are developed, implemented, maintained, owned, and operated by various organizations, including the DFAS, the military services, the Defense Agencies, and other DoD components.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) and OMB's implementing regulations² require agencies to annually evaluate and report on the compliance of their financial management and internal control systems with applicable requirements. The Federal Financial Management Improvement Act of 1996 (FFMIA) requires each Federal agency to implement and maintain financial management systems that comply with applicable Federal requirements and standards. These laws apply to systems that process financial information or financially related information even though such systems' (such as personnel, logistics, time and attendance, and medical systems) functions may not be primarily financial.

0302. **PURPOSE.** The purpose of this chapter is to (1) prescribe DoD's policy for complying with Federal financial management systems requirements, (2) define the roles and responsibilities of DoD organizations in ensuring that financial management systems comply with applicable Federal requirements and (3) prescribe the procedures for determining whether DoD financial management systems are designed, documented, operated, evaluated and reported in accordance with the provisions of this regulation, the FMFIA and the FFMIA. Also, this chapter prescribes the policy for assessing financial management systems compliance with applicable requirements and preparing the annual reports required by Section 4 of the FMFIA.

¹ JFMIP is a joint cooperative undertaking of the Office of Management and Budget, the General Accounting Office, the Department of Treasury, and the Office of Personnel Management. JFMIP prescribes financial management systems requirements for Federal agencies.

² OMB Circular A-127 (revised).

030201. Overview. The FMFIA places the responsibility for developing and maintaining adequate financial management systems on Federal agency managers. The Act requires that agency heads, using OMB guidelines,³ annually report to the President and the Congress on the agency's financial management systems compliance with applicable Federal requirements and standards. In accordance with OMB guidelines, the annual report required by the FMFIA is to be based on management's assessment of the agency's financial management systems conformance with applicable government-wide requirements. Such system assessments are to be implemented in accordance with the requirements stipulated in this chapter.

To assist managers in carrying out the systems assessments and reporting, DFAS has established procedures and guidance for DoD managers to follow in determining whether their systems conform with government-wide requirements. The determination of conformance is principally made as the result of management's judgment from continuously monitoring the results of operations, and through the use of self assessments and independent appraisals and audits. The results of the monitoring, assessments, appraisals, and audits, as well as management's knowledge and understanding of system performance, are used to prepare the FMFIA mandated annual report (i.e., "Section 4" report) on whether the agency's financial management systems conform to applicable principles, standards, and requirements. Also, the results are used for reporting financial management system status and Remediation plans in DoD's CFO Financial Management 5-Year Plan.

0303. POLICY. The overall policy of the Department is to comply with Federal requirements for financial management systems.

0304. Systems Definitions. Within this chapter, the following definitions are applicable.

A. Information System - the organized collection, processing, transmission, and dissemination of information in accordance with defined procedures, whether automated or manual.

B. Financial Management System - integrates program management with financial management by linking program delivery to the systems that process and track financial events. Financial management systems include finance systems, accounting systems, and the financial portions of mixed systems, necessary to support financial management. Any system that provides data which supports dollar values in the agency's financial statements, including the notes thereto, is considered a financial management system.

1. Integrated Financial Management System - a unified set of financial systems and the financial portions of mixed systems that are planned for and managed together and linked together electronically. It includes the software, hardware, personnel, processes, procedures,

³ OMB Circulars A-127 (revised) and A-11 (revised).

controls and data necessary to carry out the financial management functions. The systems must have standard data classifications, common processes for similar transactions, internal controls over data entry, transaction processing and reporting, and a system design that eliminates unnecessary duplication.

2. Finance System - a system that computes and disburses entitlements and other amounts due to employees, vendors and contractors for goods and/or services provided.

3. Accounting System - a system that records, classifies, summarizes, and/or reports information on the financial position, operating results, or budgetary status of an agency. Within DoD, accounting systems are categorized as core or non-core. A core accounting system is an accounting system or the accounting part of a mixed system that performs the primary functions of the agency's integrated financial management system. Core accounting systems are owned by DFAS and control and support the key functions of a military department's or DOD component's financial management, including general ledger management, funds management, payment management, receipt management, cost management, and financial reporting. Core accounting systems receive data from the other finance, accounting, and mixed systems and provide data and support for the systems that need it.

4. Mixed System - a system that supports both financial and non-financial functions of the agency. The system may not necessarily contain financial information, but the information it does contain is used by the agency to support dollar values in financial reports/statements. For example, in the DOD environment, certain asset accountability systems track the quantities of various assets without maintaining their valuations or cost. The asset quantities from such systems, in conjunction with valuations or costs from other systems or databases, are used to generate information for financial reports/statements. Therefore, these asset accountability systems are deemed mixed systems within the DOD environment. In other instances, the asset accountability systems contain the quantities and valuations/cost of the assets even though the financial portion (valuation/cost data) of the system is relatively small. These systems are also used for financial analysis or reporting and therefore, meet the definition of mixed systems. In the DOD environment, the term "feeder systems" is commonly used in place of "mixed systems" for systems that provide data to DFAS for financial reporting purposes. Mixed systems that contain the accounting function are classified as either core or non-core mixed systems.

C. Critical financial management system - any system that provides information which is materially important to agency-wide financial management and reporting, and/or is necessary for the agency⁴ to effectively and efficiently fulfill its primary mission(s). Criticality is, by necessity, judgmental. Criticality is based on the concept that a system provides information which is important in (1) producing reliable financial reports/statements, (2) ensuring that an agency's

⁴ For DOD purposes, "agency" means a military department (Army, Navy, or Air Force) or major DOD component (such as the Defense Logistics Agency, the Defense Working Capital Fund, etc.)

primary missions are met within the financial parameters and constraints levied by the Congress, or (3) assisting decision makers, including the Congress.

0305. Financial Management System Structure. DoD is responsible for developing and maintaining a single integrated financial management system. A single integrated financial management system is composed of a unified set of financial systems and the financial portions of mixed systems.⁵

The financial management process begins with the occurrence of a financial event that requires the recording of a transaction within a financial management system. Detailed financial transactions are to be clearly documented and recorded. Within DoD, transaction details are generally recorded in various systems, subsystems, applications, or modules of mixed systems--such as inventory and property systems commonly referred to as feeder systems. Every transaction to record financial events must post, either individually or in summary, to general ledger accounts, regardless of the origin of the transaction.

A single integrated financial management system structure shall:

- A. Collect accurate, timely, complete, reliable, and consistent financial information.
- B. Provide for adequate agency management reporting.
- C. Support government-wide and agency level policy decisions.
- D. Support the preparation and execution of agency budgets.
- E. Facilitate the preparation of financial statements, and other financial reports in accordance with federal accounting and reporting standards.
- F. Provide a complete audit trail to facilitate audits.

Although DFAS owns and operates DoD's primary or core accounting systems, such systems are largely dependent upon data provided by other organizations' systems--primarily feeder systems--to fulfill accounting and financial reporting functions and to satisfy the requirements (A through F) cited above. Moreover, in many instances the primary functions performed by feeder systems are not financial.

0306. ROLES AND RESPONSIBILITIES

⁵ OMB Circular A-127 (revised).

030601. The Under Secretary of Defense (Comptroller): The Under Secretary of Defense (Comptroller) is responsible for overall policy regarding financial management systems. As such, the Under Secretary of Defense (Comptroller) will:

A. Serve as the DoD senior official under OMB Circular No. A-127 (revised) for policy guidance, direction, implementation, and coordination with the military services, Defense Agencies, DoD components, and other Federal agencies on financial management systems requirements.

B. Prescribe the principles, standards, and related requirements applicable to DoD financial management systems and enforce compliance throughout the Department with such principles, standards and requirements.

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

D. Approve proposed development of, or substantial revisions to, financial management systems for adherence to applicable requirements prior to providing DoD approval to proceed and to expend funds.

E. Approve and issue annually a CFO Financial Management 5-Year Plan for an integrated financial management system structure.

F. Ensure that Departmental efforts to develop, acquire, implement, modify, and operate financial management systems conform with Federal requirements and guidelines.

030602. The Defense Finance and Accounting Service shall:

A. Develop, implement, maintain, modify, and operate its accounting and finance systems to comply with applicable Federal and DoD requirements. This includes objectively evaluating and testing systems to ensure compliance with requirements.⁶

B. Prescribe the procedures for conducting the reviews and evaluations of financial management systems, and prepare annual reports on the status of financial management systems mandated by Section 4 of the FMFIA and OMB Circular A-127. Such reports are to be prepared for signature by Secretary of Defense.

C. Develop and maintain a Chief Financial Officers Financial Management 5-Year Plan for a single integrated financial management system structure which:

⁶ DoD Regulation 5000.2-R prescribes testing and evaluation requirements for major automated information system acquisitions and modifications.

1. Describes concisely the vision for the Department's financial management,
 2. Discusses how the goals and strategies for implementing government-wide financial management improvements that are associated with the vision statement will be achieved,
 3. Describes the impediments to achieving satisfactory audit opinions of annual financial statements and presents steps to be taken to overcome the impediments, and
 4. Discusses the current financial management systems structure and plans for moving to the targeted systems structure. The scope of the discussion on the financial management systems structure should include:
 - a. Core financial management systems,
 - b. Financial and mixed systems critical to effective agency-wide financial management, financial reporting, or financial control,
 - c. Financial and mixed systems appearing on the High Risk List in the President's latest budget,
 - d. Baseline of financial and mixed systems, including a brief narrative assessment of major problems with current systems,
 - e. Target structure for financial and mixed systems, including a brief discussion of the agency's financial management systems strategy, and
 - f. Major projects required to move from baseline to target.
- D. Develop and maintain a financial management systems planning process which monitors, coordinates and reports the state of compliance of the financial management systems with applicable requirements and the status of developmental, enhancement and improvement initiatives and projects to improve financial management systems.
- E. Develop and maintain a comprehensive inventory of critical financial management systems to be reported annually to OMB.⁷
- F. Develop, maintain, publish, and disseminate to DoD organizations A Guide to Federal Requirements for Financial Management Systems. (This document, first published in January 1998,

⁷ OMB Circulars A-127 (revised) and A-11 require that agencies annually report on their core financial systems and other financial and mixed systems critical to effective agency-wide financial management, financial reporting, or financial control.

is a comprehensive compilation of Federal requirements applicable to financial management systems.)

G. Provide advice, counsel, and interpretations to other DoD organizations on requirements for financial management systems.

H. Work with the owners/managers of financial management systems that provide data to DFAS systems to help ensure (1) proper and efficient systems interfaces are designed, implemented, and maintained; (2) transferred data is properly controlled, maintained, processed, and reported; and (3) from an integrated standpoint, applicable requirements are fulfilled.

I. Develop the Department's standard line of accounting (the Budget and Accounting Classification Code (BACC)) and implement in its systems.

030603. The Owners/Managers (non-DFAS) of Financial Management Systems shall:

A. Develop, implement, maintain, modify, and operate financial management systems and the financial portion(s) of mixed systems to comply with applicable Federal and DoD requirements, including the BACC. This includes objectively evaluating and testing systems to ensure compliance with requirements.⁸

B. Assess the state of compliance of financial management systems with the applicable requirements and report annually the results to DFAS. (DFAS is responsible for consolidating the results and reporting to the Secretary of Defense per paragraph 030602B.)

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

D. Implement corrective actions.

E. Identify and report to DFAS (1) problems with the accuracy of data in financial management systems, including feeder systems, (2) actions being taken to address the problems, and (3) efforts undertaken to integrate feeder systems with finance and accounting systems.

030604. The Users of DoD Financial Management Systems shall: Work with owners/managers in conducting the annual reviews of these systems and in producing the management assessment of system compliance.

030605. The Inspector General, Department of Defense and the Military Services' Audit Agencies shall:

⁸ See footnote no. 6.

A. Provide technical assistance and advice to Under Secretary of Defense (Comptroller), DFAS, and the military services on DoD efforts to review and improve financial management systems.

B. Perform audits to determine whether financial management system reviews and evaluations were conducted in accordance with prescribed guidelines. Performing such audits should not prevent auditors from providing technical assistance and advice to DoD management.

C. Advise the Secretary of Defense and the Military Departments annually as to the effectiveness of DoD organizations' compliance with the requirements of (1) this Regulation and (2) the FMFIA.⁹

0307 **LEGAL REQUIREMENTS.** While there are numerous laws passed by the Congress that have implications for DoD's financial management systems, the following are the principal statutes that have the greatest impact on DoD's day-to-day financial management operations. Owners/managers of DoD's financial management systems are required to be knowledgeable of and to comply with existing legal requirements applicable to their systems.

030701. Accounting and Auditing Act of 1950. This Act required the head of each executive agency to establish and maintain financial management systems 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.

030702. Federal Managers' Financial Integrity Act of 1982. This Act amended the Accounting and Auditing Act of 1950 to require ongoing evaluations and reports on the adequacy of agency financial

⁹ Such advice should be in the form of official memorandum or report.

management systems of and administrative controls. For the first time, agency heads were required under this Act to report annually to the President and the Congress as to whether financial management systems (Section 4 of the Act) conform to the principles, standards, and related requirements prescribed by the Comptroller General.

030703. Chief Financial Officers Act of 1990. This Act required DoD and other “CFO Act” agencies to improve their financial management operations and reporting. The Act required each agency CFO to develop an integrated agency accounting and financial management system, including financial reporting and internal controls. Such systems are to comply with applicable accounting principles and standards. The Act also called for, on a pilot basis, annual audits of designated agency's financial statements. In DoD, such audits were to be conducted for revolving and trust funds, and the Air Force and the Army.

030704. Government Management Reform Act of 1994. Building on the experience gained under the CFO Act, Congress passed this law to expand the CFO Act’s requirements for audited financial statements to all CFO Act agencies. As a result of this law, DoD was required to prepare and have audited consolidated department-wide financial statements.

030705. Federal Financial Management Improvement Act of 1996. This Act builds upon and complements the CFO Act. The purpose of this Act is to provide for the establishment of uniform accounting systems and standards within the Federal government. The Act specifically requires agency compliance with (1) Federal financial management systems requirements, (2) Federal accounting principles and standards, and (3) the United States Standard General Ledger.

0308. REGULATORY REQUIREMENTS. Similar to legal requirements, a multitude of regulations have been promulgated by the “central agencies” (OMB, the Department of Treasury, and GAO) that impose requirements on financial management systems. Owners/managers of DoD’s financial management systems are required to be knowledgeable of and to comply with existing regulatory requirements applicable to their systems. The following are the more significant regulations.

030801. OMB Circular No. A-11. Provides detailed instructions and guidance on the preparation and submission of agency budget requests and related materials such as the CFO Financial Management 5-Year Plan.

030802. 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 Anti-deficiency Act.

030803. OMB Circular No. A-123(revised July 23, 1993). Provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls.

030804. OMB Circular No. A-127 (revised). Prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems.

030805. OMB Circular No. A-130. Establishes policy for the management of Federal Information Resources.

030806. Statements of Federal Financial Accounting Standards (SFFAS). SFFASs result from the joint efforts of OMB, the Department of Treasury, and the General Accounting Office. These three agencies--referred to as the "Principals"--established the Federal Accounting Standards Advisory Board (FASAB) which considers and recommends accounting standards and principles for the Federal government. Once recommended principles and standards are agreed to by the Principals and accepted by the Congress, then they are formally published by OMB as the official standards for the executive branch.

030807 . Federal Financial Management System Requirements. These requirements are issued by the Joint Financial Management Improvement Program (JFMIP) and are applicable to all Federal executive agencies.

0309. GUIDELINES FOR ANNUAL SYSTEMS ASSESSMENTS

030901. Review and Evaluation of Financial Management Systems. Section 4 of the FMFIA requires an annual report on the conformance of financial management systems with applicable principles, standards, and requirements. To meet that reporting requirement DFAS developed the Accounting Systems Requirements (ASR) Database to assist managers in continuously monitoring and periodically evaluating the conformance of their systems. The ASR database contains the comprehensive list of requirements contained in DFAS's A Guide to Federal Requirements for Financial Management Systems.

The database also provides management the capability to build an Electronic Questionnaire (EQ) containing requirements applicable to major categories (such as inventory systems, property systems, payroll systems, etc.) of DoD financial management systems. Annually, DFAS develops EQs for DoD financial management systems to assist managers in assessing their systems. The EQs also contain Departure Monitoring Modules (DMM) to document/identify a departure from or nonconformance with a Federal financial management system requirement. If management considers the departure sufficiently significant to be reported to the DoD organizational head, then it is termed a "deficiency." If the organizational head determines the departure to be sufficiently significant to be reported outside of DoD, then it is considered to be a material weakness. All departures must be tracked by management and corrected. The DMM provides that capability to track the departure from a financial management requirement from identification to correction and validation.

030902. Methodology for Determining Compliance of Financial Management Systems. Systems assessments of compliance with requirements should be conducted objectively. Owners/managers of financial management systems may decide to have assessments conducted by independent third parties, including private sector entities, DoD organizations (such as the DoD Inspector General, and the military audit agencies), and other Federal entities (such as the Department of Treasury's Financial Management Service). Systems assessments conducted by management of its financial management systems should have procedures in place to ensure the objectivity and integrity of the assessments.

A. A Guide to Federal Requirements for Financial Management Systems. This DFAS-prepared document contains a compilation of Federal requirements applicable to financial management systems. The requirements contained in the guide are applicable to DFAS's accounting and finance systems as well as feeder systems owned and operated by the military services and DoD components and agencies. The guide is intended to serve as a tool to assist systems owners and managers in planning, designing, enhancing, modifying, and implementing financial management systems to comply with the myriad of Federal requirements. The requirements contained in the guide, as mentioned in paragraph 030701, are included in the ASR and will be used for assessing systems' compliance with requirements, identifying departures, and ascertaining the significance of the departures.

B. Compliance

1. Determining whether a departure from a requirement(s) will prevent a system from being in compliance with requirements necessitates judgment by the appropriate managers in the chain of command. Such judgments should be made based on objective analysis and data. The process starts with the financial management system manager. In making a judgment, the system manager must consider the impact of the departure on program performance and/management; compliance with laws, regulations, and policies; the visibility and sensitivity of the program involved; the vulnerability for fraud, waste, and abuse; and the dollar implications, if appropriate.

2. Generally, if the departure would be of concern to the next higher level of management, the manager should report the departure. As departures are reported up, judgments are made by progressively senior individuals with a broader perspective on DoD's mission and function. Departures judged to be "not reportable to the next higher level of management" are still considered significant and are to be tracked and corrected.

C. System Manager/User Review (SM/UR)

1. A SM/UR is a structured and objective method for managers to use in reviewing their financial management systems for compliance with applicable requirements. The DoD SM/UR Guide provides direction to the systems owners/managers for conducting annual reviews (FMFIA 'section 4' reviews) of their systems for compliance with requirements. The SM/UR represents

management's self-assessment of its financial management systems. As such, the review is based on all available knowledge of the system from the day-to-day operations plus the results of prior reviews and evaluations. Through the EQ the SM/UR Guide provides the financial management criteria or requirements with which DoD financial management systems must comply; it provides review techniques and guidance to assist managers in determining if their systems are in compliance with applicable requirements; and it provides them the opportunity to identify needed corrective actions. Systems owners and managers are responsible for conducting the reviews.

0310. ANNUAL REPORT ON OPERATING ACCOUNTING SYSTEMS

031001. General. The DFAS System Inventory Database (SID) contains the official DoD financial management systems inventory to be reported to OMB per OMB Circular A-127. Data extracts from the SID are used to annually provide OMB, Congress, and the President an assessment of the status of DoD financial management systems. The owners/managers of DoD financial management systems are responsible for continuously monitoring, validating, and updating information in the SID.

DFAS is responsible for submitting to the Secretary of Defense, after approval by the Under Secretary of Defense (Comptroller), the Annual Statement of Assurance required by Section 4 of the FMFIA. (See figure 3-1.) The Annual Statement of Assurance is to be based on SID data provided by the owners/managers of DoD financial management systems.

031002. Reporting on DoD's Inventory of Financial Management Systems.

A. Information on each of DoD's critical financial management systems shall be reported in the SID.¹⁰ A system that serves--directly or indirectly--a critical financial management or reporting function will be reported in the SID even though the primary function(s) of the system may not be financial (such as personnel, logistics, and medical systems).

B. A DoD entity that uses an unmodified accounting system¹¹ of another DoD entity should not report the system for inventory purposes. Likewise, a DoD entity should not report an accounting system for inventory purposes if the entity provides its accounting source documents to another DoD organization which processes the documents and related transactions, and provides outputs/reports, etc. from its accounting system to the submitting entity.

C. Owners/managers of financial management systems will review their operations to determine if systems should be added or deleted from the SID. Owners/managers will use the definitions contained in this volume when determining whether they have a reportable financial management

¹⁰ See OMB Circulars A-127 (revised) and A-11 (revised) for guidance on "critical systems."

¹¹ In DoD, some organizations acquire and use accounting systems that have been implemented by other DoD organizations. If the acquiring organization uses the system without making significant changes/modifications to it, then it is considered to be an unmodified accounting system.

system. New systems will be added and systems no longer in operation will be eliminated. System owners/managers will be responsible for entering required information in the SID.