



DEFENSE INTELLIGENCE AGENCY

WASHINGTON, D.C. 20340-5100



INFO MEMO

U-150/FE

19 August 2005

FOR: SECRETARY OF DEFENSE

THRU: UNDER SECRETARY OF DEFENSE FOR INTELLIGENCE *SC* AUG 24 2005

FROM: *L. E. Jacoby* Vice Admiral, USN, Director, Defense Intelligence Agency

SUBJECT: Annual Statement Required for FY05 under FMFIA of 1982

- I have taken the necessary steps to ensure a conscientious and thorough evaluation of the internal control program for DIA. I can provide reasonable assurance that DIA's internal controls, other than those for financial reporting, when considered as a whole, were in place, operated effectively and were being used during the fiscal year ending 30 September 2005. Our controls provide reasonable assurance that we achieved the Federal Managers' Financial Integrity Act (FMFIA) objectives of ensuring effective and efficient operations and complying with applicable laws and regulations. Details of our evaluation process are provided in TAB A.
- The evaluation confirmed that we have not yet achieved the FMFIA objective of reliable financial reporting. Unreliable financial reporting results from our dependence on outdated DoD systems and from our inability to fully support the data we input to those systems. We have identified two material weaknesses: unreliable financial systems and the inability to reconcile Fund Balance with Treasury. These weaknesses are disclosed in TAB B. We have identified unreliable financial systems as a weakness since FY03.
- Our evaluation supports my belief that the dedicated professionals of DIA use strong internal controls to enhance mission achievement. TAB B provides some examples of where we have strengthened our existing controls. Our progress in fusing controls into efficiently and effectively managing resources, achieving objectives and discouraging fraud, waste and abuse, further hones our ability to discover information and create knowledge.
- Seven reportable conditions have been disclosed in TAB C. While reportable conditions do not require reporting outside the agency, those conditions have been identified, corrective action plans developed and a monitoring system put in place to illustrate our commitment to an aggressive program that goes beyond simply meeting requirements.

Attachments: a/s

Prepared by Mr. Ken Murphy, (703) 695-5109

## TAB A

### THE EVALUATION

**Evaluation Criteria.** The Defense Intelligence Agency's (DIA) senior management evaluated the system of internal controls in effect during the fiscal year (FY) ending 30 September 2005. The evaluation was done in accordance with the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The Office of Management and Budget (OMB) provides FMFIA guidance in OMB Circular No. A-123, "Management Accountability and Control," 21 June 1995. The Government Accountability Office (GAO) provides standards for FMFIA in "Standards for Internal Control in the Federal Government" and "Internal Control Management and Evaluation Tool." The Department of Defense (DoD) provides FMFIA guidance in DoD Directive 5010.38, "Management Control Program," 26 August 1996, and, DoD Instruction 5010.40, "Management Control Program Procedures," 28 August 1996.

**Evaluation Objective.** DIA's objective was to determine whether internal controls were in place and working to provide reasonable assurance that:

- Obligations and costs comply with applicable laws
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation
- Revenues and expenditures are properly recorded, accounted for, and reported in a manner that maintains accountability over assets.

**Evaluation Coverage.** DIA's evaluation covered 99% of assigned personnel and resources and included sixteen major two letter (Deputy Directorates and Special Offices) organizations. Further, in 2005, some two letter organizations tasked subordinate components to submit separate statements of assurance (SOAs) to support the two letter organizational SOAs.

**Evaluation Limitations.** DIA's evaluation had a limited goal and process. The goal is limited to achieving a reasonable expectation that the opinion expressed about the condition of internal controls reflects the actual state of the controls. The process components for attaining a reasonable assurance also cause limitations - from the evaluator and the testing, the characteristics of fraud, and, the nature and costs of controls.

The evaluator must be qualified in the area being evaluated, and must have adequate time and resources to exercise professional care in performing the evaluation and assessing the results. The results require gathering evidence - which involves professional judgment of the areas tested; the nature, timing, and extent of the tests performed; the interpretation of test results; and the selection of appropriate controls to mitigate problems anticipated in a future time.

Fraud itself is characterized by concealment and falsification. Concealment may prevent a properly planned and performed evaluation from accurately determining and reporting the true state of affairs.

Internal controls have inherent limitations. They only address currently recognized problems, involve the allocation of resources which may not be adequate to fully implement controls, may run counter to the direction provided by Congress, and may be limited by the benefits expected.

As a result of so many limitations, qualifications, and uses of judgment, our evaluation focuses on persuading rather than convincing. Thus, this statement of reasonable assurance is a limited statement expressing a sensible opinion on an anticipated state of affairs.

**Evaluation Methodology.** Each of sixteen DIA organizations provided an organizational SOA certified by the organizational head.

Each organization was provided DIA's automated self assessment tool derived from GAO's "Standards for Internal Control in the Federal Government," and "Internal Control Management and Evaluation Tool." The tool was initially developed and fielded in 2003. It was revised with each use in 2004 and in 2005. The tool now contains 154 questions segmented into the five GAO standards. Each segment leads to an overall deductive conclusion on the five standard areas of control environment, risk assessment, control activities, information and communication, and monitoring. The tool also provides a preliminary assessment of the 2006 area of financial reporting. Use of the tool facilitates an inductive conclusion on the general risks faced and on the state of internal controls within each organization.

Organizations are required to supplement the self assessment tool with other sources of information to support their overall assessment conclusion. Other sources of information include recognition and documentation of Internal Control Program (ICP) accomplishments. The most significant improvements made during the past year are detailed in Tab B, "ICP and Related Accomplishments." Other sources include the results of internal and external reviews. These are discussed and detailed in CORROBORATING INDICATORS section of Tab A. The organizational assessment is conducted by an ICP coordinator appointed by the organization head and trained and assisted by the DIA ICP Office.

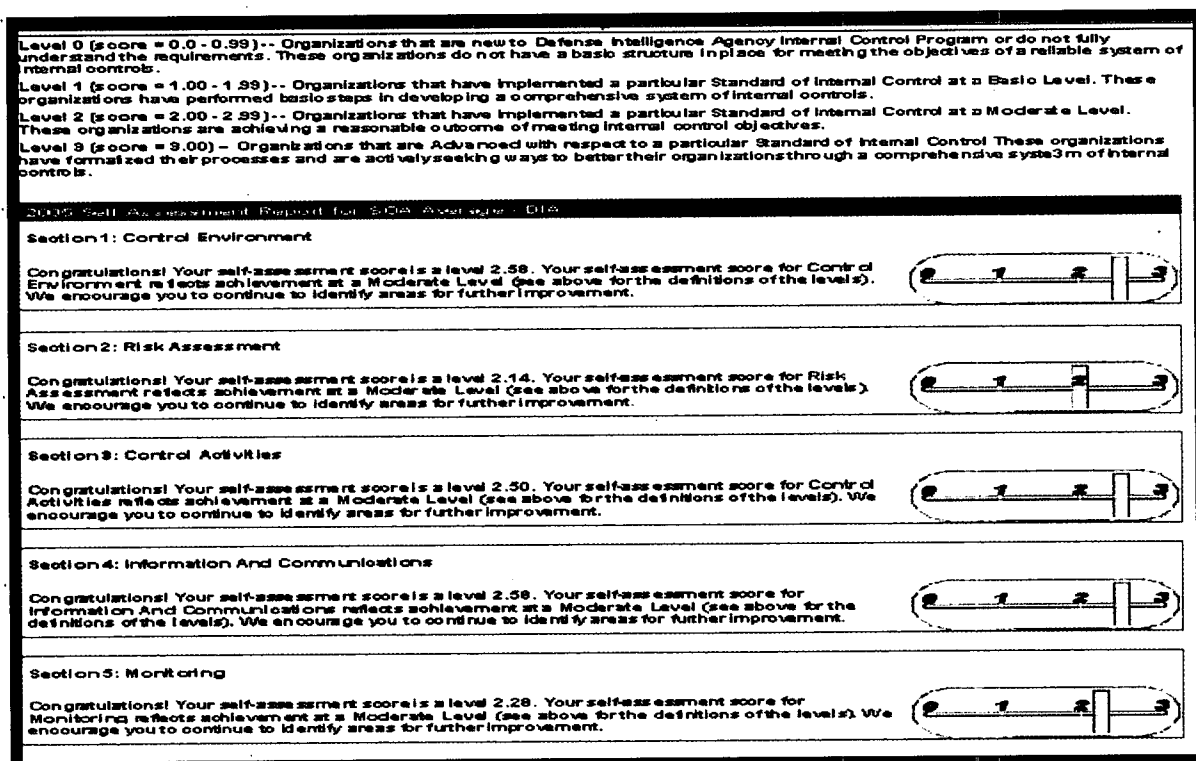
**Evaluation Conclusion.** This evaluation, performed within described limitations, resulted in a qualified SOA.

The results indicate that DIA's system of internal controls, excepting those in financial reporting, when considered as a whole, were in place, operated effectively, and were being used during the fiscal year (FY) ending 30 September 2005. The results provide a basis for reasonable assurance that DIA achieved the FMFIA objectives of ensuring effective and efficient operations and complying with applicable laws and regulations.

The evaluation confirms that we have not yet achieved the FMFIA objective of reliable financial reporting. Unreliable financial reporting results from our dependence on outdated DoD systems, and from our inability to support fully the data we inputs to those systems. As a result, we have

identified two material weaknesses: unreliable financial systems and the inability to reconcile Fund Balance with Treasury and disclosed these in Tab B. Unreliable financial systems were first identified as a material weakness in FY 2003 and we reported it each subsequent year. Inability to reconcile Fund Balance with Treasury is now identified as a material weakness and disclosed in Tab B. Seven reportable conditions related to data input have been identified in our supplemental Tab C. While reportable conditions do not require reporting outside the Agency, those conditions have been identified, corrective action plans developed and a monitoring system put in place to illustrate our commitment to an aggressive program that goes beyond simply meeting requirements. Adding a supplemental Tab C to track and manage reportable conditions illustrates our commitment to an aggressive program that goes beyond simply meeting requirements.

The self-assessment tool scoring indicated that the Agency had achieved a moderate (intermediate) level of scoring on implementation of GAO's five internal control standards. The 2005 Agency-wide averages improved for all the sections that were also assessed in 2004. Specifically, control environment improved 3.6 percent, control activities improved 9.7 percent, and risk assessment improved 18.2 percent. Risk assessment was at the low (basic) level in 2004 and improved significantly by achieving the moderate level. The tool generates a graphic that visually shows scoring in each area. The graphic below shows the Agency's overall scoring that resulted from consolidating the organizational submissions.



## TAB A

### CORROBORATING CONSIDERATIONS

#### Internal Reviews

**Office of the Inspector General.** The Office of the Inspector General (OIG) provided 40 documents from their 2005 audits, reviews, evaluations, investigations, inspections, and assessments. Three specifically referred to weaknesses in internal controls.

1. "Logistics Business Evaluation" (Project Number 04-2135-HQ-003; 23 November 2004) stated: "The current condition of Agency property accountability, and the inability of financial, acquisition, and logistics systems to cohesively and accurately integrate data, reflects a substantial internal control weakness for accountability and control of DIA capital assets." The inability of financial, acquisition, and logistics systems to integrate data is disclosed as a material weakness in Tab B. The condition of property accountability is disclosed as a Reportable Condition in Tab C.

2. "ISG (Iraq Survey Group) Property Accountability" (Project Number 05-2548-OA-031, 8 June 2005) stated: "The lack of an effective internal control structure resulted in inaccurate property records, staffing and mission support deficiencies, and inadequate documentation to accurately record obligations in DIA accounting records." The condition of property accountability is disclosed as a reportable condition in Tab C. The condition of inaccurate obligation documentation is disclosed as a reportable condition in Tab C.

3. "CT (Counterterrorism) Contracting Audit" (Project Number 03-2168-OA-023, 31 January 2005) stated: "The lack of a single source of readily available, comprehensive, reliable acquisition vehicle information indicates an internal control weakness which may adversely impact AE-2's (Acquisition Executive) ability to provide timely, accurate information necessary for management reporting and decision-making." Management comments to the recommendation stated that the information is available from multiple sources but the single source condition will be addressed with the implementation of an end-to-end life cycle acquisition management system. The OIG stated that these comments were responsive. This is not disclosed as a reportable condition.

**OIG Challenges Identified for Performance and Accountability Report.** The OIG provided a summary of the management and performance challenges that were identified in their work for inclusion into the Agency's fiscal year (FY) 2005 Performance and Accountability Report (PAR). There were five challenges identified:

1. Property Accountability. "The area of property accountability continues to present a challenge as corrective actions are planned and implemented. An OIG Logistics Evaluation identified the current condition of Agency property accountability – coupled with the inability of financial acquisition and logistics system to cohesively and accurately integrate data – as an

internal control deficiency for accountability and control of Agency assets.” This condition is disclosed as a reportable condition in Tab C.

2. Fiscal Management/Reporting. A draft auditability assessment report “identified a number of management and performance challenges to include: the accuracy of – and supporting documentation for – the recorded amounts for plant, property, and equipment; lack of a standard periodic process for reconciling accounting detail with subsidiary detail, and DIA’s reliance on the National Security Agency (NSA) to provide the accounting/general ledger system that serves as DIA’s system of record.” The property accountability condition is disclosed as a reportable condition in Tab C. Lack of reconciliation is disclosed as part of the new Material Weakness disclosed in Tab B. Reliance on the nonintegrated NSA system is part of the material weakness disclosed in Tab B.

3. Data Linkage. “OIG identified recurring issues with the inability of decision-makers to reconcile information among separate information technology support systems. For example, during the conduct of the logistics business evaluation, OIG found that the ability of DIA to manage property accountability was inhibited by limitations on linkages among the financial, acquisition, and logistics information system. The team conducting the assessment of the ISG found similar issues in the ability to link financial and property information necessary to reconcile financial data.” The lack of integration of financial systems is disclosed as a material weakness in Tab B.

4. Collection Management Program Communication. There were a lack of current operating directives from headquarters to drive field collection and a limited number of evaluations provided to the field on their intelligence information reports. Improvements in the currency of operating directives were observed during more recent inspections. The OIG indicated that this was not considered a significant weakness, and this item is not disclosed as a reportable weakness.

5. Information Technology Support to the Field. Inspection teams found that field activities did not have a common suite of information technology (IT) support tools. A new IT support program has been tested and will be deployed. Since this issue will be resolved with deployment of the new support program, this item is not disclosed as a reportable weakness.

**Office of the Inspector General Three Year Trend Analysis.** The OIG reviewed the inspections, evaluations, and assessments that the inspections unit had completed since the beginning of FY 2003. The purpose was to identify common trends in OIG findings and recommendations that might further enable continuing performance improvements consistent with the Director’s Strategic Intent and the specific tasks from the Agency Mission Essential Task List. The review included more than 80 separate field activities and 18 organizational, functional, or process issues under headquarters purview.

The review noted that OIG recommendations in the reports had been, or were being, acted upon. This observation addressed the GAO internal control monitoring standard that requires audit findings be promptly resolved. The review highlighted the contribution that a strong metrics-driven internal management control program can make to inform management decision-making

and improve organizational performance. The review also noted that Defense Attaché Offices and field operation units were held in the highest regard by the embassy country teams and combatant command personnel supported which served as a testament to, and measure of, mission success. The review did not specifically identify any material weaknesses.

### **External Reviews**

There were not any GAO or DoD IG reports provided which included the DIA during FY 2005.

## **TAB A**

### **SYSTEMIC WEAKNESSES**

#### **LISTING OF DOD SYSTEMIC WEAKNESSES AND RELATED DIA WEAKNESSES**

##### **1. Financial Management Systems and Processes.**

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|---|--------------------|
| a. Material Weakness - Reconciling Fund Balance With Treasury.                | Tab B-2, Page B-2. |
| b. Material Weakness - Unreliable Financial Management Systems and Processes. | Tab B-2, Page B-4. |
| c. Reportable Condition - Lack of Established Financial Policies.             | Tab C, Page C-2.   |
| d. Reportable Condition - Lack of Documented Business Processes.              | Tab C, Page C-4.   |
| e. Reportable Condition - Lack of Implementing Procedures.                    | Tab C, Page C-6.   |
| f. Reportable Condition - Monitoring Unliquidated Obligations.                | Tab C, Page C-8.   |
| g. Reportable Condition - Reliability of Financial Information.               | Tab C, Page C-10.  |

##### **2. Management of Information Technology and Assurance.**

##### **3. Environmental Liabilities.**

##### **4. Personnel Security Investigations Program.**

##### **5. Real Property Infrastructure.**

##### **6. Government Card Program Management.**

##### **7. Valuation of Property, Plant, and Equipment on Financial Reports.**

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|---|-------------------|
| a. Reportable Condition - Reliability of Financial Information. | Tab C, Page C-12. |
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##### **8. Valuation of Inventory on Financial Reports.**

##### **9. Improper Use of Non-Department of Defense Contracting Vehicles.**

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| a. Reportable Condition - Risk Assessment and Documentation in Acquisition Management. | Tab C, Page C-15. |
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