

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

INSPECTOR GENERAL, DOD, OVERSIGHT
OF THE AIR FORCE AUDIT AGENCY AUDIT
OF THE FY 1996 AIR FORCE CONSOLIDATED
FINANCIAL STATEMENTS

Report No. 97-122

April 10, 1997

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DTIC QUALITY INSPECTED 2

AOI 00-03-0793

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Inspector General, DOD, Oversight of the Air Force Audit Agency Audit of the FY 1996 Air Force Consolidated Financial Statements

B. DATE Report Downloaded From the Internet: 12/23/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
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D. Currently Applicable Classification Level: Unclassified

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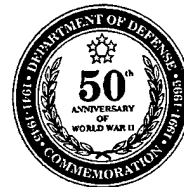
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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



April 10, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Air Force
Audit Agency Audit of the FY 1996 Air Force Consolidated Financial
Statements (Report No. 97-122)

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Air Force Audit Agency (AFAA) disclaimer of opinion on the FY 1996 Air Force Consolidated Financial Statements, along with the AFAA Report of Audit, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements." An audit of the Air Force consolidated financial statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Since this report contains no recommendations, comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. David C. Funk, Audit Program Director, at (303) 676-7445 (DSN 926-7445; e-mail dfunk@DODIG.OSD.MIL) or Mr. W. Andy Cooley, Audit Project Manager, at (303) 676-7393 (DSN 926-7393; e-mail wcooley@DODIG.OSD.MIL). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 97-122
(Project No. 6FD-2025.01)

April 10, 1997

**Inspector General, DoD, Oversight of the
Air Force Audit Agency Audit of the
FY 1996 Air Force Consolidated
Financial Statements**

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an audit of the Air Force consolidated financial statements. We delegated the audit of the FY 1996 Air Force consolidated financial statements to the Air Force Audit Agency on May 17, 1996. This report provides our endorsement of the Air Force Audit Agency disclaimer of opinion on the Air Force consolidated financial statements for FY 1996, along with the Air Force Audit Agency Report of Audit, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements."

Audit Objective. The audit objective was to determine the accuracy and completeness of the audit of the FY 1996 Air Force consolidated financial statements conducted by the Air Force Audit Agency. See Appendix C for a discussion of the audit process.

Audit Results. The Air Force Audit Agency Report of Audit, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements," March 1, 1997, stated that the Air Force Audit Agency was unable to express an opinion on the Air Force financial statements for FY 1996. We concur with the Air Force Audit Agency disclaimer of opinion; our endorsement of that disclaimer is Appendix A. The Air Force Audit Agency report is Appendix B.

Internal Control Structure and Compliance With Laws and Regulations. The Air Force Audit Agency issued reports on the Air Force internal controls and compliance with laws and regulations. These reports are included in the Air Force Audit Agency report (Appendix B).

Summary of Recommendations and Management Comments. This report contains no recommendations that are subject to resolution in accordance with DoD Directive 7650.3. Accordingly, comments are not required.

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Appendix A. IG, DoD, Endorsement Memorandum



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



March 1, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND
CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1996 Air Force
Consolidated Financial Statements (Project No. 6FD-2025)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. On May 17, 1996, we delegated to the Air Force Audit Agency (AFAA) the audit of the FY 1996 Air Force consolidated financial statements. Summarized below are the AFAA opinion letter on those financial statements and the results of our review of the audit conducted by AFAA. We endorse the disclaimer of opinion expressed by AFAA (see the Enclosure) in its audit of the FY 1996 Air Force consolidated financial statements. *

Endorsement of the Disclaimer of Opinion. The AFAA disclaimer of opinion on the FY 1996 Air Force consolidated financial statements, dated March 1, 1997, stated that AFAA was unable to satisfy itself as to the fairness of the information presented in the financial statements. Consequently, the AFAA was unable to express an opinion on the FY 1996 Air Force consolidated financial statements. We concur with the AFAA disclaimer of opinion.

The primary reasons for the AFAA disclaimer of opinion were that financial information used to compile the FY 1996 Air Force consolidated financial statements was not reliable, and financial systems and processes, as well as the associated internal control structure, did not produce reliable financial data. Specific reasons cited by the AFAA are summarized below.

- o Accounts were overstated by approximately \$1.3 billion and understated by \$983.8 million.
- o As in previous years, the acquisition cost of assets, valued at \$282 billion, could not be verified due to system problems and document retention practices; this problem was further compounded by the lack of a transaction-driven general ledger.
- o The Government-furnished property balance was \$20.4 billion less than the values that contractors reported to the Defense Logistics Agency for inclusion in the Contractor Property Management System.
- o The value of munitions was overstated by \$852.7 million.
- o Assets were excluded from account balances.

Several of the conditions that resulted in disclaimers of opinion for the FYs 1992, 1993, 1994, and 1995 Air Force consolidated financial statements still existed in the FY 1996 financial statements.

*The Enclosure is omitted from Appendix A and included in Appendix B.

Appendix A. IG, DoD, Endorsement Memorandum

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Internal Controls and Compliance With Laws and Regulations. In accordance with generally accepted Government auditing standards, the AFAA issued reports on the Air Force's internal controls and its compliance with laws and regulations. These reports stated that:

- o the internal control structure for financial reporting did not provide reasonable assurance of achieving the internal control objectives described in the Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, and

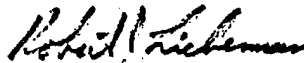
- o existing systems and controls did not enable the Air Force and the Defense Finance and Accounting Service to fully comply with laws and regulations that materially affect the financial statements.

Review of Air Force Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent audit conducted by the AFAA, we:

- o reviewed the AFAA approach and planning of the audit, and
- o monitored the progress of the audit at key points.

We also performed other procedures to satisfy ourselves as to the fairness and accuracy of the audit approach and conclusions.

We conducted our review of the AFAA audit of the FY 1996 Air Force consolidated financial statements from May 17, 1996, through March 1, 1997, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the AFAA disclaimer of opinion on the FY 1996 Air Force consolidated financial statements and the AFAA reports on internal controls and compliance with laws and regulations.



Robert J. Lieberman
Assistant Inspector General
for Auditing

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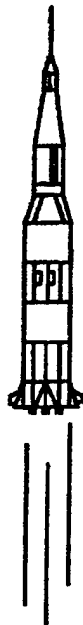
Enclosure

*The Enclosure is omitted from Appendix A and included in Appendix B.

**Appendix B. AFAA Report, "Opinion on Fiscal
Year 1996 Air Force Consolidated Financial
Statements"**

Project 96053001

1 March 1997



REPORT OF AUDIT

**OPINION ON FISCAL YEAR 1996
AIR FORCE CONSOLIDATED
FINANCIAL STATEMENTS**



AIR FORCE AUDIT AGENCY

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"



DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

MEMORANDUM FOR SECRETARY OF THE AIR FORCE
CHIEF OF STAFF, USAF

FROM: SAF/AG

SUBJECT: Report of Audit, Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements (Project 96053001)

Our audit opinion letter concerning the Fiscal Year 1996 Air Force Consolidated Financial Statements follows. Similar to the past 4 years, we were unable to express an opinion. For details, please refer to the opinion letter and audit report. Management comments from the Assistant Secretary of the Air Force, Financial Management and Comptroller (SAF/FM), and the Defense Finance and Accounting Service (DFAS) are at Appendix IV.

SAF/FM comments indicated agreement with our basis for disclaiming an opinion, and Air Force and DFAS have planned actions that address recurring issues related to noncompliance with existing policy or regulations. Furthermore, SAF/FM recognizes that, even though they are making progress, resolving existing accounting system weaknesses will take several years. DFAS did express concern with some data presented in the opinion and supporting reports (i.e., Prompt Payment Act data). We will address these concerns and resolve any disagreements during processing of the supporting reports identified in Appendix VI.

We consider SAF/FM comments responsive, and DFAS comments were generally responsive. However, some further resolution actions are required in conjunction with our supporting reports.

Jackie R. Crawford
JACKIE R. CRAWFORD
The Auditor General

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

Project 96053001

**OPINION ON FISCAL YEAR 1996
AIR FORCE CONSOLIDATED
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Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"



DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

1 March 1997

To the Secretary of the Air Force
Chief of Staff, USAF

1. We audited the consolidated financial statements of the Air Force for fiscal years (FYs) ended 30 September 1996 and 30 September 1995. The Defense Finance and Accounting Service (DFAS) and Air Force management prepared the accompanying financial statements in accordance with the Government Management Reform Act (GMRA) of 1994. Our audits of the Air Force's FY 1996 principal financial statements resulted in 11 reports containing 26 recommendations for improving Air Force financial management, internal controls, and compliance with laws and regulations. This report presents our opinion on the principal financial statements, evaluation of the underlying system of internal controls, and assessment of compliance with laws and regulations. Our audit showed that several conditions causing us to disclaim an opinion for FYs 1992 through 1995 still existed.

OPINION ON FINANCIAL STATEMENTS

2. We were not able to obtain sufficient evidential matter, or to apply other auditing procedures, to satisfy ourselves as to the fairness of the Air Force consolidated financial statements. As a result, we are unable to express an opinion on the reliability of the FY 1996 Air Force financial statements. Financial information was not reliable, and financial systems and processes, as well as the associated internal control structure, were not adequate to produce reliable financial information.

3. Our audit found account overstatements of \$1.3 billion and account understatements of \$983.8 million. Further, as in prior years, we could not verify the acquisition cost of assets, valued at \$282 billion, due to the absence of a transaction-driven general ledger, system problems, and documentation retention practices. In addition, the government furnished property balance reported by DFAS-Denver Center (DFAS-DE) in the FY 1996 Air Force consolidated financial statements was \$20.4 billion less than the values contractors reported to the

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Defense Logistics Agency for inclusion in the Contractor Property Management System. We also determined the Air Force overstated the value of munitions by \$852.7 million in the data submitted to DFAS-DE for inclusion in the financial statements. Finally, account balances continued to exclude some assets. The details of these and other conditions are more fully discussed in Tab A of this report.

REPORT ON INTERNAL CONTROLS

4. Internal controls were generally adequate to physically safeguard assets. However, the internal control structure for financial reporting did not provide reasonable assurance of achieving the internal control objectives described in Office of Management and Budget (OMB) Bulletin 93-06, Audit Requirements for Federal Financial Statements, 8 January 1993. We also determined that existing internal controls did not provide a reasonable basis for determining material compliance with certain laws and regulations or for preventing material misstatements in the financial statements. For example, the Air Force had limited assurance that only valid transactions were processed because financial personnel did not always properly record, support, and report the transactions. In addition, we identified reportable conditions related to accounting systems, independent checks, and transaction cutoff and recording. Further discussion of these issues is presented in Tab B of this report.

COMPLIANCE WITH LAWS AND REGULATIONS

5. Existing systems and controls did not enable the Air Force and DFAS to fully comply with laws and regulations that materially affect the financial statements (the laws and regulations reviewed are presented at Appendix V). For example, management officials did not report materially nonconforming accounting systems or identify the lack of supporting documentation as a material weakness under the Federal Managers' Financial Integrity Act (FMFIA). Further, the Air Force incurred interest penalties and lost vendor discounts because accounting offices did not promptly pay Air Force debts as intended by the Prompt Payment Act. These and other issues are discussed in Tab C of this report.

INITIATIVES TO IMPROVE FINANCIAL DATA

6. The Air Force, DoD, and DFAS initiated several actions to improve Air Force financial data. The Secretary of the Air Force established a Financial Improvement Policy Council to coordinate Air Force and DFAS systems development work. DoD established the Acquisition and Financial Management Working

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Group to resolve the DoD-wide problem of mismatched disbursements. The working group report, *Eliminating Unmatched Disbursements, A Combined Approach*, June 1995, contains 48 recommendations that should correct conditions that cause unmatched disbursements and eliminate existing mismatches. Also, DFAS is developing a transaction-driven accounting system called the Defense Joint Accounting System to improve DoD financial data. In addition, DFAS has implemented the Direct Contract Payment Notice System and the Automated Reconciliation System. These systems will improve controls over the obligation process and reduce the time required to reconcile problem disbursements as well as discrepancies between Air Force data and DFAS-Columbus Center (DFAS-CO) data. DFAS-DE also made significant improvements in reconciling pay and personnel records, which contributed to increased accuracy of payroll data. Further, DFAS-DE made all appropriate audit-recommended adjustments to reported account balances and footnote disclosures to improve the presentation of Air Force financial statement data.

OBJECTIVES, SCOPE, AND METHODOLOGY

7. Management is responsible for

a. preparing annual financial statements in accordance with generally accepted accounting principles; OMB Bulletin 94-01, Form and Content of Agency Financial Statements, 16 November 1993; and OMB Bulletin 97-01, Form and Content of Agency Financial Statements, 16 October 1996;

b. establishing and maintaining internal controls to provide reasonable assurance that the internal control objectives in OMB Bulletin 93-06 are met; and

c. complying with applicable laws and regulations.

8. We are responsible for obtaining reasonable assurance about whether (a) the financial statements are reliable (free of material misstatement and presented fairly in conformity with generally accepted accounting principles), and (b) relevant internal controls are in place and operating effectively. We are also responsible for testing compliance with selected provisions of laws and regulations.

9. To fulfill these responsibilities, we

a. examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

b. assessed the accounting principles used and significant estimates made by management;

c. evaluated the overall presentation of the financial statements;

d. evaluated and tested relevant internal controls; and

e. tested compliance with significant provisions of applicable laws and regulations.

10. We limited our work to accounting and other controls necessary to achieve the objectives outlined in our report on internal controls. Because of inherent limitations in any system of internal control, losses, noncompliance, or misstatements may nevertheless occur and not be detected.

11. We performed our work in accordance with generally accepted government auditing standards and the provisions of OMB Bulletin 93-06.


JACKIE R. CRAWFORD
The Auditor General

**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

Project 96053001

TAB A

ACCURACY OF ACCOUNT BALANCES

BACKGROUND

1. As of 30 September 1996, the Air Force Consolidated Statement of Financial Position reported total assets of \$342.1 billion, liabilities of \$11.4 billion, and net position totaling \$330.7 billion. The Statement of Operations reported total revenues and financing sources of \$59.5 billion and expenses of \$59.6 billion, while the budget for FY 1996 was about \$73.9 billion.

2. We performed an audit of the accompanying statement of financial position of the Air Force as of 30 September 1996 and the related statement of operations and changes in net position for the year then ended to determine if the financial statements fairly presented the Air Force financial condition as of 30 September 1996. DFAS published the Air Force consolidated financial statements¹ on 1 March 1997 (Appendix III).

CONCLUSION

3. Material uncertainties exist regarding the reasonableness of amounts reported in the FY 1996 Air Force consolidated financial statements. Amounts reported on the statements, such as \$246 billion in property, plant, and equipment, and \$36.5 billion in inventory, were assembled from a variety of separate information systems of uncertain reliability. Further, for most items, we were unable to verify account balances. Because of the unverifiable account balances and accounting system inadequacies, we do not express an opinion on the consolidated financial statements and caution users that these statements may not be totally reliable.

MANAGEMENT ACTIONS

4. In response to this and prior audits,² as well as continuing congressional and public concerns, the Air Force, DoD, and DFAS have initiated actions to address

¹ DFAS-DE provided the FY 1996 Air Force financial statements for audit on 18 December 1996. Based on our audit and other information, DFAS-DE updated and reissued the statements on 3 February 1997.

² Reference Appendix II for a summary of prior audits.

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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TAB A

Accuracy of Account Balances

the problems discussed in this report. Once management corrects the reported problems, the Air Force should achieve more effective financial control over assets and provide reliable financial information to Air Force senior managers, Congress, and other interested parties. Specifically

a. During FY 1994, the Secretary of the Air Force established a Financial Improvement Policy Council to coordinate developments between the Air Force and DFAS, particularly in areas where Air Force information systems will interface with DFAS accounting systems. This council continues to meet at least quarterly to discuss systems issues.

b. The DoD Comptroller established the DoD Acquisition and Financial Management Working Group to resolve the DoD-wide problem of matching disbursements to valid obligations. The working group report, *Eliminating Unmatched Disbursements, A Combined Approach*, June 1995, contains 48 recommendations for DFAS and other agencies to correct conditions that cause unmatched disbursements and to eliminate existing mismatches, including possible write-offs.

c. DFAS-DE, in conjunction with Air Force program managers and AFAA auditors, undertook a special project to correct specific problems reported in prior audits. As a result of the special project, DFAS-DE

(1) developed and implemented a capitalized satellite reporting process which eliminated duplicate reporting problems which had caused overstatements of \$369 million in FY 1995;

(2) assisted the Los Angeles AFB Systems Program Office in capitalizing satellite launch costs of \$5.8 billion;

(3) developed procedures to fully disclose and accurately report excess and surplus property valued at over \$2.2 billion;

(4) developed and implemented new procedures to capture more accurate munitions year-end values for FY 1996, and corrected an \$8.5 billion understatement from FY 1995; and

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Project 96053001

Accuracy of Account Balances

TAB A

(5) developed a reporting process for special tooling and special test equipment used to accumulate \$4.5 billion of property not reported in FY 1995.

d. DFAS-DE is developing concepts for a Defense Joint Accounting System (DJAS). DFAS-DE completed the Interim Migratory Accounting System Conceptual Foundation and Implementation Strategy in August 1995, the General Ledger/Funds Control Concept Design and Requirements in June 1996, and a limited review of the Corps of Engineers Financial Management System in May 1996. Subsequently, the Under Secretary of Defense (Comptroller) directed the continued development of the Corps of Engineers system as the baseline for DJAS, a transaction-driven general accounting migratory system. The major goals of DJAS include providing double entry, transaction-based general ledgers; converting to the government standard chart of accounts (augmented by DoD); using the standard Budget and Accounting Classification Code (BACC); and providing a general ledger for each appropriation. The Air Force has established a DJAS team, composed of members from all major commands, to work with DFAS-DE on this initiative. This effort is intended to (1) ensure all Air Force requirements are included and (2) increase communication between Air Force and DFAS-DE.

e. The Air Force has taken the lead role in implementing the BACC which is an integral part of the budget information system called the Financial Information Resource System. When completed, BACC and DJAS should enable DoD to reduce the total number of financial systems and meet General Accounting Office (GAO), Treasury, GMRA, FMFIA, Federal Financial Management Improvement Act, and DoD accounting standards and requirements.

f. DFAS-DE, in conjunction with the Air Force, has completed the Transfer of Management Responsibility project. Assessments of mixed systems, which are information systems that have both a nonfinancial (e.g., inventory tracking) and financial application (asset valuation), were accomplished by LOGICON Corporation and KPMG Peat Marwick LLP. The evaluation phase resulted in recommendations as to whether DFAS or the Air Force should have primary responsibility for maintaining each system and what type of FMFIA review was appropriate. DFAS Headquarters is developing standard requirements checklists for FMFIA systems. The checklists are to be published in the DoD Financial Management Regulation, along with definitive responsibilities, criteria, and timelines for conducting annual FMFIA Section 2 and Section 4 reviews

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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TAB A

Accuracy of Account Balances

(reference Appendix I for details). Currently, DFAS-DE is working memorandums of agreement between DFAS and the Air Force to implement transfer recommendations.

g. The Air Force is pursuing system development or modification of four major logistics systems being modernized under the Global Combat Support System and Defense Information Infrastructure concepts. The four systems, the Global Combat Support System-Air Force (Standard Base Supply System [SBSS]), the Ammunition Management Standard System, the Automated Civil Engineer System, and the Integrated Maintenance Data System, account for 85 percent of the Air Force property, plant and equipment inventory.

h. DFAS-DE continues to develop the Departmental Cash Management System to satisfy departmental accounting requirements and increase productivity while substantially reducing costs. The system should correct material weaknesses, respond to audit findings, and reduce the outstanding balance of undistributed disbursements and negative unliquidated obligations/problem disbursements. The Departmental Cash Management System will replace the Merged Accountability and Fund Reporting (MAFR) system and the Cash Accountability Subsystem in the Cash Management Control System. DFAS Headquarters granted permission to proceed with software development in September 1995. DFAS-DE implemented two Departmental Cash Management System subsystems in August 1996 and plans to complete implementation by the end of 1997.

i. DFAS is converting the Air Force Standard Civilian Automated Pay System to the Defense Civilian Pay System with completion expected in 1997. DFAS converted the Air Force Joint Uniform Military Pay System to the Defense Joint Military Pay System (DJMS) in FY 1994 and has made several enhancements to DJMS during FYs 1995 and 1996.

j. DFAS-DE implemented the Direct Contract Payment Notice System at all central procurement accounting system locations. The Automated Reconciliation System has also been fully implemented at all Air Force Materiel Command (AFMC) locations, DFAS-CO, Air National Guard Headquarters, and other locations. DFAS-DE expects these development efforts to improve controls over the obligation process and reduce the time required to reconcile problem disbursements and discrepancies between Air Force and DFAS-CO data.

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
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Accuracy of Account Balances

TAB A

k. DoD, DFAS, and Air Force have initiated several programs that significantly reduced cash needed for daily Air Force operations. These initiatives decreased disbursing officer cash holding authority at Air Force active duty and reserve locations. For example, disbursing officers now make disbursements using electronic fund transfers whenever possible, and government travelers use the American Express card to obtain cash advances. DFAS and Air Force financial managers have made effective cash management more attainable with these initiatives. Reduced cash levels provide less opportunity for misappropriation of this highly vulnerable asset.

l. DFAS-DE and Air Force officials are developing a systematic process for compiling and reporting contingent liabilities. The Air Force contracted to have the entire area of contingent liabilities reviewed. The Air Force sent the completed study to DoD for their consideration in updating policy in this area. DFAS Headquarters issued guidance for recording and reporting contingent liabilities in the consolidated financial statements, and AFMC issued a memorandum providing field activities direction on managing contingent liabilities. The DoD Deputy Chief Financial Officer included requirements for contingent liability reporting in the DoD Guidance on Form and Content of Financial Statements for FY 1996, October 1996. DFAS-DE changed financial statement reporting of contingent liabilities by correctly reporting worker's compensation as an actuarial liability, recording environmental cleanup costs as an "other" liability, and discontinuing the practice of treating budgetary contingencies as contingent liabilities.

m. The Air Force began to develop the Automated Business Services System in FY 1996, including an electronic commerce/electronic data interchange "front-end commitment document processing system." This initiative, which consolidates the best of four other electronic commerce/electronic data interchange Air Force initiatives, is currently being field tested throughout the Air Force and is projected for full deployment in early FY 1998. The Air Force expects the Automated Business Services System to not only improve business processes, but to substantially reduce negative unliquidated obligations (NULOs).

5. While awaiting the completion of system development efforts, DFAS-DE and Air Force management must address several significant issues to improve financial operations and reporting. These issues include accounting for and valuing Air Force inventories and contractor-held Air Force property; improving internal controls by properly classifying, recording, supporting, and reporting financial

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

TAB A

Accuracy of Account Balances

transactions; deobligating current year funds before expiration and expiring funds before cancellation; and properly accounting for progress payments. The following paragraphs summarize the significant issues which preclude an opinion on the Air Force financial statements for the fiscal year ended 30 September 1996.

AUDIT RESULTS

Summary

6. Conditions reported in past audits that precluded us from expressing an opinion on the reliability of the financial statements for FYs 1992 through 1995 still exist. Also, we found significant conditions that adversely impacted four of the five management assertions embodied in the financial statement components. During this audit, we identified over \$9.2 billion of required adjustments to amounts reported in the statements. DFAS-DE made all appropriate adjustments. However, we arrived at the adjustments using existing accounting systems and data, and many of those systems and associated data are known to be unreliable. Consequently, even though DFAS made all the proposed adjustments, sufficient uncertainties regarding other amounts reported precluded us from expressing an opinion on the consolidated statements.

7. Conversely, our audit work on civilian pay, military pay, contingent liabilities, and eliminating entries and nonoperating changes provided very positive results. We concluded that Air Force civilian payroll and related accruals and military personnel costs at the installations reviewed were generally accurate and reliable, and internal controls were generally effective when properly applied. DFAS-DE personnel made significant progress in reporting contingent liabilities and correcting deficiencies previously reported. Further, DFAS-DE personnel accurately identified, eliminated, and reported Air Force intra-fund sales transactions in the Air Force financial statements.

Previously Reported Conditions

8. Our reports on the Air Force FYs 1992 through 1995 financial statements identified a number of conditions which prevented us from expressing an opinion on the reliability of those statements. In our audit for FY 1996, we compared prior findings with current conditions and found that the following conditions still exist:

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

Accuracy of Account Balances

TAB A

- a. The financial data, used to develop the Air Force financial statements, are not produced by a transaction-driven general ledger.
- b. Existing accounting systems cannot produce auditable financial statements.
- c. The financial statements do not accurately report equipment and inventories, including contractor-held Air Force property.
- d. The financial statements do not report acquisition costs for most assets.
- e. Accounting personnel do not properly account for progress payments.

Significant Conditions

9. Significant conditions adversely impacted four of the five management assertions defined by generally accepted government auditing standards³ and embodied in the financial statements. Specifically, we found significant conditions concerning management assertions related to valuation or allocation, existence or occurrence, completeness, and presentation and disclosure. Nothing came to our attention indicating significant conditions related to the management assertion of rights and obligations. We covered the significant conditions in more detail in separate reports provided to Air Force and DFAS management for comment (Appendix VI). The following paragraphs address management assertions, the significant conditions we identified for each assertion, and the report that summarizes the conditions.

a. Valuation or Allocation. We identified the following conditions related to the appropriateness of amounts included in the financial statements for asset, liability, revenue, and expense accounts.

(1) Munitions. The Air Force overstated munitions values by \$852.7 million in the data submitted to DFAS-DE for inclusion in the consolidated financial statements. At 11 Air Force locations, the data in the command Combat Ammunition System (CAS-A) exceeded the data in the base-level Combat

³ Generally accepted government auditing standards incorporate financial statement assertions defined by the American Institute of Certified Public Accountants in the Codification of Statements on Auditing Standards, AU Section 326.

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Ammunition System (CAS-B) by \$231.4 million. At 14 Army locations storing Air Force munitions, the data in CAS-A also exceeded the data in the Army Commodity Command Standard System (CCSS) by \$621.3 million. Audit observation of inventories and independent sampling verified the accuracy of CAS-B and CCSS data. In addition, footnote 8c to the financial statements stated that the value reported for munitions did not include an unspecified amount of cartridge and propellant actuated devices and Maverick missiles. These conditions were primarily due to systems interface problems and reconciling CAS-A and CAS-B data. (Report of Audit 96053005)

(2) Military Equipment. The Air Force provided DFAS-DE with erroneous military equipment valuation data. HQ AFMC excluded \$171 million in modification costs related to converting C-130 aircraft to the MC-130P series because AFMC personnel did not review and revise the unit cost in the Equipment Inventory, Multiple Status, and Utilization Reporting System. Space and Missile Systems Center personnel included one nonoperational⁴ Global Positioning System satellite valued at \$89 million in the data provided to the Los Angeles AFB Defense Accounting Office because a proposed memorandum of agreement related to reviewing and reporting satellite data was not fully implemented. While the net value of these errors is not material to the financial statements, we are disclosing the errors because they are similar to findings reported in FYs 1992 through 1995. (Report of Audit 96053002)

b. Existence or Occurrence. We identified the following significant conditions related to whether all assets and liabilities included in the 30 September 1996 financial statements existed at that date and whether all recorded transactions had occurred within the fiscal year ending on that date.

(1) Account Support. Over \$88 million of accounts receivable, accounts payable, operating expenses, and unexpired appropriations were either invalid, inadequately supported, or inaccurate. (Report of Audit 96053003)

(a) Accounts Receivable. Our review at 18 Air Force locations found that \$56 million of \$129 million in accounts receivable were either invalid,

⁴ When satellites become nonoperational, their full value is removed from financial records. The memorandum of agreement will affix responsibility for providing changes in satellite status and adjusting financial records.

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unsupported, or inaccurate. Specifically, accounting personnel did not record accounts receivable transactions or comply with regulatory guidance. We also identified this condition in our accounts receivable audits in FYs 1992 through 1995.

(b) Accounts Payable. Accounting office personnel were unable to locate documents to support 227 accounts payable transactions valued at \$5.2 million of \$47.8 million reviewed. Further, we were unable to reconcile and validate accounts payable balances for 56 contracts centrally disbursed by DFAS-CO. As a result, we concluded the accounts payable amount reported in the FY 1996 Air Force financial statements is unreliable.

(c) Operating Expenses. Fifteen of twenty locations reviewed did not maintain adequate support for operating expenses. We could not validate \$2.6 of \$91.2 million of operating expense transactions. Accounting personnel were unable to locate copies of payment vouchers, receiving reports, and, in 85 of 2,102 instances, entire files. Kelly AFB did not maintain adequate support for transactions totaling \$1.7 million. This condition occurred because accounting personnel did not maintain supporting documentation for the processed payments as required by DFAS-DE Regulation (DER) 177-102, Commercial Transactions at Base Level, 31 January 1996.

(d) Unexpended Appropriations. Our review of \$186 million in unexpended appropriations disclosed discrepancies of \$21.7 million. Total unexpended appropriations were valued at \$2.4 billion.

1. Random Selection. At 15 locations, we randomly selected and tested 1,506 undelivered orders outstanding (UOO) balances valued at \$2.8 million. Nineteen percent were invalid or no longer needed. We statistically projected that \$11.6 of \$89.1 million in obligations were invalid or no longer needed.

2. Judgmental Selection. At 15 locations, we judgmentally^s selected and tested 470 UOO balances valued at \$96.9 million. We determined that \$10.1 of \$96.9 million were invalid or no longer needed.

^s We judgmentally selected a sample from dormant and large dollar UOO balances.

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(2) Foreign-Owned Property. Spangdahlem Air Base, Germany, recorded and reported US-funded, foreign-owned property. Specifically, property built by the German government and furnished to the Air Force, valued at \$254 million, was included in the real property balance reported to DFAS because Air Force Instruction 32-9005, Real Property Accountability and Reporting, 30 September 1994, requires that these properties be treated as though owned by the Air Force. However, the DoD Financial Management Regulation specifies that foreign-owned properties be carried in a capital lease account. (Report of Audit 96053019)

(3) Unmatched Transactions. Accounting personnel at the five defense accounting offices audited did not research unmatched progress payment transactions to determine transaction validity and assess the impact of these transactions on general ledger account accuracy, and did not report the unmatched transactions to DFAS-DE. We identified unmatched payments of \$147.6 million and unmatched recoupments of \$196.3 million. (Report of Audit 96053006)

c. Completeness. We identified the following significant conditions concerning the completeness of data included in the FY 1996 Air Force financial statements.

(1) NULOs. Despite DFAS and Air Force actions to identify, report, correct, and obligate NULO transactions, negative obligations remain a serious problem. DFAS-DE reported \$594 million in NULOs on 30 September 1996, an 8 percent increase for the year. Also, at seven of nine locations, reports to DFAS-DE were understated by \$47 million. For example, the report from Los Angeles AFB was understated by \$40 million. This condition occurred because accounting office personnel did not post Central Procurement Accounting System disbursements, did not report selected transactions in the General Accounting and Finance System, and were unaware of the new requirements to report NULOs when the progress payment exceeds the unliquidated obligation at contract level. Accurate reporting is important because NULOs affect the accuracy of the Air Force fund balances with Treasury, accounts receivable, accounts payable, and capital expenditures. Further, the Under Secretary of Defense (Comptroller) must periodically advise Congress of progress in resolving the long-standing DoD problem with negative obligations. (Report of Audit 96053003)

(2) Capital Leases. Bases did not report, and DFAS accounting personnel did not record, three leases according to criteria contained in Statement of Federal

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Financial Accounting Standards Number 5⁶ and DoD Financial Management Regulation 7000.14-R, Volume 4.⁷ In two instances the net present value of the lease payments over the 20-year life of the leases exceeded the fair market value, and in the third instance the lease contained a bargain purchase option which the Air Force could exercise at any time during the lease. Under these lease terms, these leases should have been recorded as operating leases, capitalized, and included in the financial statements. We estimate that these errors caused an understatement of real property in the financial statements of approximately \$114 million of \$3.2 billion reviewed. (Report of Audit 96053019)

(3) Construction In Progress. Base personnel at 7 of 11 bases did not report to DFAS the value of actual outstanding capitalizable work or project orders for inclusion in the financial statements. Three bases excluded Simplified Acquisition of Base Engineering Resources and other locally contracted projects from construction in progress, and three other bases included the entire estimated contract cost prior to work performance or making progress payments. Civil engineer and DFAS-DE personnel had not established a procedure to periodically reconcile the general ledger with civil engineer work-in-progress records, resulting in a net understatement on the Air Force financial statements of \$129.4 million. (Report of Audit 96053019)

(4) Canceled Appropriations. Accounting personnel at the five defense accounting offices audited did not report recoupments of \$3.7 billion and outstanding progress payments of \$480.7 million disbursed from active appropriations that subsequently canceled. DFAS personnel could not explain the large number of recoupment transactions, nor did DFAS take action to research and clear these transactions or determine their impact on the general ledger account. As a result, significant information was omitted from the financial statements. (Report of Audit 96053006)

(5) Progress Payment Holdbacks. DFAS-DE accounting personnel did not accurately report accrued payable amounts withheld by contracting officers

⁶ Accounting for Liabilities of the Federal Government, 20 December 1995. The requirements of this standard were provided for information purposes. This standard did not go into effect until 1 October 1996, and did not impact the FY 1996 financial statements.

⁷ Accounting Policy and Procedures, January 1995.

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under contract progress payment provisions. While DFAS-DE included \$1.1 billion in accounts payable to nonfederal agencies as reported by DFAS-CO in their accrued expenditure report, we calculated that the actual holdback payable was about \$1.75 billion. We concluded that accounts payable as of 30 September 1996 were probably understated by more than \$650 million, but available information was not reliable enough to determine the exact amount. (Report of Audit 96053006)

(6) Government Furnished Property (GFP). We were unable to confirm the accuracy of GFP balances in the financial statements. This occurred because the Air Force does not have a system designed to record, track, and report government property in the custody of contractors. Instead, DFAS-DE must create GFP balances manually by extracting partial data from a number of automated systems which were designed for other purposes. As a result, although we have identified a number of reasons for variances in reported values, neither we, Air Force, nor DFAS-DE can accurately reconcile the \$20 billion difference between GFP reported in the financial statements and GFP reported in the Contractor Property Management System. (Report of Audit 96053017)

(a) Equipment With Contractors. The Air Force had no assurance that Air Force general ledger account 169, Equipment and Contractors, was complete and accurate. DFAS-DE/AD (Directorate of Departmental Accounting) personnel manually computed the GFP value of aircraft and missiles with contractors from the Equipment Inventory, Multiple Status, and Utilization Reporting System asset location reports. Air Force personnel stated the purpose and location codes in these reports were not designed for or intended to identify GFP that contractors are required to report and, therefore, using these codes could result in invalid data. However, DFAS-DE personnel believed the codes were adequate. We agree with Air Force personnel that these codes are not always reliable and that DFAS-DE has no assurance that reported GFP balances for aircraft and missiles are complete or accurate.

(b) Equipment in Use/Real Property With Contractor. Air Force and DFAS-DE cannot determine GFP balances for land, real property, other plant, equipment, or military property. Various systems such as SBSS, Air Force Equipment Management System, Information Management Processing System, On-Line Vehicle Interactive Management System, and Work Information Management System contain GFP information, but the value of that GFP cannot be determined.

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Consequently, reliable GFP values are not available for comparison with contractor-reported balances, and Air Force general ledger accounts are understated.

(c) Aircraft Valuation. Contractor-furnished GFP balances were unreliable primarily due to inconsistent aircraft valuations. We found contractors applying different valuations to aircraft of the same mission design series because the Air Force had not provided aircraft valuation tables or guidance on the valuation of aircraft reported as GFP. As a result, contractor-reported aircraft values in the Contractor Property Management System are not comparable to values DFAS-DE reported in the financial statements.

d. Presentation and Disclosure. We identified the following significant conditions related to the way the financial statement components were classified, described, and disclosed.

(1) Operating Materials and Supplies. DFAS-DE incorrectly included \$36.5 billion of operating materials and supplies on the Inventory, Net line of the Statement of Financial Position of the Air Force consolidated financial statements. While DFAS and Air Force accounting records correctly accounted for these assets, the DoD Comptroller directed that they be reported as inventory. This reporting conflicts with the definitions of inventory and operating materials and supplies delineated in Statement of Federal Financial Accounting Standards Number 3.⁸ Since the DoD Comptroller direction on reporting operating materials and supplies as inventory affects all Services, we have referred this issue to the DoD Inspector General (DoDIG). (Report of Audit 96053005)

(2) War Reserve Materiel (WRM). DFAS-DE did not separately identify WRM in the financial statements as required by the DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity. While footnote 8 to the financial statements states that DFAS-DE was unable to distinguish WRM from inventory, this condition occurred because they did not request Air Force organizations to identify WRM separately. (Report of Audit 96053005)

⁸ Accounting for Inventory and Related Property, 27 October 1993.

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Required Adjustments

10. We identified nearly \$9.2 billion of required adjustments to amounts reported in the financial statements. We recommended adjustments of nearly \$567 million to improve the accuracy of accounts impacting the FY 1996 property, plant, and equipment balance. We also recommended over \$8.6 billion of adjustments to prior period records affecting operating materials and supplies and contractor-held property. DFAS-DE made all appropriate adjustments.

Basis for Adjustments

11. The adjustments summarized above are required based on audit findings. However, we arrived at the adjustments using existing accounting systems and data, and many of those systems and associated data are known to be unreliable. Consequently, even though DFAS-DE made all the proposed adjustments, sufficient uncertainties regarding other amounts reported precluded us from expressing an opinion on the consolidated financial statements.

**ADJUSTMENTS MADE TO FY 1996 FINANCIAL STATEMENTS
(\$ Millions)**

| | | |
|--|--------------|------------------|
| FY 1996 | | |
| Aircraft | \$171.0 | |
| Engines | 6.2 | |
| Satellites | 98.2 | |
| Equipment In Use | <u>291.3</u> | |
| FY Total | | \$ 566.7 |
| FY 1995 | | |
| Operating Materials and Supplies (Ammunition) | \$8,511.8 | |
| Contractor Held Property | <u>99.3</u> | |
| FY Total | | <u>8,611.1</u> |
| Total Adjustments | | <u>\$9,177.8</u> |

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TAB B

REPORT ON INTERNAL CONTROLS

BACKGROUND

1. Management is responsible for establishing and maintaining an internal control structure to provide reasonable but not absolute assurance that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and financial resources and expenditures applicable to the entity's operations are properly recorded and accounted for. A sound internal control structure helps management prepare reliable financial reports in accordance with applicable accounting standards and maintain accountability over assets. In fulfilling this responsibility, management estimates and judgments are required to assess the expected benefits and related costs of internal control structure policies and procedures.

AUDIT RESULTS

Summary

2. We determined that the internal control structure did not provide reasonable assurance of achieving the internal control objectives⁹ described in OMB Bulletin 93-06. We identified reportable conditions in the areas of accounting systems, independent checks, transaction cutoff and recording, and adequate safeguards. We believe these reportable conditions, in combination, result in material weaknesses.

Reportable Conditions

3. We noted certain matters involving the internal control structure and its operation that we consider reportable conditions under standards established by generally accepted government auditing standards and OMB Bulletin 93-06. Reportable conditions involve matters coming to our attention related to significant deficiencies in the design or operation of the internal control structure. These

⁹ Reference Appendix I, paragraph 5.

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deficiencies could adversely affect the entity's ability to ensure that the objectives of the internal control structure are being achieved.

a. Accounting Systems.

(1) Accounting Processes. Due to significant accounting system internal control weaknesses, neither DFAS nor the Air Force can ensure they properly record, process, and summarize only valid transactions and provide accurate financial information. DFAS and the Air Force do not have a transaction-driven general ledger to provide a single source for compiling and reporting financial information for use in preparing the Air Force financial statements. Although DFAS-DE is developing a transaction-based financial management system, the system will not be fully operational for several years. Consequently, Air Force and DFAS-DE accounting personnel must extract data from multiple automated systems, as well as some manual systems, to prepare the annual Air Force consolidated financial statements. Some of the information used in the financial statements comes from Air Force sources that are not part of the financial community. Accounting personnel do not have the means to verify the validity of much of this data. This cumbersome compilation process contributes to control problems in presenting accurate financial statements.

(2) Disbursement and Collection Data. The DFAS-DE MAFR system did not contain sufficient controls to facilitate identification of transactions that impact financial statement reporting. Our review disclosed 6,867 disbursement and collection differences between DFAS-DE departmental records and installation-level subsidiary data as of 30 September 1996. These differences, with an absolute value of \$1.07 billion (net value of \$156,000), existed in part because the accounting system had not processed the most recent transactions to match DFAS and installation-level data. Further, the MAFR system did not maintain an adequate audit trail for entries originating at DFAS-DE. (Report of Audit 96053003)

b. Independent Checks.

(1) Reconciliations. Accounting personnel did not perform required reconciliations of accounts receivable transactions and MAFR differences. (Report of Audit 96053003)

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(a) Accounting technicians at 11 locations reviewed did not reconcile daily accounts receivable transactions to originating source documentation as Air Force Manual (AFM) 177-370, USAF Standard Base-Level General Accounting and Finance System, 5 February 1994, requires. As an alternative, locations relied on daily MAFR reconciliations to identify erroneous conditions. Reconciling daily transactions against source documents is a key internal control designed to ensure accounting personnel properly enter transactions into the accounting system.

(b) The differences in disbursement and collection data identified in paragraph 3a(2) above resulted in part because DFAS field and departmental personnel did not perform adequate reconciliations between departmental and subsidiary records as Air Force Regulation (AFR) 177-101, General Accounting and Finance Systems at Base Level, 15 February 1991, requires.

(2) Inventories. Our physical inventory of \$1.1 billion in selected assets reported in the Financial Inventory Accounting and Billing System¹⁸ and SBSS disclosed \$21.6 million of inventory errors. Poor physical inventory practices and inadequate guidance caused these errors. Consequently, the operating materials and supplies balance reported in the financial statements may be based on inaccurate quantities and values. (Report of Audit 96053005)

c. Transaction Cutoff or Recording. DFAS personnel at three accountable stations did not execute proper year-end cutoff or recording for progress payment transactions. Specifically, the personnel recorded FY 1996 progress payments of \$28.1 million and recoupment transactions of \$35.6 million in FY 1997. Further, these personnel did not adjust reported progress payment account balances when processing the excluded transactions in early FY 1997. Accounting personnel did not comply with the guidance issued to correct this same condition reported in FY 1996. (Report of Audit 96053006)

d. Adequate Safeguards. Access controls for the General Accounting and Finance System, Integrated Accounts Payable System, and Integrated Paying and Collecting System require improvement. System managers at 10 of 20 locations

¹⁸ This system (D035J) obtains quantities and values from the Wholesale and Retail Receiving and Shipping System (D035K) and the Item Manager Wholesale Requisition Process (D035A), respectively. These systems are three of the six systems that make up the Stock Control and Distribution System.

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did not promptly discontinue user access to the General Accounting and Finance System when use was no longer required, and accounting office personnel at 11 locations did not adequately control access to the Integrated Accounts Payable System and Integrated Paying and Collecting System. In the latter instance, 62 previously authorized personnel maintained system access after their employment was terminated or they were reassigned to other functions. (Report of Audit 96053003)

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TAB C

**REPORT ON COMPLIANCE WITH
LAWS AND REGULATIONS**

BACKGROUND

1. An entity's management is responsible for establishing an internal control structure to assure compliance with applicable laws and regulations. Issues which should concern management include:

a. Resources. Compliance with laws and regulations that could significantly affect the acquisition, protection, and use of the entity's resources, and the quantity, quality, timeliness, and cost of the products and services it produces and delivers.

b. Programs. Compliance with laws and regulations pertaining to the objectives of the entity's programs, activities, and functions; the manner in which programs and services are to be delivered; the population a program or service is to serve; and whether the programs, activities, and functions are being carried out in conformity with these laws and regulations.

2. Material instances of noncompliance are failures to follow requirements or violations of prohibitions contained in laws or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause others to perceive the misstatements as significant. (Appendix V lists the laws and regulations reviewed during this audit.)

AUDIT RESULTS

Compliance With Laws and Regulations

3. Existing systems and controls did not enable the Air Force and DFAS to fully comply with laws and regulations that could have a direct and material effect on the FY 1996 Air Force financial statements. As a result, the Air Force incurred penalties and lost vendor discounts because accounting offices did not always pay Air Force debts promptly as intended by the Prompt Payment Act. DFAS operating location personnel incorrectly reported accounts receivable. Further, we

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Report on Compliance With Laws and Regulations

identified some instances of noncompliance with the FMFIA, the Statements of Federal Financial Accounting Standards, OMB guidance, and DoD and Air Force directives. We considered the noncompliance reported below in forming our opinion on whether the FY 1996 Air Force consolidated financial statements are fairly presented in all material respects in accordance with applicable accounting standards in effect for federal entities during the preparation of the entity's financial statements. The issues discussed in this tab do not affect our report on those statements presented in our opinion letter.

a. Prompt Payment Act. Contrary to the intent of the Prompt Payment Act, accounting offices did not always pay Air Force bills promptly, resulting in interest penalties. In addition, the accounting offices lost vendor discounts, and DFAS-DE underreported interest penalties paid with Air Force appropriated funds. (Report of Audit 96053003)

(1) Late Payments. The 18 offices audited made 270 late payments out of 1,726 sample payments subject to the Prompt Payment Act. As a result, the offices paid \$13,396 in interest penalties. Air Force-wide, interest penalties paid in FY 1996 amounted to \$5.6 million.

(2) Lost Discounts. During FY 1996, accounting office personnel did not always take advantage of authorized discounts. Specifically, our review of 2,102 randomly selected payments at 20 locations revealed the offices lost 138 discounts, valued at \$20,167, due to late payments.

(3) Underreported Interest Penalties. DFAS-DE did not report on the financial statements \$2.6 million in interest penalties paid with Air Force appropriated funds. DFAS-DE reported \$3 million rather than \$5.6 million. The underreporting occurred because DFAS Headquarters did not establish a reporting process between DFAS-CO and DFAS-DE to capture interest penalties paid by DFAS-CO with Air Force appropriated funds.

b. Reporting Accounts Receivable. DFAS operating location personnel incorrectly reported accounts receivable at all four locations. Further, amounts listed on accounts receivable reports were not always complete, properly supported, and validated. These conditions occurred because operating location personnel were generally unfamiliar with or not trained on DFAS-DE guidance on reporting requirements for the three accounts receivable reports. In addition,

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operating location personnel were unfamiliar with report contents and could not readily identify incomplete or missing information. Accurate reporting of accounts receivable is necessary to comply with financial reporting requirements and to provide accurate amounts for the financial statements. (Report of Audit 96053003)

(1) Incomplete Reports. Accounts receivable amounts that DFAS operating locations reported to DFAS-DE were not comprehensive. Specifically, Omaha Operating Location personnel omitted a total of \$93,219 off-line accounts receivable, collections, and transfers from their reports. In addition, Limestone Operating Location personnel did not include \$51,087 of refunds receivable.

(2) Unsupported Report Line Items. We could not substantiate all amounts identified on the accounts receivable reports. For example, Omaha Operating Location personnel were unable to determine the accuracy of \$35.4 million of reimbursements receivable and \$8.5 million of refunds receivable.

(3) Reports Not Validated. DFAS operating location personnel at all four locations did not validate accounting reports through reconciliation as required, or only partially reconciled their reports. To illustrate, Dayton Operating Location personnel did not reconcile over \$132 million in report differences prior to forwarding accounts receivable data to DFAS-DE.

c. FMFIA. While we noted a significant improvement in reporting internal control weaknesses in FMFIA Section 2, the Air Force continued to exclude, from FMFIA Section 4 reporting, accounting systems not conforming to the principles, standards, and related requirements prescribed by the Comptroller General.

(1) FMFIA Section 2. The Air Force and DFAS substantially improved the reporting of material internal control weaknesses over previous years. DFAS included in their FY 1996 Statement of Assurance a number of previously unreported weaknesses related to the reconciliation of control and subsidiary records. We reported the exclusion of these issues in our FYs 1994 and 1995 reports. Neither the Air Force nor DFAS prepared summary presentations of three material weaknesses.

(a) Pay and Personnel Records Reconciliation. DFAS reported a number of material weaknesses related to the reconciliation of military pay and

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personnel records. DFAS-DE reported as corrected a material weakness between the Air Force Standard Civilian Automated Pay System, which is being phased out, and civilian personnel records. For FY 1996, we identified discrepancies between the new Defense Civilian Pay System and personnel records that may require future Section 2 reporting.

(b) GFP. The Air Force and DFAS acknowledged in their Statements of Assurance that controls over the management and accountability of GFP were inadequate. Although DFAS listed property furnished to contractors as a departmental systemic internal control weakness, they did not include a detailed presentation in Section C or D of their Statement of Assurance as they stated.

(c) Fund Control Transactions. Neither the Air Force nor DFAS provided a summary presentation in Section C reporting that fund control transactions were not properly supported. Although DFAS acknowledged the "lack of supporting documentation and audit trails" in Section B and stated that Section C addressed the issue, Section C did not address the lack of supporting documentation and audit trails. We reported this condition in our FYs 1994 and 1995 reports on the Air Force financial statements.

(2) FMFIA Section 4. The Air Force continued to exclude four materially nonconforming accounting systems from Section 4 of their FY 1996 Statement of Assurance. The CAS and the Equipment Inventory, Multiple Status, and Utilization Reporting System were reported as having material weaknesses and were included in Section 2. The Comprehensive Engine Management System and the manual process for compiling satellite values were not included in either section. We recommended reporting the four systems in Section 4 because they produce information used in the Air Force financial statements. We previously reported these conditions in our FYs 1992 through 1995 audits of Air Force financial statements.¹¹ Air Force and DFAS-DE did not implement our recommendations pending the outcome of the Transfer of Management Responsibility review cited in Tab A, paragraph 4e. Implementation of the Transfer of Management Responsibility recommendations is in the initial stages.

¹¹ Reference Appendix VI.

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d. Statements of Federal Financial Accounting Standards.

(1) Consumption Method. DFAS-DE personnel did not use the consumption method to recognize expenses related to operating materials and supplies, as required by Statement of Federal Financial Accounting Standards Number 3. This deviation likely had a material effect on the financial statements. AF/IL¹² supply policy personnel had not developed procedures for using the consumption method, and DFAS-DE personnel cannot currently distinguish between capital and operating expenses within appropriations. While we determined the \$5.2 billion reported expenses for supplies and materials were understated, these accounting deficiencies prevent us from determining the amount of the understatement. (Report of Audit 96053005)

(2) Changing Standards. The Air Force did not value federal mission assets (military equipment) in accordance with existing or future accounting standards. The Air Force used uniform values applied to like equipment items rather than historical cost as required by current standards. This condition occurred because Air Force and DFAS-DE managers had not made changes to current systems or introduced new systems to effect proper financial accountability. Statement of Federal Financial Accounting Standards Number 6, Accounting for Property, Plant, and Equipment, and Number 8, Supplementary Stewardship Reporting, which become effective in FY 1998, will allow valuation of federal mission assets using the total cost or latest acquisition cost method. Historical cost is the valuation method prescribed for all other equipment. (Reports of Audit 96053002 and 96053019)

e. OMB Guidance. The real property officer did not fund one of the military family housing capital leases discussed in Tab A in accordance with OMB Circular A-11, Preparation and Submission of Budget Estimates, 13 June 1996. This circular requires that capital leases, entered into during FY 1992 and thereafter, be fully funded in the first year of the lease. The Air Force Real Estate Agency did not instruct real property officers on OMB Circular A-11 requirements. As a result, the base may have to obtain approximately \$200 million in funding for the remainder of the lease. (Report of Audit 96053019)

¹² Deputy Chief of Staff, Installations and Logistics, formerly Deputy Chief of Staff, Logistics (AF/LG).

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f. DoD Regulations.

(1) Chart of Accounts. DFAS-DE used the DoD Uniform Chart of Accounts to categorize financial information for the Air Force consolidated financial statements. However, Air Force and DFAS-DE personnel did not use the chart in day-to-day operations, including the general ledger account for contingent liabilities, as required by the DoD Financial Management Regulation 7000.14-R, Volume 1, General Financial Management Information, Systems, and Requirements, May 1993. As a result, Air Force and DFAS-DE personnel extracted data from multiple automated and manual systems to obtain account balances, such as operating materials and supplies, significantly increasing the potential for misstatements. DFAS-DE personnel are continuing to implement corrective action. (Reports of Audit 96053005 and 97053012)

(2) Capitalization Criteria. Air Force real property personnel did not use the standard DoD capitalization criterion of \$100,000 for completed minor construction projects. Instead, they used a combination of cost (\$15,000) and physical criteria such as changed facility use or dimensions or extended useful life. Air Force personnel had not revised property directives to meet DoD- and DFAS-directed capitalization criteria. This condition creates large differences between general ledger balances and civil engineering records. (Report of Audit 96053019)

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BACKGROUND INFORMATION

GENERAL

1. **Statutory Requirements.** Not later than 1 March 1997, and each year thereafter, the GMRA requires the head of DoD to prepare and submit to the Director of OMB an audited financial statement for the preceding fiscal year for each office, bureau, and activity of the department. Not later than 31 March 1998, and each year thereafter, the GMRA requires the Secretary of the Treasury, in coordination with the Director of OMB, to prepare and submit to the President and Congress an audited financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the government. DoD has published timeframes to be used within the department for financial statement preparation and audit.

2. **Accounting for Air Force Activity.** The Air Force general fund accounts for more than 99 percent of the assets, liabilities, revenues, and expenses shown on Air Force consolidated financial statements. The Air Force uses two methods to account for financial data as described below.

a. **General Ledger.** Air Force general ledger summary accounts track Air Force equity and budgetary items. Those individual general ledger accounts were reported in the Air Force Trial Balance for General Funds, RCS: HAF-ACF (SA) 7105 (7105 report). DFAS-DE summarizes this information into general ledger account balances but only uses selected asset and liability account balances to prepare the annual Air Force financial statements.

b. **Status of Funds.** The Air Force uses the Status of Funds Data Base Transmission (DBT), RCS: HAF-ACF (AR) 7801, to report certain Air Force financial statement account balances such as accounts receivable, accounts payable, revenues, and expenses. Accounting offices initially prepare the DBT, and the next higher Air Force command level consolidates the data by command. During FY 1994, most of the command-level review and consolidation process was moved to the Command Accounting and Reporting Division at DFAS-DE. Pacific Air Forces was moved during FY 1996, and United States Air Forces in Europe was moved to DFAS-DE effective 1 October 1996. The Command Accounting and Reporting Division reviews, updates, and edits the base-level data and enters the data into the Command On-Line Accounting and Reporting System. Command accounting prepares a consolidated DBT report and forwards this report

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to the Accounting and Reporting Division in DFAS-DE which enters the data into the Departmental On-Line Accounting and Reporting System (DOLARS), the Air Force departmental status of funds system. DFAS-DE ultimately summarizes this data and data from the 7105 reports in the Air Force financial statements. The Air Force uses the DBT reporting process because DFAS-DE has determined this process is more reliable than general ledger reporting for certain accounts.

3. Financial Statement Preparation. The Air Force must use the DoD Uniform Chart of Accounts, based upon the US Government Standard General Ledger Chart of Accounts, to accumulate and report financial information. DFAS-DE first used the DoD Chart of Accounts in FY 1994 to categorize and prepare the Air Force financial statements, using a personal computer-based spreadsheet. In FY 1995, DFAS-DE began implementing the Chief Financial Officer (CFO) Reporting System. Further implementation in FY 1996 allowed the CFO Reporting System to extract data from DOLARS by appropriation and assign it to general ledger accounts based on the DoD Uniform Chart of Accounts and reimbursable sales codes. Current year changes in accounts, where data sources are external to DOLARS, continued to be updated using journal voucher adjustments to the CFO Reporting System database. After all FY 1996 current year changes in account balances were updated (by automatic import of DOLARS data extracts and manual insertion of data external to DOLARS), the system automatically created the FY 1996 financial statements. When fully implemented, this system will extract data and categorize financial information in trial balance format through an automatic link to DOLARS, automatically prepare journal vouchers, and prepare the financial statements. The system will summarize data to the US Government Standard General Ledger Chart of Accounts and produce the Air Force trial balance provided to the Department of the Treasury through the Federal Agencies' Centralized Trial Balance System.

4. FY 1996 Financial Statement Balances. As of 30 September 1996, the Air Force Consolidated Statement of Financial Position reported total assets valued at about \$342.1 billion, liabilities of \$11.4 billion, and net position totaling \$330.7 billion. The Statement of Operations reported total revenues and financing sources of \$59.5 billion and expenses of \$59.6 billion. The Air Force budget authority for FY 1996 was \$73.9 billion.

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INTERNAL CONTROLS

5. Purpose of Internal Controls. The DoD Financial Management Regulation, Volume 1, states that the objectives of internal controls are to reasonably assure that

- a. obligations and costs comply with applicable laws;
- b. all assets are safeguarded against waste, loss, unauthorized use, and misappropriation; and
- c. revenues and expenditures are recorded and accounted for properly so that accounts and reliable financial reports may be prepared and accountability of assets may be maintained.

6. OMB Bulletin 93-06. "Internal control structure," as it relates to the financial statements required by the CFO Act and as discussed in OMB Bulletin 93-06, means the plan of organization and policies and procedures adopted by management to provide reasonable assurance that the following objectives are met:

- a. Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets.
- b. Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.
- c. Transactions, including those related to obligations and costs, are executed in compliance with (1) laws and regulations that could have a direct and material effect on the principal statements and, where applicable, combining statements; and (2) any other laws and regulations that OMB, entity management, or the Inspectors General have identified as being significant for which compliance can be objectively measured and evaluated.

7. Other Authoritative Guidance.

- a. **FMFIA of 1982.** This act directs government executive agencies to report annually on whether their internal and administrative controls and accounting systems comply with Comptroller General standards.

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(1) FMFIA, Section 2, requires each executive agency to report the status of management controls to the President and Congress annually by 31 December. The OMB developed guidelines in Circular A-123 (Revised), Management Accountability and Control, 21 June 1995, implemented by DoD and Air Force regulations, to meet Section 2 requirements. The status of management controls is reported via a Statement of Assurance and a Report on Material Weaknesses. The Statement of Assurance represents the agency head's informed judgment as to the overall adequacy and effectiveness of management controls within the agency. The Report on Material Weaknesses is the agency's vehicle for reporting plans to correct material weaknesses and progress against those plans. The Air Force annually evaluates internal controls through the Internal Management Control Program and reports the results to the Secretary of Defense.

(2) FMFIA, Section 4, requires each executive agency head to report annually to the President and the Congress whether its accounting systems are in conformance with Comptroller General principles and standards. The OMB developed guidelines in Circular A-127, Financial Management Systems, 23 July 1993, implemented by Air Force and DoD regulations, to meet Section 4 requirements. OMB guidance, further modified by DoD for its components, provides policies and procedures to develop, operate, evaluate, and report on financial management systems. Air Force guidance includes procedures for performing general and detailed accounting system reviews, determining material system weaknesses, and maintaining an accounting system inventory.

b. Defense Guidance. In addition to including the objectives of internal control as stated above, DoD Financial Management Regulation 7000.14-R, Volume 1, Chapter 7, DoD Standard General Ledger, includes standards for: documenting and recording transactions and events, executing transactions and events, separation of duties, supervision of accounting operations, and access to and accountability for resources to achieve those objectives.

LAWS AND REGULATIONS

8. Applicable Laws and Regulations.

a. Laws. Title 31, United States Code (U.S.C.), Sections 3512 (Executive Agency Accounting Systems), 3515 (Financial Statements of Agencies), and 3521 (Audits by Agencies) legislate accounting controls and systems and the preparation and audit of financial statements. The FMFIA of 1982 is included in 31 U.S.C. 3512. Under FMFIA, the head of each agency is responsible for establishing and

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maintaining adequate systems of accounting and internal control. The law requires that these systems conform to Comptroller General accounting principles, standards, and related requirements and internal control standards. Agencies must report in an annual statement of assurance whether their accounting and internal control systems conform to Comptroller General standards. The Budget and Accounting Procedures Act of 1950 is also included in Section 3512. The Government Management Reform Act of 1994 amended Sections 3515 and 3521 relative to the preparation and audit of executive agency financial statements.

b. Regulations. Various DoD, DFAS-DE, and Air Force regulations provide policy guidance and direction related to this audit. Among those, the significant provisions of the following pertain to this audit: DoD Financial Management Regulation 7000.14-R; DoD Directive 7200.1, Administrative Control of Appropriations, 7 May 1984; AFR 170-8, Accounting for Obligations, 15 January 1990; DFAS-DE 170-9, Fiscal Year-End Certification of Appropriation and Fund Balances, 30 June 1995; AFR 170-13, Accounting for Commitments, 30 July 1990; AFR 177-16, Administrative Control of Appropriations, 30 November 1988; AFR 177-101; DFAS-DE 177-102; AFR 177-120, Central Procurement Transactions, 17 February 1988; AFM 177-370; DFAS-DE 177-373, DJMS-AC Financial Services Offices (FSO) Procedures, 1 November 1994; and AFM 177-372A, Volume I, Air Force Standard Civilian Automated Pay System (PA) Users Manual, 1 June 1994.

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AUDIT SCOPE AND PRIOR AUDIT COVERAGE

AUDIT SCOPE

1. Management is responsible for
 - a. preparing the annual financial statements in conformity with applicable accounting principles,
 - b. establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of FMFIA are met, and
 - c. complying with applicable laws and regulations.
2. The AFAA must plan and perform an audit to obtain reasonable assurance about whether (a) the financial statements are reliable (free of material misstatement and presented fairly in conformity with OMB Bulletins 94-01 and 94-07, and applicable accounting principles) and (b) relevant internal controls are in place and operating effectively. The AFAA must also test compliance with selected provisions of laws and regulations and perform limited audit procedures with respect to testing the consistency of other information presented in the annual financial statement with the consolidated financial statements.
3. To fulfill these responsibilities, we
 - a. examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
 - b. assessed the accounting principles used and significant estimates made by management;
 - c. evaluated the overall presentation of the financial statements;
 - d. considered compliance with the process required by FMFIA for evaluating and reporting on internal control and accounting systems;
 - e. tested compliance with selected provisions of laws and regulations listed at Appendix V;

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- f. evaluated and tested relevant internal controls; and
 - g. obtained audit support from the Army Audit Agency and the Defense Contract Audit Agency at selected contractor facilities.
4. We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our work to accounting and other controls necessary to achieve the objectives outlined in our opinion on internal controls. Because of inherent limitations in any system of internal control, losses, noncompliance, or misstatements may nevertheless occur and not be detected. During the audit, we relied on computer-based data, although the scope of our audits did not always include a comprehensive test of system general and application controls to confirm the reliability of data. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may increase or deteriorate.
5. We accomplished the audit from June to December 1996 at the Assistant Secretary of the Air Force, Financial Management and Comptroller (SAF/FM); Assistant Secretary of the Air Force, Acquisition (SAF/AQ); Office of the General Counsel (SAF/GC); Deputy Chief of Staff, Installations and Logistics, Office of the Civil Engineer (AF/ILE) (formerly AF/CE); AF/IL; Deputy Chief of Staff, Plans and Programs (AF/XP) (formerly Programs and Evaluations [AF/PE]); 3 field operating agencies/direct reporting units; 9 Defense Contract Management Command (DCMC) locations; 23 DFAS locations (DFAS Headquarters, DFAS centers, DFAS operating locations, and defense accounting offices); 3 major command headquarters; and 52 Air Force active duty, reserve, and guard units. Specific locations are listed in the individual audit reports identified at Appendix VI. A draft of this report was provided to management in February 1997.
6. We conducted our audit in accordance with generally accepted government auditing standards and the provisions of OMB Bulletin 93-06. Audit results related to selected activities were based in part on the work of other auditors. Specifically, the Army Audit Agency performed audit work at two Army weapons arsenals in support of our audit of Operating Materials and Supplies, Fiscal Year 1996 Air Force Consolidated Financial Statements (Report of Audit 96053005), and the Defense Contract Audit Agency performed audit work at selected contractor facilities in support of our audit of Federal Mission Property, Plant, and Equipment, Fiscal Year 1996 Air Force Consolidated Financial

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Statements (Report of Audit 96053002). We believe our audit and the audit work of the Army Audit Agency and the Defense Contract Audit Agency provide a reasonable basis for our opinion on Air Force consolidated financial statements.

PRIOR AUDIT COVERAGE

7. During the past 5 years, the GAO and the DoDIG have issued five and six reports, respectively, addressing subjects related to issues in this report. In addition, AFAA issued audit opinions on the FYs 1992 through 1995 Air Force consolidated financial statements.

a. **GAO Reports.** The five GAO reports included two reports on Air Force financial management and three reports on DoD-wide financial management.

(1) GAO Report AFMD 92-12, Financial Audit: Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act, 19 February 1992. The GAO concluded that Air Force accounting systems generated unreliable and inaccurate financial information which was of little value for either internal management purposes or external reporting. Additionally, GAO found that the Air Force system of internal controls did not adequately safeguard all assets or ensure that account payments and financial reports were reliable. DoD stated that actions have been taken or are planned to address internal control weaknesses and inaccurate financial reporting problems discussed in this report.

(2) GAO Report NSIAD 94-106, DoD Procurement: Millions in Overpayments Returned by DoD Contractors, 14 March 1994. GAO concluded that virtually all overpayments examined were detected by the contractors rather than the government. GAO further concluded that contractor overpayments resulted because DFAS-CO either paid contractor invoices without recovering progress payments or made duplicate payments. DoD stated that actions were being taken to clarify and strengthen payment practices, reinforce prompt debt collection procedures, and issue clearly stated and complete contract documents to deal with contractor overpayments.

(3) GAO Report AIMD 95-7, Financial Management: Status of Defense Efforts to Correct Disbursement Problems, 5 October 1994. The GAO found DoD records contained at least \$24.8 billion of problem disbursements as of 30 June 1994, including about \$5 billion related to canceled "M" account balances that DoD had been unable to reconcile. GAO concluded, despite numerous audit reports over the last 14 years that repeatedly identified DoD internal control

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weaknesses, DoD continued to experience serious problems in accounting for disbursements. GAO stated DoD will not adequately resolve disbursement problems until the department corrects weaknesses in control procedures, which allow problem disbursements to occur, and improves DoD contract pay and accounting systems. This report did not include management's response to the issues and findings addressed in the report.

(4) GAO Report NSIAD 96-8, Millions in Contract Payment Errors Not Detected and Resolved Promptly, 6 October 1995. GAO concluded that contractors do not always return overpayments unless told to do so. Further, DFAS-CO cannot readily detect payment discrepancies because of significant errors in automated payment records. GAO also found that even after a public accounting firm completed contract reconciliations to identify the amounts owed the government, DFAS-CO did not recover payments promptly. This report did not include management's response to the issues and findings addressed in the report.

(5) GAO Report NSIAD-96-129, Defense Ammunition-Significant Problems Left Unattended Will Get Worse, 21 June 1996. GAO stated that approximately \$31 of an \$80 billion ammunition inventory was excess. In some cases, services were maintaining over 50 times stated needs. Expenditures in FYs 1993 and 1994 exceeded requirements by \$125 million, the age of over half the inventory is not in the database, and shortages exist in over 25 percent of inventory items. Readiness is threatened because the condition of some ammunition is unknown, the single item manager has made little progress in implementing the 1994 Integrated Ammunition Stockpile Management Plan, inventory excess to one service is not used to fill another service's needs, and funding to manage the stockpile adequately and dispose of ammunition has not been forthcoming. DoD partially concurred with the report findings but disagreed with the report recommendation and the options presented by GAO for handling ammunition storage and the disposal problem.

b. DoDIG Reports. The six DoDIG reports summarized their audit work related to the Air Force FYs 1992, 1993, and 1994 financial statements and addressed concerns relative to obligations and disbursements and deficiencies preventing the rendering of audit opinions.

(1) DoDIG Report 94-048, Uncleared Transactions By and For Others, 2 March 1994. Management was not exercising needed oversight to clear transactions and reduce undistributed disbursements and collections valued at

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\$34.6 billion as of 31 January 1993. Higher priority placed on disbursements than on resolving uncleared transactions created the risk of violating the Antideficiency Act. DFAS Headquarters managers did not receive complete and accurate information from the centers on the status of undistributed disbursements. Transactions over 180 days old were understated by about 860,000 transactions and at least \$7.2 billion. The Deputy Comptroller disagreed that disbursements were not being matched to obligations, but agreed the policy requiring this action may not be fully carried out, and generally concurred with the finding related to reporting by the DFAS centers.

(2) DoDIG Report 94-073, Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements, 31 March 1994. DoDIG concluded that DFAS-DE did not prepare complete, accurate, and reliable FY 1992 Air Force financial statements. They reported that DFAS-DE did not comply with the DoD Accounting Manual or maintain effective procedures and internal controls over its systems. In addition, DoDIG determined that internal controls over the budgetary process were ineffective. Further, the audit disclosed that the Statement of Operations did not include all activity affecting Air Force operations. As a result, revenues were overstated by \$424.5 million; support for operating expenses was unavailable for leases of \$8.3 billion, asset damage of \$568.7 million, and bad debts of \$24.7 million; extraordinary losses of \$1.2 billion were excluded; and prior period adjustments of \$13.0 billion were incorrect or omitted. Finally, DoDIG concluded DFAS-DE did not validate the accuracy of construction-in-progress data and did not adhere to Air Force guidance on government-furnished material and contractor-acquired material when preparing the financial statements.

(3) DoDIG Report 95-067, Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements, 30 December 1994. DoDIG reported that DFAS-DE did not adequately monitor US Treasury clearing accounts. Specifically, DFAS-DE did not reconcile differences, maintain accounts related to contract payments, monitor old accounts, or prepare written procedures for account oversight. These conditions could allow improper payments to go undetected and cause defense accounting offices to lose their authority to disburse available appropriated funds. DoDIG also reported that accounts receivable and payable reported on the FY 1993 financial statements contained material errors because internal controls over manual computations used to calculate these balances did not ensure that only Air Force data was presented in the statements. DFAS-DE included a claim (receivable) against a contractor on a foreign military sales direct cite contract and a corresponding payable amount to the Foreign

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Military Sales Trust Fund. As a result, Accounts Receivable-Public and Accounts Payable-Federal were overstated by \$605 million each. DFAS-DE either concurred or concurred in principle with all recommendations and agreed to establish policies and procedures to monitor US Treasury clearing accounts and to improve the processes used to compile and compute the amounts shown on the financial statements.

(4) DoDIG Report 95-264, Defense Finance and Accounting Service Work on the Air Force FY 1994 Finance Statements, 29 June 1995. DoDIG reported that DFAS-DE did not adequately monitor the MAFR system because they did not designate a security manager for the system. Further, DFAS-DE did not perform periodic reviews to determine whether individuals had a continued need for access, and had not prepared written procedures for system security oversight. In addition, DoDIG reported that the MAFR system does not maintain audit trails or transaction histories for transactions originating at DFAS-DE. DFAS-DE agreed to complete a center operating instruction on MAFR system security by 30 September 1995. To correct the lack of an audit trail, DFAS-DE will implement the Defense Cash Management System during January 1998.

(5) DoDIG Report 95-301, Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements, 29 August 1995. DoDIG identified four major deficiencies preventing auditors from rendering audit opinions: adequate accounting systems were not in place; assets were not reported adequately or valued properly; disbursements and collections were not adequately disclosed; and contingent liabilities were not recognized or adequately disclosed. DoDIG used examples of Air Force deficiencies cited in the AFAA reports referenced in paragraph 7c below. In addition, DoDIG reported the following: the Air Force selected five accounting systems as the interim migratory accounting system to allow the Air Force to meet accounting system standards. While DFAS-DE established a September 1998 date for implementation, the interim migratory accounting system has not been approved by the Air Force or DFAS Headquarters. Further, military department auditors noted the planned general ledger systems will not fully integrate financial management systems with nonfinancial systems such as acquisition, logistics, supply, civil engineering, and other systems that compile data needed by the financial systems. The report stated DoD, DFAS, and military departments have initiated actions to ensure disbursements, collections, and contingent liabilities were properly disclosed, but that actions to date have not corrected the conditions. The report contained no recommendations requiring management action.

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(6) DoDIG Report 96-156, Implementation of the DoD Plan to Match Disbursements to Obligations Prior to Payment, 11 June 1996. DFAS took aggressive actions to meet legislative requirements by implementing the DoD plan to match contractor and vendor invoices to corresponding obligations before paying them. For transactions that were prevalidated, those actions generally ensured that disbursements could be matched to corresponding obligations; however, prevalidation efforts did not reduce the overall magnitude of problem disbursements. Increased prevalidation was needed due to weaknesses in the prevalidation system. HQ DFAS personnel did not have the necessary information to monitor the status and measure the success of prevalidation efforts because DFAS did not ensure reporting complied with existing guidance or identify needs for other management information. The Deputy Chief Financial Officer concurred with all findings and agreed to take action to implement system changes, develop and document procedures for prevalidation, improve the use and accuracy of prevalidation data, and provide needed training.

c. AFAA Reports. AFAA issued audit opinions on the FYs 1992 through 1995 Air Force consolidated financial statements.

(1) Report of Audit 92053011, Opinion on Fiscal Year 1992 Air Force Financial Statements, 29 June 1993. The report disclaimed an opinion on the FY 1992 Air Force consolidated financial statements because of material uncertainties related to the reasonableness of amounts reported in the financial statements and the adequacy of Air Force accounting systems. DFAS-DE assembled amounts reported on the statements from a variety of separate information systems of uncertain reliability, and, for most items, auditors were unable to verify account balances. In addition, Air Force management did not provide management or legal representation letters. Also, the Air Force internal control structure did not provide reasonable assurance of achieving the internal control objectives described in OMB Bulletin 93-06. Finally, the Air Force did not fully comply with laws and regulations that materially affect the financial statements.

(2) Report of Audit 94053022, Opinion on Fiscal Year 1993 Air Force Consolidated Financial Statements, 30 June 1994. We reported the conditions found in FY 1992 continued in FY 1993, resulting in a disclaimer of opinion on the FY 1993 Air Force consolidated financial statements. Air Force and accounting personnel errors found in the property, plant, and equipment and real property accounts ranged from \$83 million to \$18 billion, and DFAS-DE disbursement and collection records contained over 12,000 unreconciled

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differences valued at \$3.3 billion. While Air Force physical controls over assets were generally effective, Air Force and DFAS controls used to compile and report accurate, complete, and reliable financial information required improvement. Existing Air Force and DFAS systems and controls impacted compliance with laws and regulations which materially affect the financial statements. We also reported noncompliance with other laws and regulations that materially affect the financial statements.

(3) Report of Audit 94053001, Opinion on Fiscal Year 1994 Air Force Financial Statements, 1 March 1995. This report also disclaimed an opinion. Air Force and DFAS accounting errors caused double counting and over- and understatements of financial statement lines ranging from \$9.4 million to \$1.8 billion. The financial statement line items affected included accounts receivable; accounts payable; operating expenses; property, plant, and equipment; and progress payments; and the contingent liabilities footnote understated this liability by \$72.3 billion. The DFAS-DE presentation of negative unliquidated obligations resulted in less than full disclosure of conditions and an understatement of over \$1.5 billion. Air Force was not using the DoD Uniform Chart of Accounts, controls over computers continued to be lacking, independent verifications of sensitive assets were not always performed, and weaknesses were noted in computer system access and cash controls. Existing Air Force and DFAS policies, procedures, systems, and controls caused the Air Force to be in danger of violating the Antideficiency Act, FMFIA, and the Prompt Payment Act. We identified defense accounting office noncompliance with DoD and Air Force regulations, primarily in not performing required reconciliations.

(4) Report of Audit 95053001, Opinion on Fiscal Year 1995 Air Force Financial Statements, 1 March 1996. This report disclaimed an opinion on the FY 1995 Air Force financial statements. Account balances for property, plant, and equipment and operating materials and supplies could not be determined, and the value of government furnished property reported was \$33.9 billion less than that reported in the Defense Logistics Agency Contractor Property Management System. Collection and disbursement mismatches totaling over \$1.1 billion were identified; satellite launch cost of over \$673 million, and munitions, aircraft, and photo shelters valued at \$4.3 billion were excluded from the financial statements; and satellites, depot munitions, and signal system assets valued at over \$1 billion were double counted. Various supply systems continued to contain inventory and unit price errors, and progress payments exceeding \$312 million were recorded in the wrong fiscal year. Accounts receivable, accounts payable, expenses, and obligations in excess of \$227 million were either invalid, inadequately supported,

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or inaccurate. Over \$1.5 billion in noncontingency transactions were reported as contingent liabilities. The preceding findings resulted from internal control weaknesses, primarily because reviews of accounting reports and transactions and required reconciliations were not being performed. Finally, internal control weaknesses and systems not conforming to Comptroller General standards were not always reported in the annual Statement of Assurance in accordance with the FMFIA.

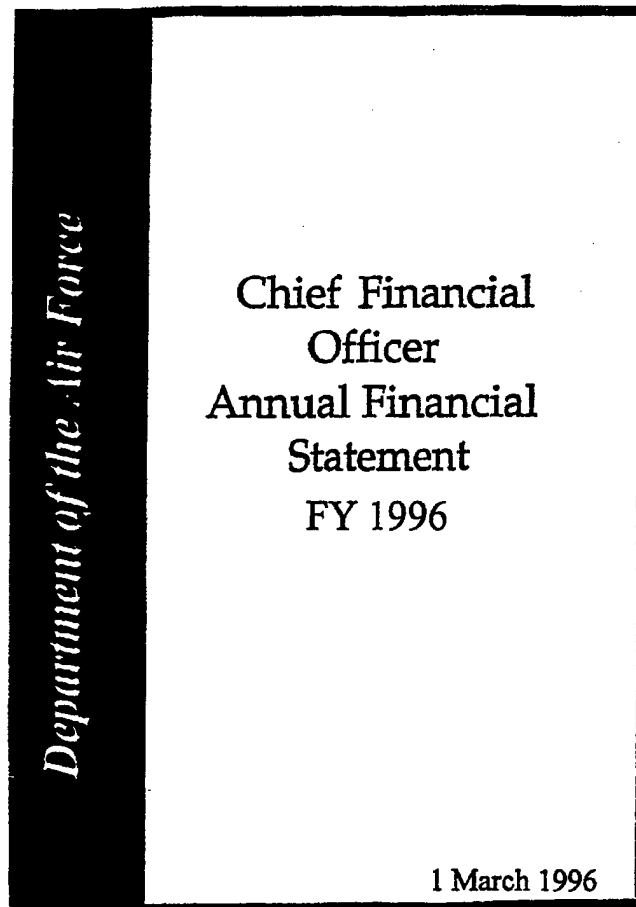
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FINANCIAL STATEMENTS AND NOTES



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Financial Statements and Notes

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Overview



SECRETARY OF THE AIR FORCE
WASHINGTON

JUN 18 1997

MEMORANDUM FOR CHIEF FINANCIAL OFFICERS

SUBJECT: General Funds Overview

Over the past year, in operations on every continent and across the spectrum of conflict, the United States Air Force has demonstrated its readiness and repeatedly confirmed the unique strengths that we offer our Nation. We can certainly expect that in an uncertain world, the United States will continue to face threats of various sorts.

We are building an Air Force that will provide this Nation the capabilities it will demand of its air and space force far into the future. To do that, we have recently formulated a new vision document entitled *Global Engagement: A Vision for the 21st Century Air Force*. The document highlights our six core competencies and identifies key initiatives to meet the Nation's air and space needs.

To meet these needs, we utilize substantial sums of the public's resources. The total Air Force budget for Fiscal Year 1996 amounted to more than \$74 billion. This report documents our use of those resources and so meets the requirements of the Chief Financial Officers Act of 1990.

While they remain substantial, Air Force budgets declined sharply as the Cold War ended. We are striving to make more efficient use of our remaining resources through initiatives such as acquisition reform and outsourcing and privatization.

We also realize that we need to reform our financial management systems and practices. We must do so in order to provide the information our commanders require to manage efficiently. We also need financial management reform to comply with current laws that require a full and accurate accounting to the public for the monies we spend. The Air Force seeks to establish itself as a leader in financial management reform.

On September 18, 1997, the Air Force will celebrate its 50th birthday. Through a combination of warfighting skills and careful management, we have served the Nation well for half a century. On the foundation of this golden legacy, we will build our boundless future.

Attachment:
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AIR FORCE MISSION

The Air Force Mission is to **DEFEND** our Nation, to **DETER** aggression, and when called upon to **FLY, FIGHT, & WIN** our Nation's wars operating as a **TOTAL FORCE** composed of Active, Air Force Reserve, and Air National Guard units.

★★★★★

- ★ In order to effectively fulfill these commitments, we need **PEOPLE** functioning under an efficient & responsive organization, operating out of many locations (**PLACES**), and using many weapons systems (**THINGS**). However, during the 1990s, as the Cold War has wound down, our resources and organizations have undergone historic changes. Our **PEOPLE** have been reduced, many **PLACES** have been eliminated, and we have fewer **THINGS**.

PEOPLE

Active duty personnel have decreased significantly. While our Reserve forces have not experienced as severe a reduction, it must be realized that their mission commitments have grown significantly.

Active:

FY90

FY96



Military
535,000



Civilian
215,000



Military
389,000



Civilian
151,000

Reserve Forces (Air Force Reserve & Air National Guard):

FY90

FY96



Military
201,000



Technicians
34,000



Military
183,000



Technicians
33,000

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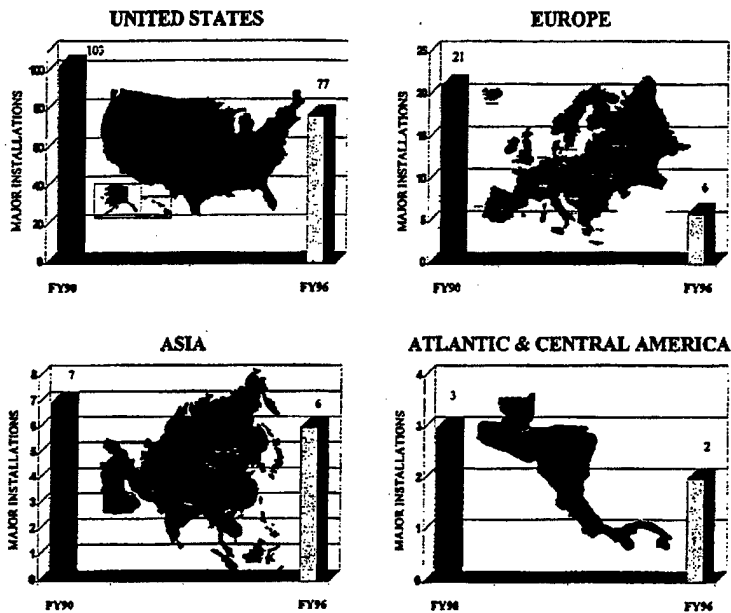
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PLACES

Correspondingly, the bases from which we operate have been significantly reduced.



Note: While the Air Force has closed a significant number of installations, in many cases they have retained ownership. Less than 4500 acres have been permanently transferred to the civil sector.

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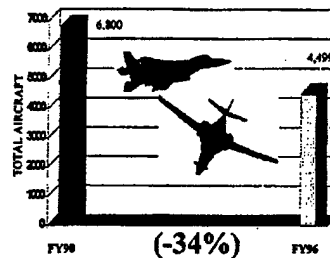
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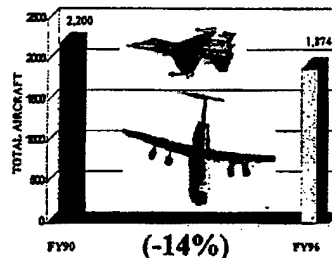
THINGS

Aircraft weapons systems, the basic means by which we discharge our responsibility to DEFEND & DETER, have also declined dramatically:

ACTIVE



RESERVE/GUARD FORCES



Note: While the total number of aircraft has steadily declined (e.g., 288 were dropped in FY 96 alone), the value as reflected in the Assets section of the Financial Statement has increased. This is primarily due to: (1) the value of one new aircraft is significantly higher than the value of older aircraft that were dropped, (2) there was a change in the accounting method used for evaluating the excess & surplus property account, and (3) a major cataloging error in the value of ammunition was corrected in FY96.

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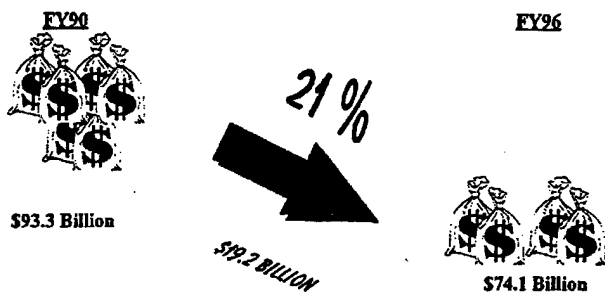
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FUNDING

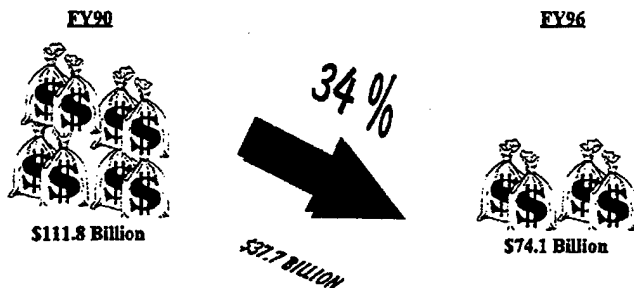
These reductions are clearly reflected by the steep decline in funding over this period of time:

Air Force General Fund Budget Authority

- ★ Current (then-year) Dollars: (Not adjusted for inflation (i.e., rate of inflation distorts and understates the programmatic effect of funding changes))



- ★ Constant (real) Dollars: (Adjusted for inflation (i.e., the programmatic changes are not distorted by inflation))



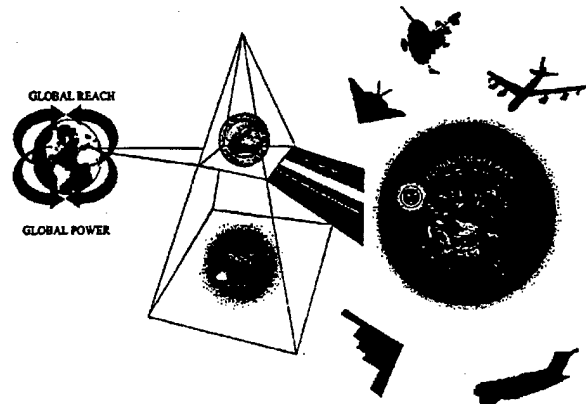
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AIR FORCE VISION



Our strategic architecture for the 1990s has been *Global Reach - Global Power*. This document drove the way we restructured and reorganized the Air Force, and it has driven our modernization priorities. *Global Reach - Global Power* gave the Air Force its map for the 90s, the initial vision of the post-Cold War world environment. But the Air Force is approaching the edge of that map, and it needs a new vision, a more comprehensive map, to guide it well into the 21st Century. As the Air Force moves into the future, its priorities must be well defined and be in lock step with the Nation's priorities.

The backbone of our military advantage is technology. During the Cold War, we countered numerical superiority with advanced technology. We have continued to push this advantage to arrive at new levels in the form of stealth, smart munitions, information warfare, and the effective use of space. Any look into the future must be based to a large degree on what technology is available, or will be available, that will enable us to continue to substitute technological superiority for numerical superiority. Two recent visionary studies, *New World Vistas* and *Air Force 2025* serve as a prism which reflects the Air Force's new look into the future -- **GLOBAL ENGAGEMENT: A VISION FOR THE 21st CENTURY AIR FORCE**.

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- ★ Fifty years ago, at the birth of the Air Force, a study called **Toward New Horizons** was accomplished. Completed during an era of propeller driven fighters and massed bomber raids, this study established a vector towards many of the Air Force's current capabilities:



TOWARD
NEW
HORIZONS

- Supersonic aircraft
- Pilotless aircraft
- The Global Positioning System (GPS)
- Precision guided munitions
- Weather satellites

- ★ A year ago, the Secretary of the Air Force (SECAF) and the Chief of Staff of the Air Force (CSAF) asked the Scientific Advisory Board to look at the technical possibilities opening over the next fifty years. The objective was to repeat the New Horizons study of 1946. The board reported its findings in **New World Vistas** and they are inspiring. Consider these possibilities:



NEW WORLD
VISTAS

- Directed-energy weapons, like airborne lasers and high powered microwaves
- Unmanned aerial vehicles in combat roles
- Every airplane carrying a digital map of the world with 1 meter resolution
- GPS with 1-centimeter accuracy
- Extensive integration of military and commercial space efforts
- Using precision-guided munitions expertise to deliver supplies right to their point of use
- Continuous worldwide hyperspectral observations with 5-to-10 meter accuracy using small distributed satellites
- Hypersonic stealthy transport aircraft

- ★ The CSAF also tasked the Air University at Maxwell AFB, AL to look 30 years into the future to identify the concepts, capabilities, and technologies the United States will require to remain the **DOMINANT** air and space force in the 21st Century. The resulting study is called **AIR FORCE 2025**, or 2025 for short. This is an extensive study consisting of a collection of "white papers" totaling about 3,300 pages of text, which use the concept of alternate futures as a backdrop against which these papers were developed. From these complex and studied attempts to see the future, certain *systems*, *technologies*, and *trends* emerged that serve as brilliant pointers to the future.



AIR FORCE
2025

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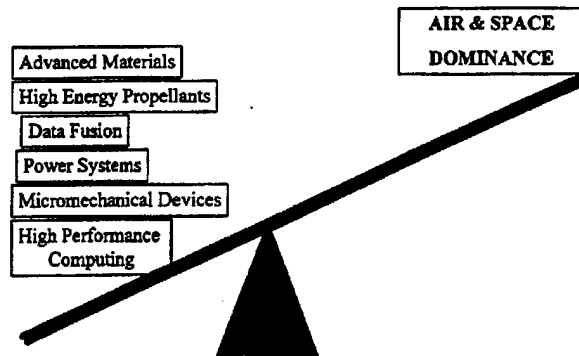
TOP SYSTEMS

- *Global Information Management System *
- *Sanctuary Base *
- *Global Surveillance, Reconnaissance, *
- Target System *
- *Global Area Strike System *
- *Attack Microbots *



- *Space High Energy Laser*
- *Solar High Energy Laser*
- *Uninhabited Combat Air Vehicle*
- *Reconnaissance Unmanned Air Vehicle*
- *Piloted Single Stage Space Plane*

HIGH LEVERAGE TECHNOLOGIES



These are the six high leverage technologies that have emerged from this study as the best investments to ensure the United States' continued air & space dominance in the future.

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TRENDS

| | Move From | To |
|---|------------------|---------------|
| Humans | "in the cockpit" | "in the loop" |
| Air Force Operation Medium | Air & space | Space & air |
| Development of Critical Technologies and Capabilities | Government | Industry |
| Exertion of Influence | Bombs | Information |
| Military Education | Rigid | Responsive |

While these forecasted *Systems*, *Technologies*, and *Trends* may seem hard to understand and conceptualize today, past experience has shown that what appears far-fetched now becomes common place in the future.

The Air Force must integrate information technologies with air and space capabilities to produce what the 2025 team calls the *VIGILANT EDGE*. A future *full service* Air Force providing this *VIGILANT EDGE* is central to providing our national security into and through the 21st Century.

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GLOBAL ENGAGEMENT: A VISION FOR THE 21ST CENTURY AIR FORCE



- ★ The Chairman of the Joint Chiefs of Staff recently published a document with his vision of the future called *Joint Vision 2010 (JV2010)*. This document clearly states that the overall strength of the military establishment will be based on each Service's *Core Competencies*, but those core competencies must support the *joint vision*. It is important for the Air Force to know and understand the elements of that *vision* as it begins its look at the new long range strategic game plan and lays out operational concepts for the future.
- ★ The Air Force's new look into the future is its vision of **GLOBAL ENGAGEMENT**. This is not just a lofty statement of intent, but is an *actionable* vision, a vision specific enough for action, and specific enough so that the Air Force can lay out pathways to take us toward our goals. The foundation of this vision is the Air Force's *Core Competencies* which fully support the operational concepts of Joint Vision 2010.

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| | |
|--|---|
| <ul style="list-style-type: none"> • Air and Space Superiority • Global Attack • Rapid Global Mobility • Precision Engagement • Information Superiority • Agile Combat Support | <ul style="list-style-type: none"> • Dominant Maneuver • Precision Engagement • Full-Dimensional Protection • Forward Logistics |
|--|---|

| | |
|------------------------------------|---|
| AIR & SPACE SUPERIORITY | Control the battlespace through the atmosphere into the void of space |
|------------------------------------|---|



Control of the battlespace begins at the perimeter, goes beyond the perimeter, and extends out to air and space. The Air Force cannot be just defensive in its approach to gaining full-dimensional protection. Full-dimensional protection means air and space superiority, not just freedom from attack, but freedom to attack. It's denying the enemy any kind of sanctuary, because the Air Force must own the enemy's battle-space. U.S. forces need to be able to operate with impunity throughout the entire battle area. This is not just air superiority, it is **AIR DOMINANCE**.

★★★★★

| | |
|----------------------|--|
| GLOBAL ATTACK | Project power rapidly, precisely, and globally |
|----------------------|--|

This competency was clearly shown last August in Operation Desert Strike, the joint strike against Iraqi air defense facilities. B-52s from Barksdale AFB, LA were staged out of Guam on a 34-hour mission and fired 13 conventional air-launched cruise missiles (CALCM). This B-52/CALCM weapons system demonstrated our Nation's ability to project power rapidly.



Rapid power projection is not just a group of individual sorties, but is being institutionalized in the Air Force as an *Air Expeditionary Force (AEF)*. An AEF consists of fighters, tankers, attack airplanes, and other types of aircraft that deploy overseas for a limited time to provide a deterring presence and to conduct actual combat operations if needed. Tied to this deploying force are bombers in the U.S. that are poised to deploy within hours if needed.

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- The power of this AEF concept was vividly demonstrated during the past year by actual deployments to Bahrain, Qatar, and Jordan. Within 48 hours after notification to deploy, these forces were flying their first combat sorties. In a relative instant, the Air Force had a balanced capability for air superiority, precision attack missions, and suppression of enemy air defenses.
- In the coming year, the Air Force expects to deploy AEFs to areas outside the Middle East and to exercise the concept under controlled conditions at a Red Flag exercise in Nevada.
- In the longer term, we expect this concept to mature into a significant component of our global capability, at which point we'll adapt our operational and logistics systems to support its widespread use.

★★★★★

RAPID GLOBAL MOBILITY

Air lifters contribute greatly to our global presence

Our airlifters provide this nation the ability to shape and influence events around the world. The C-17 will provide the backbone of this capability. In its first full year in operation, it has already dramatically demonstrated its capability by the insertion of Bradley fighting vehicles into Tuzla, Bosnia in late December of 1995 to bolster the U.S. ground presence.



★★★★★

PRECISION ENGAGEMENT

The ability to apply lethal force very discriminately



The Air Force has been a leader in developing precision engagement technologies, with current systems like JSTARS (Joint Surveillance Target Acquisition Radar System) to new precision weapons like JDAM (Joint Direct Attack Munitions) and JASSM (Joint Air to Surface Stand Off Missile). Another system on the leading edge of technology is the Airborne Laser (ABL) -- a way to attack theater ballistic missiles during the boost phase.

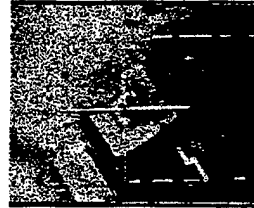
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Precision weaponry is essential to modern air operations. In *Vietnam*, about 0.2% of the weapons expended were precision; in *Desert Storm*, where the general perception of a "video war" prevailed, only about 9% of the bombs were precision guided; in *Deliberate Force* more than 60% of the bombs dropped by NATO forces were precision guided. This steadily expanding growth of precision weaponry not only enables the Air Force to strike more targets with far less exposure of friendly forces, but also enables it to significantly limit collateral damage, which has become a highly visible issue in the media-intensive environment in which the Armed Forces operate.



★★★★★

INFORMATION SUPERIORITY

Be aware of your opponents' general and specific capabilities & how to counter them



The Air Force is focusing huge resources, energy, and attention to achieving not only information superiority, but **INFORMATION DOMINANCE**. Airborne Warning And Control System (AWACS), JSTARS, and Rivet Joint are proven heavyweights in this area. We are working closely with the National Reconnaissance Office (NRO) to integrate information flow in a real-time operational mode. The

Predator Unmanned Aerial Vehicle (UAV) has moved seamlessly from its concept demonstration phase to actual operations as a key component of our information superiority forces.

Awareness of an opponent's capabilities, and how to counter them, provides a critical and often decisive advantage. A good example of this is the airborne reconnaissance system called JSTARS. It is currently being used in the peace enforcement effort in Bosnia. This system provides such incredibly detailed real-time pictures of Serbian movements and encampments that the NATO commander is able to show these pictures to the Serbs and say "See, you can't do anything we don't know about." This is like playing poker and being able to see all the cards - - against an opponent that knows you can do just that. This is **INFORMATION DOMINANCE**.

★★★★★

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| | |
|-----------------------------|--|
| AGILE COMBAT SUPPORT | Uncompromising logistical support for all our nation's fighting forces |
|-----------------------------|--|

The Air Force's basic logistical strategy is changing dramatically. It is trying to shift away from large inventories and take advantage of its communications-based systems so it can move supplies to where they are needed, when they are needed. It is a simple concept, but one that's different from the large stockpiles of spare parts and large war-ready supply kits the Air Force grew up with. Why did these exist? Because during the Second World War, supplies were relatively cheap, while transportation was either non-existent or a very scarce resource. The first step in an operation was moving great mountains of supplies forward. Stores and supplies have become expensive, while transportation and information are relatively cheap. Our Air Mobility Forces, especially the C-17, play a critical role in assuring that we have what we need, where we need it, when we need it.



★ ★ ★ ★ ★

★ These core competencies are the integral part of the Air Force's **GLOBAL ENGAGEMENT** vision and support its commitment to *Joint Vision 2010*.

However, the fulfillment of this vision of **GLOBAL ENGAGEMENT** requires continual attention and refining as environments change and alternate futures come in and out of focus. The Air Force needs to keep *exploring, planning, and preparing* for the future:

| | |
|------------------------|---|
| EXPLORE THE FUTURE | <ul style="list-style-type: none"> Identify alternatives and opportunities for national defense and the role to be played by tomorrow's Air Force Capitalize upon rapid advances in technology, especially in the areas of information, computing, and space-based operations |
| PLAN FOR THE FUTURE | <ul style="list-style-type: none"> Institutionalize long-range planning in the Air Force Formulate a shared, long-range vision of its future in joint war fighting |
| PREPARE FOR THE FUTURE | <ul style="list-style-type: none"> Ensure our people can support the expected changes in tomorrow's Air Force |

To keep its thinking of the future agile and innovative, the Air Force is setting up a number of *focused battle labs* that will be aimed at enhancing capabilities critical to Air Force core competencies: space, air expeditionary forces, battle management, force protection, information warfare, and unmanned aerial vehicles.

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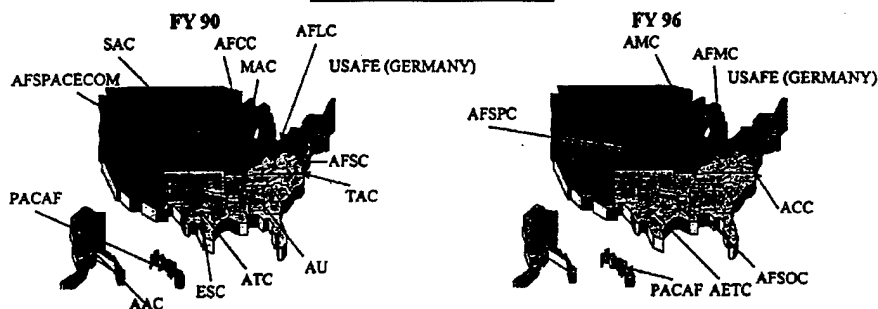
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AIR FORCE ORGANIZATION

Historic changes to the Air Force's operating environment, as to specific mission requirements vs. available resources, made it inevitable that the Air Force organization needed to change and adapt to the new world order. While the national command line, President - DoD - Secretary of the Air Force - Chief of Staff of the Air Force, remained the same, the operating structure of the Air Force saw evolutionary changes as the number of Major Commands (MAJCOMs) dropped from 13 to 8. This evolution can best be shown by a snapshot of the MAJCOMs in 1990 and as they are now in 1996:

AIR FORCE MAJCOMs



| MAJCOM | MISSION | MAJCOM | MISSION |
|--|--|---|---|
| Air Force Communications Command (AFCC) Scott AFB, IL | Provided communication and computer system support | Air Combat Command (ACC) Langley AFB, VA | Tactical & strategic air missions |
| Air Force Logistics Command (AFLC) Wright-Patterson AFB, OH | Provided logistics support | Air Education & Training Command (AETC) Randolph AFB, TX | Train & educate people |
| Air Force Space Command (AFSPACECOM) Peterson AFB, CO | Provided operational command of space | Air Force Materiel Command (AFMC) Wright-Patterson AFB, OH | Systems acquisition from conception to maturity |

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| MAJCOM | MISSION | MAJCOM | MISSION |
|---|--|--|--|
| Alaskan Air Command (AAC) Elmendorf AFB, AK | Provided air support within the Alaskan theater of operations | Air Force Space Command (AFSPC) Peterson AFB, CO | Control & manage systems that operate in space |
| Air Force Systems Command (AFSC) Andrews AFB, MD | Provided technology and acquisition support | Air Force Special Operations Command (AFSOC) Hurlbert Field, FL | Provide specialized and unconventional mission air related support |
| Air Training Command (ATC) Randolph AFB, TX | Recruited & trained people | Air Mobility Command (AMC) Scott AFB, IL | Provide global airlift and refueling support |
| Air University (AU) Maxwell AFB, AL | Provided professional military education | Pacific Air Forces (PACAF) Hickam AFB, HI | Control air operations in the Pacific and Asian theaters |
| Electronic Security Command (ESC) Kelly AFB, TX | Provided electronic combat support and operations security support | US Air Forces in Europe (USAFE) Ramstein AB, GE | Provide air operational support in European theater of operations |
| Military Airlift Command (MAC) Scott AFB, IL | Provided global airlift support | | |
| Pacific Air Forces (PACAF) Hickam AFB, HI | Controlled air operations in the Pacific and Asian theaters | | |
| Strategic Air Command (SAC) Offutt AFB, NE | Performed strategic air mission and provided ICBM capability | | |
| Tactical Air Command (TAC) Langley AFB, VA | Performed tactical air missions | | |
| US Air Forces in Europe (USAFE) Ramstein AB, GE | Provided air operational support in the European theater of operations | | |

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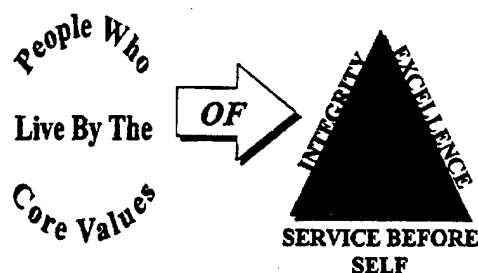
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AIR FORCE INITIATIVES

PEOPLE FIRST

- ★ When people look at the Air Force, they are impressed by high technology: supersonic aircraft, satellites of all kinds, computers, and communications networks at the leading edge of technology. But it's not our technology that ultimately makes the Air Force successful. It's the people operating the technology -- their dedication, their skill, and most important, the core values that they live and work by.



INTEGRITY. Integrity is essential. Everyone must know the right thing to do and have the moral courage to do it. They must be responsible and accountable.

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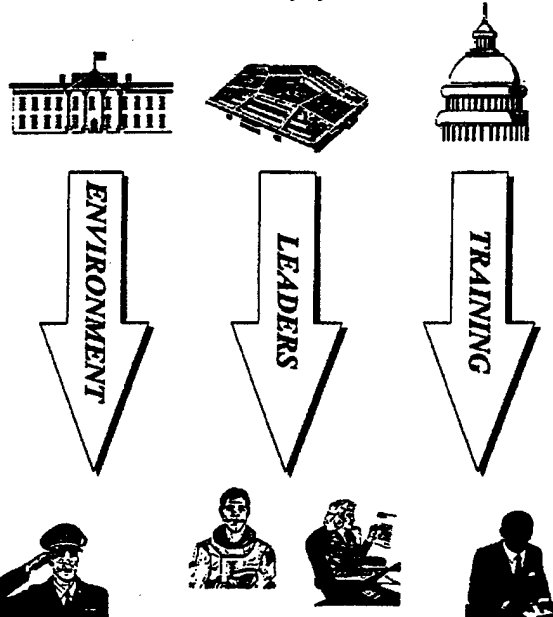
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SERVICE BEFORE SELF. One purpose rises above all others -- to serve your country. Selfless acts of courage and service fill our history books. After all, heroes are only ordinary men and women who place service before self. We need these heroes, now more than ever.

EXCELLENCE. Excellence is not easy. Everyone needs to always perform their critical duties to the best of their abilities. Mediocrity is not wanted -- excellence is.

But this can't be a one way street. We owe our people:



ENVIRONMENT, that treats them fairly, gives them the opportunity to advance based on their merits, and is free of discrimination and harassment. They also deserve working and living conditions that provide an acceptable quality of life.

LEADERS, who are trained to conduct their responsibilities, who take responsibility for their actions and those of their unit, and who in turn are held accountable by their superiors for the outcome of their decisions.

TRAINING, that teaches them to perform their missions safely and effectively in a lethal environment.

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- ★ Last year, the Air Force worked towards a set of personnel goals focused on creating an environment where our people could perform at their best. The actions we have taken in support of these initiatives are:

| GOALS | ACTIONS |
|--|---|
| <p><i>Fair & Equitable Compensation:</i></p> <p>Pursue fair and equitable compensation & benefits that keep pace with inflation and private sector growth, within the confines of current law</p> | <ul style="list-style-type: none"> Fully funded pay raise of: <ul style="list-style-type: none"> → 2.4% in FY96 → 3.0% in FY97 Providing money to provide CONUS COLA for members in high cost areas Successfully pursued legislation to: <ul style="list-style-type: none"> → provide TLE to first-duty station PCSers → fund round-trips to ports → store POV when prohibited overseas |
| <p><i>Safe & Affordable Housing:</i></p> <p>Provide access to safe and affordable housing</p> | <ul style="list-style-type: none"> Upgraded standards for airman dormitories (#1 housing concern) <ul style="list-style-type: none"> → Gained approval of the new 1 + 1 DoD dormitory construction standard. Increases living space and privacy in new dormitory construction projects → Gained approval of new private-room assignment policy for unaccompanied enlisted personnel. New policy to be phased in between FY97-FY02. Increases privacy in existing dormitories → Increased BAQ allowances by 5.2% in 1996 and 4.6% for 1997 → Programmed the replacement or conversion of all remaining permanent party central latrine dormitories by FY00 Accomplished critical maintenance and repair to alleviate deteriorating facilities and infrastructure <ul style="list-style-type: none"> → Increased MFH maintenance funding: applied \$418M to maintenance → Awarded infrastructure projects → Improved housing energy efficiencies → Applied \$100M FY96 Congressional RPM plus-up in dormitories. Helped convert latrine dorms to 1 + 1 Implemented "whole house, whole neighborhood" concept <ul style="list-style-type: none"> → Constructed and revitalized a total of 2,500 housing units |

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| | |
|---|---|
| | <ul style="list-style-type: none"> → Invested \$293M to improve quality of life for Air Force families → Awarded 80% of our program in the year of appropriation, an all-time high that revitalized houses faster for our people |
| Base & Community Programs: Increase and enhance support to community programs | <ul style="list-style-type: none"> • Child Care: <ul style="list-style-type: none"> → Expanding capabilities by building new centers and refurbishing others → Adding 15,000 child care spaces → Training caregivers → Increased supervision of children → Upgrading equipment/supplies • Fitness Centers: <ul style="list-style-type: none"> → Validated 178 additional fitness positions beginning in FY98 → Working to increase operating hours to 112/week -- a 35% increase to 16 hours/day |
| Accessible Quality Health Care: Provide access to quality health care | <ul style="list-style-type: none"> • Implemented Health and Welcome Centers at 37 bases to provide one-stop "shopping" for fitness, health, and prevention activities -- expanding to all bases • Overseas Family Member Dental Program implemented in USAFE -- expanding to PACAF |
| Educational Opportunities: Expand educational opportunities and access | <ul style="list-style-type: none"> • Working to preserve tuition assistance at the current 75% rate • Allow Montgomery GI Bill open season for those who previously declined |
| Reduce Operations Tempo: Balance the impact of high deployment rates | <ul style="list-style-type: none"> • Global sourcing to balance the workload • Reduced taskings where appropriate • Establish Associate Reserve squadron to augment KC-135 units • Standing up an Associate Reserve AWACS squadron • Established strong family and member readiness programs to assist with deployment issues |

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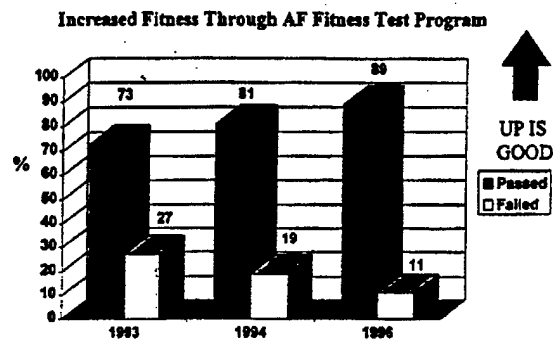
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- ★ Some examples of the performance measures used to determine the Air Force's success with respect to its *Base and Community Program* goals are:

Quality of Life - People Initiatives Base and Community Programs



This indicator shows how the AF Fitness Test Program has improved the fitness of AF members. Percentage of members who passed is steadily climbing.

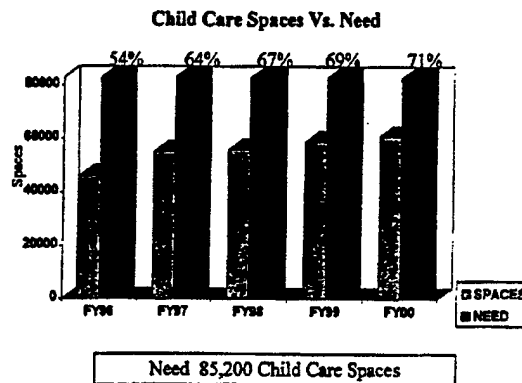
Note: No testing was done during the FY95 software program revision.

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This indicator shows the number of child care spaces provided in comparison to the number of spaces needed.

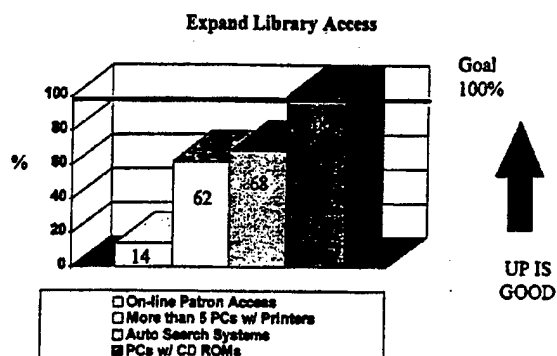
- The Air Force needs 85,200 child care spaces
- Presently meeting 54% of the need for care
- Expanding school age care
- Improving supervision of children

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Depicts the number of Air Force libraries that have on-line/external access; more than 5 computers with direct printing capability; Auto Search Systems that allow patrons to do research and print without going to the library shelves; and PCs with CD ROMs.

★★★

★ A key indicator of the success of the Air Force's Quality of Life programs is the percentage of members reenlisting in FY96.

| | FY95 Goal (%) | FY96 Actual (%) |
|------------|---------------|-----------------|
| First Term | 55 | 59 |
| Mid Career | 75 | 76 |
| Career | 95 | 95 |

* Goals are historical averages

Though the gains are modest, they do reflect an upward trend.

★★★

When the Air Force talks of its people, its weapons systems, and its relationships to other Services and our allies, it is not just speaking of the Active Air Force, but of the Total Force.

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TOTAL FORCE

When we use the concept "jointness", we tend to think of joint-service operations or coalitions with our allies. However, we need to remember that the United States Air Force is in itself a team, the **TOTAL FORCE** of Active Duty, Air Force Reserve (AFRES), and Air National Guard (ANG) members. AFRES/ANG team members have dramatically increased their participation in contingencies and deployments world-wide. The Air Force is re-examining what "balance" of Guard and Active Duty forces will be right in the future. The composition of the *Total Air Force* team is by no means static, but is dynamic and will continue to be so.



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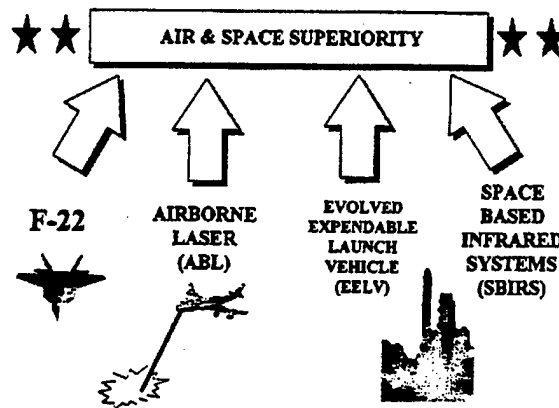
MODERNIZATION

MODERNIZATION STRATEGY:

Technological breakthroughs, as envisioned in *New World Vistas* and *Air Force 2025*, cannot be allowed to happen in a haphazard manner. We need to make sure that they are vectored in ways that fully support the Air Force's movement from *Global Reach* -- *Global Power* to its new vision of the future -- *Global Engagement*. The Air Force weapons system modernization strategy was built around two tenants: (1) it must focus on *Sustaining Core Competencies* and (2) it must be a *Time-Phased Approach* due to fiscal realities.

★ ★ ★ SUSTAINING CORE COMPETENCIES

The Air Force's Core Competencies represent the combination of professional knowledge, air power expertise, and technology that when applied, produces superior military capabilities. These core competencies are the heart of the Air Force's vision of *Global Engagement* which, in turn, is fully supportive of the Chairman Joint Chiefs of Staff's vision for the future, *Joint Vision 2010*. All the Air Force efforts in modernizing its weapon and support systems must in some way be linked to enhancing and sustaining its core competencies.



Allows the Air Force to control the battlespace through the atmosphere into the void of space
★ ★ ★ ★ ★

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GLOBAL ATTACK



BOMBER
UPGRADES



CV - 22

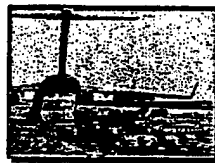


Provides for power projection rapidly, precisely, and globally

★★★★★



RAPID GLOBAL MOBILITY



C -17

Contributes greatly to our Nation's global presence

★★★★★

29

71

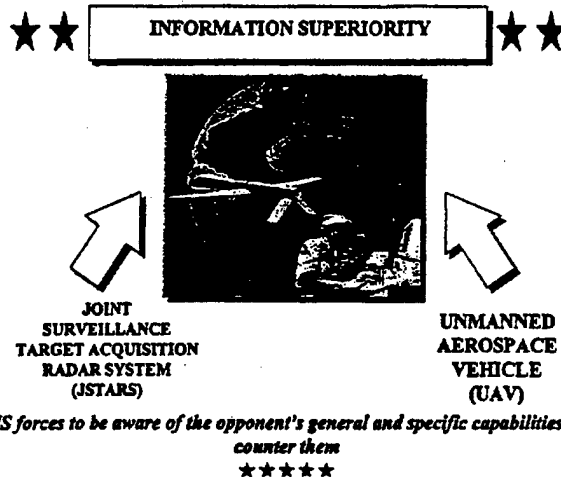
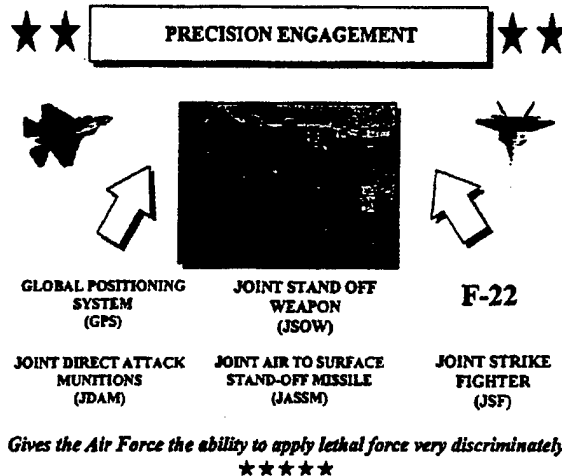
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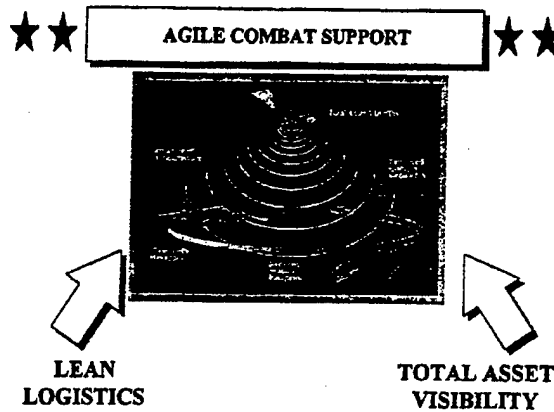


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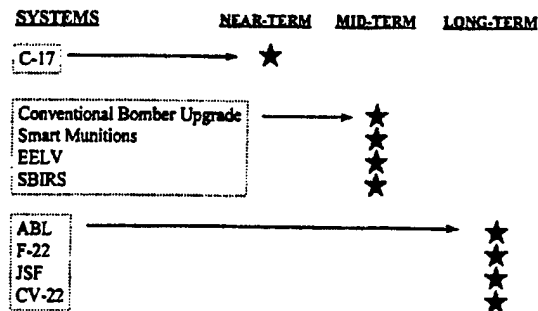
Overview



Provides for uncompromising logistical support for all our Nation's fighting forces
★★★★★

★★★ TIME-PHASED APPROACH

The Air Force's modernization efforts, in addition to being supportive of its core competencies, must be phased in a way that maximizes the use of the Nation's resources.



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BUSINESS REFORMS

OUTSOURCING & PRIVATIZATION:

- ★ *Outsourcing & Privatization (O&P)* is a means to harness the expertise and efficiencies of the commercial sector. Realized savings can be used towards modernization. O&P are receiving strong emphasis from OSD, the Secretary of the Air Force, and the Air Force Chief of Staff. The O&P Panel has been formed as an integral part of the Air Force corporate structure. This panel will review all Air Force activities to determine which functions can be outsourced or privatized. While A-76 cost comparisons will be an integral part of this effort, some activities will be examined with studies of larger scope for possible multi-location business reengineering.

| | |
|--------------------------------------|---|
| OBJECTIVES | <ul style="list-style-type: none">• Maximize the performance, quality, efficiency, and <i>cost effectiveness</i> of Air Force activities• Generate <i>savings</i> for modernization• Focus management attention and resources on <i>core competencies</i> |
| RECENT INITIATIVES | <ul style="list-style-type: none">• Newark privatization in place -- Aerospace Guidance and Metrology Center• Outsourced Altus AFB aircraft maintenance• Stood up Air Force Center for Quality & Management Innovation• Committed to \$1.25B savings through outsourcing & privatization |
| SUCCESS STORY HEADS DOING A-76 GREEN | <ul style="list-style-type: none">• \$5.1 billion cost avoidance since 1979• Average savings is 29%• 13,500 positions announced for study |

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ACQUISITION REFORM:

★ Lightning Bolt Initiatives

The Air Force's "Lightning Bolt" initiatives that have been recently instituted to jump-start the revolution in acquisition processes have already shown tangible results:

- Weapons systems coming on-board at a third of their projected costs
- Aircraft modification programs coming in under cost and ahead of schedule
- Achieved \$17 billion in combined cost savings and avoidance

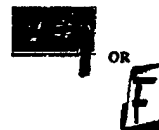


★ Other Air Force Initiatives

The Air Force is far from being finished. We intend to sweep away:

- Shelves of old regulations and directives
- Tons of paperwork
- The adversarial relationships that for so long existed between the Air Force and our partners in industry

This reform movement is not "nice to have" - it is a *PASS-FAIL* item. These reforms must succeed. The Air Force must free up the resources it needs to sustain its modernization programs and place its programs on a solid basis of efficiency. These are not just surface changes to rules and regulations, but real, deep-seated changes in the whole culture and mindset in which the Air Force does business. And this reformed way of thinking must be *institutionalized* so it doesn't blow away with the next shift in the wind.



The Air Force dare not fail in these reforms, for if it does, it will fail in its efforts to build the capabilities needed to execute its missions - it will have failed our Nation and our people.

While these reforms have started in the acquisition area, they are occurring throughout the financial arena as well.

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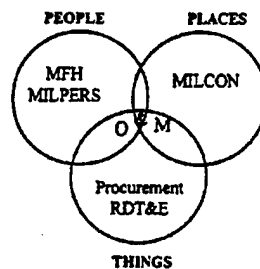
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FINANCIAL HIGHLIGHTS

- ★ The \$74.1 billion Air Force FY96 budget was composed of different programs which can be related to the PEOPLE who perform the mission, the THINGS they use to perform the mission, and the PLACES from which they perform the mission.



| APPROPRIATION | PRIMARY PURPOSE | AMOUNT IN BILLIONS |
|---|--|--------------------|
| Military Family Housing (MFH) | Used for construction & maintenance of living quarters for military personnel | \$1.1 |
| Military Personnel (MILPERS) | Payment of military personnel | \$19.3 |
| Military Construction (MILCON) | Construction of military facilities that have an extended life | \$0.8 |
| Procurement (Proc.) | Purchase of "capital" expenditure items vs. "expense" type items | \$16.7 |
| Research, Development, Test, & Evaluation (RDT&E) | Development of new weapon systems technologies | \$12.7 |
| Operations & Maintenance (O&M) | Used for day-to-day operations of our bases (heat, light, supply items of an expense nature, etc.) and the pay of civilian employees | \$23.5 |
| TOTAL | | \$74.1 |

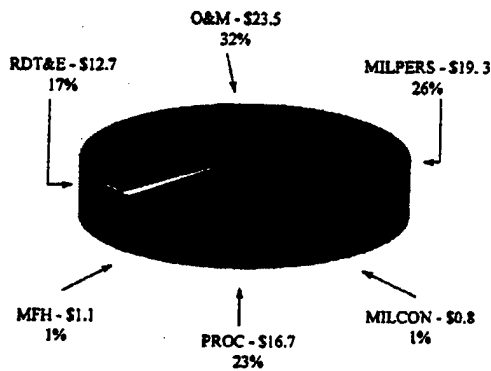
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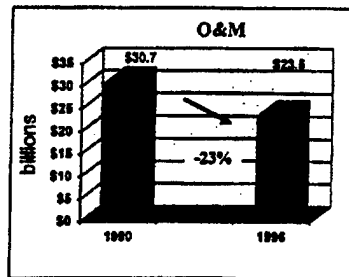
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FUND DISTRIBUTION (\$ In Billions)



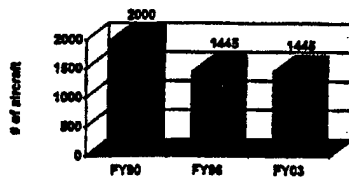
★ During the turbulent 1990s, the substantial downsizing of our *people, places, and things* has been mirrored by a steady and steep funding decline (amounts are in constant dollars):



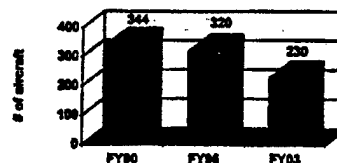
While there was a significant decline in Operations & Maintenance, some key force structures declined and are projected to decline even more.

This suggests a need to trim infrastructure by moving to more economical modes of operations (e.g., outsourcing & privatization).

FIGHTERS



STRATEGIC AIRLIFT



35

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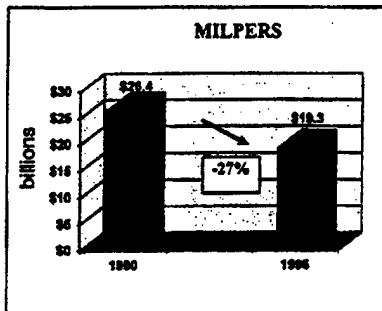
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This drop in funding reflects the aggressive downsizing that the Air Force military force has undergone since 1990; however, unseen in the aggregate numbers are the uneven reductions in certain career fields. These low density, high demand career fields are still a challenge:

- Combat Control Teams
- RC - 135RJ
- A/OA-10A
- HC - 130
- U - 2

These shortages, along with the increased demands of our global military force policy, cause our deployment operations tempo or PERSTEMPO to become too high with respect to certain weapon systems.

The Air Force has taken a series of steps to share the burden of these taskings and posture the force to sustain the tempo. We have a goal for limiting the time Air Force people spend deployed to no more than 120 days per year. To achieve this goal, the Air Force structured a strategy to:

- Share the burden of these taskings across the force so that temporary duty (TDY) days are more equitable
- Eliminate or find alternative capabilities where taskings allow
- Adjust our forces where appropriate to meet the need, using the ANG and Reserve when possible

As we sought to share the wealth, the Air National Guard and the Air Force Reserve have once again proven their professionalism. Our combat commanders long ago ceased to ask whether the Air Force units deployed to their theaters are active duty or not; they confidently, and rightly so, expect that any unit from across our Total Force can provide the capabilities they need.

The effort to spread the deployment burden has also been strengthened by our adaptation of Global Sourcing Conferences, which have enabled us to take a force-wide look at requirements and ensure an equitable tasking level across our commands.

The results of these efforts in one of the Air Force's major commands -- Air Combat Command -- is shown in the following graphs:

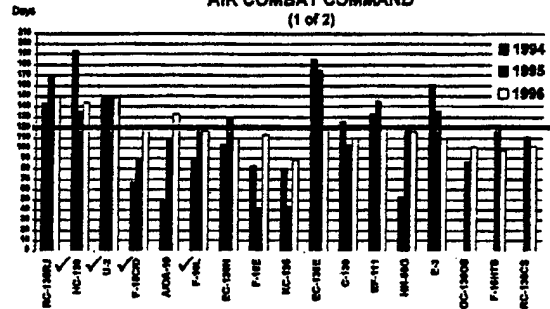
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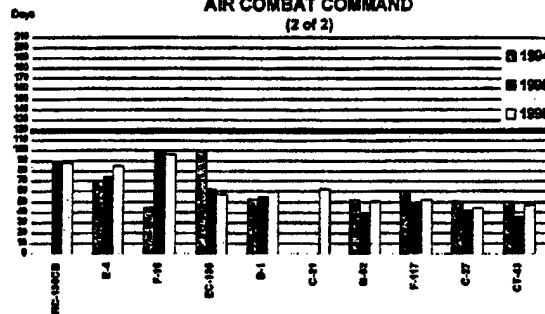
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Days Away from Home by
Aircraft or Specialty (FYs 94-96)
AIR COMBAT COMMAND
(1 of 2)



Days Away from Home by
Aircraft or Specialty (FYs 94-96)
AIR COMBAT COMMAND
(2 of 2)



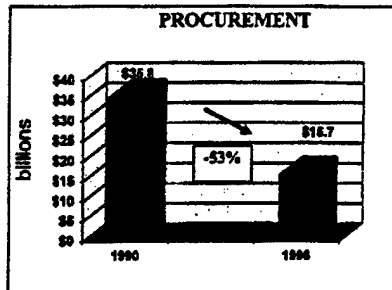
While the Air Force has made considerable progress in some weapons systems, Air Force leadership needs to continue to do all it can to achieve its goal of less than 120 days/year.

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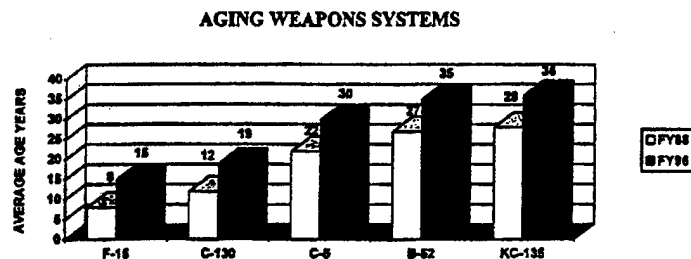
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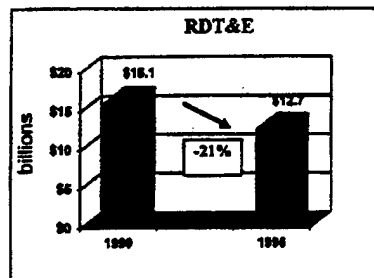
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One result of this draconian reduction of more than half of the procurement appropriations is the rapid aging of the Air Force's primary asset, airplanes. Some examples are:



These are just a few examples of how the Air Force's fleet is rapidly aging due to the lack of new weapon systems coming on line and the fact that current weapon systems are not being upgraded with new procurements. These five weapons systems represent 36% of our total operational fighter/bomber/tanker/airlift force. In fact, the entire Air Force inventory has an average age of 17 years.



Though the Air Force's commitment to RDT&E has decreased; the expansion of the Air Force into space has increased significantly.

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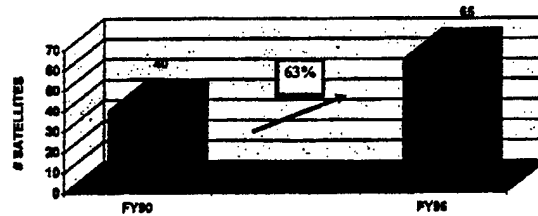
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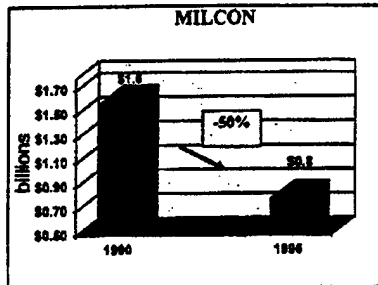
FORCE STRUCTURE: SATELLITES ON ORBIT



- Satellites (e.g., GPS, POLAR, SBIRS, MILSTAR, etc.)

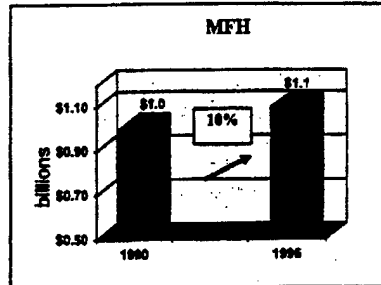
This increase, along with the aging of the aircraft inventory, are the beginning signs of the movement of the Air Force from an Air and Space mission to a Space and Air mission.

MILCON



This 50% drop in the Military Construction appropriation is consistent with the decrease in major Air Force military installations from 134 in FY90 to 91 in FY96, a drop of 32%.

MFH



It is interesting to note that the only appropriation to increase from FY90 to FY96 was the Military Family Housing appropriation. This shows that the Air Force really is committed to putting people first wherever and whenever it can.

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CURRENT FINANCIAL REFORM EFFORTS

★ IMPROVING FINANCIAL SYSTEMS:

The Air Force has undertaken many initiatives to improve its financial systems. Some improvements are required to make them CFO compliant; others are for the sake of process improvement. Some systems are owned, and therefore the responsibility of the Air Force; others are owned and are the responsibility of the Defense Finance and Accounting Service (DFAS). Although some improvements can be accomplished through short-term upgrades to current systems, other systems must be totally replaced or require major revisions. Unfortunately, replacing legacy systems or initiating major improvements is a long, tedious process – quick fixes are simply not possible. Some of the Air Force's major efforts are described below.

- The Air Force has joined forces with the Defense Finance and Accounting Service – Denver Center (DFAS-DE) in an effort to expedite and enhance their development of an interim migratory general accounting system. The Air Force established a team representing all MAJCOMs and Field Operating Agencies (FOAs) to augment DFAS-DE in this prodigious undertaking. Developing a transaction-driven general ledger general accounting system is the cornerstone to the Air Force becoming CFO Act compliant. This system, currently called the Defense Joint Accounting System (DJAS), was chosen by the DoD Comptroller to be the interim migratory general accounting system for both the Air Force and the Army – a major step in DoD's efforts to consolidate and standardize its financial systems. It is scheduled to be operational by FY01. Additionally, the Air Force supports and is incorporating a standardized accounting code called the Budget and Accounting Classification Code (BACC) into its version of DJAS and into its modernization of its budget information system.
- Implementing BACC is a monumental undertaking to incorporate a standard data structure within the DoD. Benefits include better communication between systems, data warehousing, standard reporting, and reduced future system costs.
- The Air Force's modernized budget information system will be called the Financial Information Resource System (FIRST). This system will result in a seamless budget system environment, a paperless environment through electronic sharing, standardization of data elements and technology, and faster, more accurate access to budget execution information. Phase I of this modernization is expected to be operational in FY98. Complete modernization is scheduled to be deployed by FY00.

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- The Air Force strongly supports the move towards a paperless environment. It is developing the Automated Business Services System (ABSS) and testing the DFAS initiative, Electronic Data Access (EDA). ABSS is an electronic commerce/electronic data interchange (EC/EDI) commitment document processing system that consolidates the best parts of four other Air Force EC/EDI initiatives. The system's features include: generation of electronic forms and funding documents, user-specific pick screens/lists for form data population, automatic routing for internal and external coordination, electronic signature, automated commitments, and automated upload of our standard contracting systems. A primary ABSS benefit is single data entry, which is expected to help reduce Air Force problem disbursements. Additional benefits include: reduced paper handling, reduced processing cycle time, improved document traceability, and reduced DFAS reconciliation efforts. ABSS is currently being field tested and is scheduled for deployment in FY98. The Army, Navy, and Defense Logistics Agency are also reviewing ABSS for possible implementation.
 - Electronic Data Access (EDA) will provide multiple DoD communities on-line, real-time access to documents, primarily post award contracts and modifications, used to support the procurement, contract administration, contract payment, and accounting processes. EDA replaces the voluminous paper trail by providing a single "electronic file cabinet" that can be accessed by any authorized DoD user. All users, especially DFAS, expect to realize both monetary and manpower savings through process improvements. The Air Force hopes to fully implement EDA during FY97.
 - The Air Force has also undertaken another major initiative called Transfer of Management Responsibility (TMR) which is designed to identify and subsequently improve the numerous systems that feed our general accounting system. The primary focus is on the plant, property, and equipment feeder systems. The Financial Management and Comptroller community is working with the Air Force Audit Agency and a private contractor to identify which systems are not CFO compliant and what it will take to fix them. The results of this project are scheduled to be reviewed by early 1997.
- ★ **IMPLEMENTING ACTIVITY-BASED COSTING (ABC) AND THE GOVERNMENT PERFORMANCE AND RESULTS ACT (GPRA):**

Activity-based costing (ABC), as implemented by the Air Force, is a solution to the problem of not having a current cost accounting system, nor one in the foreseeable future. Initial findings of ABC applicability at base level show promise for not only functional managers, but base/wing commanders as well. The Air Force is currently producing a handbook showing the value of ABC at base level and is concurrently identifying MAJCOM ABC Points Of Contact for education/training in Feb 97. A web site with general ABC information is being built with the idea that its broad applicability can meet the needs of outsourcing and privatization decisions, continuous process improvement identification, business process reengineering decisions, and identification of value-added and non value-added processes. Implementing ABC will also

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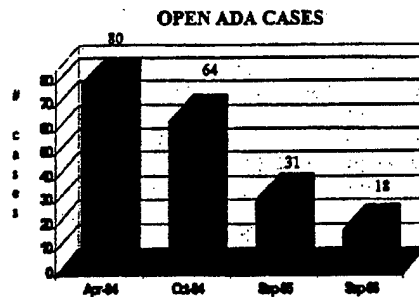
facilitate Air Force implementation of the GPRA, which focuses on measuring the outcome of resource inputs, such as manpower and dollars.

★ MAKING CFO STATEMENTS MORE USEFUL:

All Air Force functional communities made a concerted effort to improve this year's financial statements. This year's Overview and Supplemental sections contain more descriptive material and clearly demonstrate the Air Force's intention of implementing the provisions of the Government Performance and Results Act (GPRA). These sections feature the relationships between budget changes and broad measures of performance.

★ REDUCED ANTIDEFICIENCY ACT CASES:

- The Antideficiency Act (ADA) is codified in sections of Title 31, United States Code, and limits the amount of funds available for obligation and expenditure in an attempt to avoid situations of deficient funding. Funds are only available if authorized and appropriated as to correct purpose, time, and amount. ADA violations are reported to the President, Office of Management and Budget, and the Congress.
- The Air Force Assistant Secretary (Financial Management and Comptroller) has placed considerable emphasis on *reducing* the number of ongoing ADA investigations. As a result, the number of active ADA investigations continues to significantly decline -- dropping from 31 in FY95 to 18 at the end of FY96.



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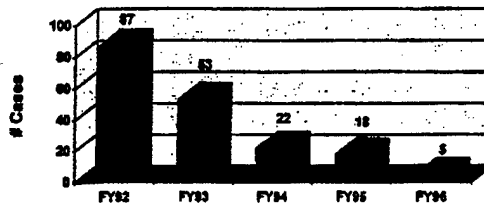
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- An equal amount of emphasis has been placed on *preventing* ADA violations. For example, the number of new Air Force ADA cases reported and investigated has dropped from a FY92 high of 87 to a FY96 low of 5 cases.

NEW ADA CASES



The Air Force attributes the significant drop in the number of reported ADA violations to improved ADA guidance and increased fiscal awareness training.

★ REDUCED PROBLEM DISBURSEMENTS:

- Problem Disbursements are made up of Unmatched Disbursements (UMDs), Negative Unliquidated Obligations (NULO's), and Aged In-Transit Disbursements. A UMD is a financial disbursement that cannot be readily matched to a recorded obligation. A NULO is a financial disbursement that appears to exceed the obligation to which it has been matched. Aged In-Transit Disbursements are those disbursements reported to Treasury, but not yet recorded by the Accounting Station.
- During the past three years, the Air Force has worked hand-in-hand with the Defense Finance and Accounting Service (DFAS) to reduce the overall level of problem disbursements by more than 70%. During FY96, they declined by 35%. Improving Problem Disbursements lessens the chances of over-payments and over-obligations, thereby raising public confidence.

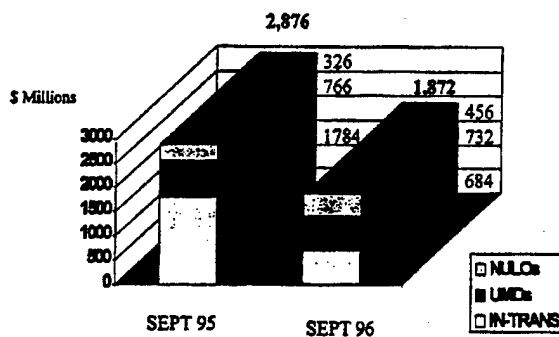
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TOTAL AIR FORCE PROBLEM DISBURSEMENTS



* IMPROVING COMPLIANCE:

- In 1993, the Air Force established a joint Defense Finance and Accounting Service/Air Force plan to improve compliance with accounting requirements. A comprehensive listing of CFO-related audit recommendations was developed and used to track the status of corrective actions. As a result of this increased emphasis, over 70 percent (or over 300) of the recommendations have been closed.
- The Air Force also made a concentrated effort in FY96 to improve the Federal Managers Financial Integrity Act (FMFIA) Statement. SAF/FM, with the assistance of the Air Force Audit Agency (AFAA), the Air Force Inspector General (AF/IG), and the Air Force Communications and Information Community (AF/SC), made significant progress in improving internal controls, computer security, and inventory management.

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★ WORKING SMARTER:

- The Air Force has been in lock step with the DFAS efforts to consolidate accounting operations within the Air Force. An additional 22 bases were consolidated in FY96, for a total of 35 bases. With a huge push in FY97, this effort will be largely completed within the CONUS. The primary benefit of consolidated accounting operations is reduced operating costs.
- Just as we're making noteworthy progress in improving our financial systems, the Air Force is also striving to increase financial automation. We have developed and deployed an *Automated Battlefield System (ABS)*, are in the midst of deploying a *Financial Management Local Area Network (LAN)* to facilitate paperless transactions, and utilized "expert system" technology to develop a decision support system for upward obligation adjustments.
- Faced with the necessity of having to do less with less, the Financial Management community initiated various workload reduction initiatives. Examples include the *streamlining of*: the annual financial plans, the internal management control program, the use of the International Merchant Purchase Authorization Card (IMPAC) for small purchases, and the automated travel system.

★ SEEKING OUTSIDE ASSISTANCE:

Making progress in the financial management reform arena requires dedicated human resources and a wide depth and breadth of expertise. Last year, SAF/FM created a *Financial Reform Office* that is responsible for the facilitation of the numerous, usually prodigious efforts that must take place. This year, the Financial Management community has sought to take advantage of all available resources by contracting studies with various commercial industry experts, developing an excellent relationship with the Financial Executives Institute, and fully utilizing the manpower and wealth of expertise of the Air Force Audit Agency.

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FINANCIAL REFORM EFFORTS FOR THE FUTURE

"Long Range Planning does not deal with future decisions -- but with the future of present decisions."

-- Peter Drucker

The results of our decisions on how the financial community will support the Air Force's vision of **GLOBAL ENGAGEMENT** in moving effectively into the 21st Century are documented in the:



At the heart of this Strategic Plan are major goals that seek to improve the Air Force's ability to carry out its financial management activities. These goals relate to people, our key resource; seek better ways to organize our activities, use technology, make decisions; and also address major current issues.

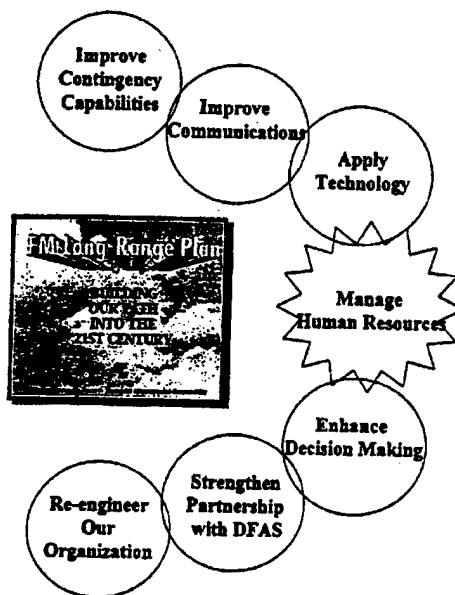
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★★GOALS★★



While all these goals are linked together, the **KEY LINK** remains our **PEOPLE**.

Some of the many subobjectives relating to these goals are:

Define & Improve our Wartime Fighting & Contingency Capabilities. Develop Automated Battlefield Systems to provide remote financial management capabilities during contingencies and deployments.

Improve Communications. Provide centralized guidance for continued improvement of computer and communication techniques and technologies throughout the comptroller field.

Apply Technology For More Responsive Systems. Improve financial processes, systems, and compliance procedures within existing systems through the use of on-hand and commercial off-

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the-shelf technology. Incorporate new ideas to streamline the resource allocation and resource management processes.

Manage Human Resources. Ensure a cross flow of people, both military and civilian, between DFAS and the Air Force and between acquisition and operational commands. Make sure our people receive adequate training to perform at their maximum potential and high achievers are publicly rewarded and recognized.

Enhance Decision Making. Through analysis, identify high pay off areas for analysis and improve our analytical capabilities by: adapting the best analytical procedures used by other governmental departments and agencies, and integrating analytical capabilities already developed in the field with analysts at base and MAJCOM levels.

Strengthen Partnership With DFAS. Consolidate links between Air Force and DFAS to ensure that accounting and finance systems and processes provide our customers with world-class services.

Re-engineer Our Organization to Better Serve Our Customers. Determine the financial management needs of our customers and then identify the financial management organization functions, tasks, and manpower required to completely satisfy these needs.

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INTO THE 21ST CENTURY

- ★ As the Air Force starts its journey into the next 50 years and beyond, it is postured to build on the foundation of its *golden legacy* to construct its *boundless future*.

The Air Force has defined GLOBAL ENGAGEMENT as the strategic vision that will take it into the 21st Century and this vision lays out a comprehensive vector toward an exciting future.

- ★ We will continue to work hard to ensure we recruit and train our Nation's top quality youth to serve. To retain them, we will continue to provide them and their families with a reasonable quality of life.
- ★ We will move toward an increasing emphasis on expeditionary capabilities, and develop the systems and logistics structures to support that goal.
- ★ We will regenerate the ingenuity and flexibility that is part of our birthright, but which we have neglected for years. We will build "battle labs", for example, to let us test and field equipment and operational concepts in realistic conditions much quicker than has been the case in the past.
- ★ We will continue the efforts of the past years and capitalize on the experience we have gained to reduce our infrastructure and support costs.

- ★ The force of the next century is beginning to take shape - - but we know that there
- ★ are many surprises along the path to that future. Perhaps the only certainty is that
- ★ our future will be built on the most solid foundation imaginable - - the legacy of
- ★ integrity - - service above self - - and excellence created by millions of Air Force
- ★ people over five decades.
- ★

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Limitations of the Financial Statements

The financial statements included in this report have been prepared to report on the financial position of the Air Force pursuant to the requirements of the CFO Act of 1990.

While the statements have been prepared from the books and records of the Air Force, in accordance with the formats prescribed by OMB, the statements are different from the financial statements used to monitor and control budgetary resources that are prepared from the same books and records.

The statements should be read with the realization that they are for a federal entity, that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities, other than for contracts, can be abrogated by the sovereign entity.

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Department of Defense
Department of the Air Force
Statement of Financial Position
as of September 30, 1996
(in Thousands)

1996

1995

ASSETS

1. Entity Assets:

a. Transactions with Federal (Intragovernmental) Entities:

| | | |
|---|--------------|--------------|
| (1). Fund Balance with Treasury (Note 2) | \$50,663,271 | \$54,780,775 |
| (2). Investments, Net (Note 4) | 863 | |
| (3). Accounts Receivable, Net (Note 5) | 1,378,292 | 1,362,859 |
| (4). Interest Receivable, Net | | |
| (5). Advances and Prepayments | 1,904 | 3,152 |
| (6). Other Federal (Intragovernmental) (Note 6) | | |

b. Transactions With Non-Federal (Governmental) Entities:

| | | |
|--|-----------|-----------|
| (1). Investments (Note 4) | | |
| (2). Accounts Receivable, Net (Note 5) | 189,637 | 186,606 |
| (3). Credit Program Receivables/Related Foreclosed Property, Net (Note 7) | | |
| (4). Interest Receivable, Net | | |
| (5). Advances and Prepayments | 7,106,537 | 8,121,479 |
| (6). Other Non-Federal (Governmental) (Note 6) | | |

c. Cash and Other Monetary Assets (Note 3)

42,437

d. Inventory, Net (Note 8)

36,519,292

e. Work in Process (Note 9)

f. Operating Materials/Supplies, Net (Note 10)

23,936,463

g. Stockpile Materials, Net, (Note 11)

h. Seized Property (Note 12)

i. Forfeited Property, Net (Note 13)

**j. Goods Held Under Price Support and
Stabilization Programs, Net (Note 14)**

k. Property, Plant and Equipment, Net (Note 15)

246,058,972

234,478,315

l. Other Entity Assets

m. Total Entity Assets

\$341,961,205

\$322,869,649

2. Non-Entity Assets:

a. Transactions With Federal (Intragovernmental) Entities:

| | | |
|--|--------|--------|
| (1). Fund Balance With Treasury (Note 2) | 47,661 | 54,492 |
| (2). Accounts Receivable, Net (Note 5) | | |
| (3). Interest Receivable, Net | | |
| (4). Other (Note 6) | | |

The accompanying notes are an integral part of these statements.

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Department of Defense
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as of September 30, 1996
(in Thousands)

| | 1996 | 1995 |
|--|----------------------|----------------------|
| Assets Continued | | |
| 2. Non-Entity Assets Continued: | | |
| b. Transactions With Non-Federal (Governmental) Entities: | | |
| (1). Accounts Receivable, Net (Note 5) | 9,410 | 773,902 |
| (2). Interest Receivable, Net | 46,616 | |
| (3). Other (Note 6) | 7,851 | 621 |
| c. Cash and Other Monetary Assets (Note 3) | 68,726 | 113,791 |
| d. Other Non-Entity Assets | | |
| e. Total Non-Entity Assets | <u>\$180,264</u> | <u>\$942,806</u> |
| 3. Total Assets | <u>\$342,141,469</u> | <u>\$323,812,455</u> |
| LIABILITIES | | |
| 4. Liabilities Covered by Budgetary Resources: | | |
| a. Transactions With Federal (Intragovernmental) Entities: | | |
| (1). Accounts Payable | 101,602 | 1,147,223 |
| (2). Interest Payable | | |
| (3). Debt (Note 16) | | |
| (4). Other Federal (Intragovernmental) Liabilities (Note 17) | 722,395 | 839,553 |
| b. Transactions With Non-Federal (Governmental) Entities: | | |
| (1). Accounts Payable | 2,342,764 | 3,989,962 |
| (2). Accrued Payroll and Benefits | | |
| (a). Salaries and Wages | 1,057,347 | 474,889 |
| (b). Annual Accrued Leave | | |
| (c). Severance Pay and Separation Allowance | 17,275 | 16,643 |
| (3). Interest Payable | | |
| (4). Liabilities for Loan Guarantees (Note 7) | | |
| (5). Lease Liabilities (Note 18) | | |
| (6). Pensions and Other Actuarial Liabilities (Note 19) | | |
| (7). Other Non-Federal (Governmental) Liabilities (Note 17) | 17,113 | 2,357 |
| c. Total Liabilities Covered by Budgetary Resources | <u>\$4,258,496</u> | <u>\$6,470,627</u> |

The accompanying notes are an integral part of these statements.

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(In Thousands)

Liabilities Continued

5. Liabilities Not Covered By Budgetary Resources:

a. Transactions With Federal (Intragovernmental) Entities

- (1). Accounts Payable
- (2). Debt (Note 16)

(3). Other Federal (Intragovernmental) Liabilities (Note 17)

b. Transactions With Non-Federal (Governmental) Entities

- (1). Accounts Payable
- (2). Debt (Note 16)
- (3). Lease Liabilities (Note 18)
- (4). Pensions and Other Actuarial Liabilities (Note 19)

(5). Other Non-Federal (Governmental) Liabilities (Note 17)

**c. Total Liabilities Not Covered by
Budgetary Resources**

6. Total Liabilities

NET POSITION (Note 20)

7. Balances:

- a. Unexpended Appropriations
- b. Invested Capital
- c. Cumulative Results of Operations
- d. Other
- e. Future Funding Requirements
- f. Total Net Position

8. Total Liabilities and Net Position

| | 1996 | 1995 |
|--|----------------------|----------------------|
| | 993,134 | |
| | 6,142,964 | 1,812,972 |
| | <u>\$7,136,098</u> | <u>\$1,812,972</u> |
| | <u>\$11,394,594</u> | <u>\$8,283,599</u> |
| | 48,303,502 | 50,867,644 |
| | 289,574,853 | 266,433,656 |
| | 2,830 | |
| | 1,788 | 1,714 |
| | <u>(7,136,098)</u> | <u>(1,774,158)</u> |
| | <u>\$330,746,875</u> | <u>\$315,528,856</u> |
| | <u>\$342,141,469</u> | <u>\$323,812,455</u> |

The accompanying notes are an integral part of these statements.

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Department of Defense
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For the Period Ended September 30, 1996
(in Thousands)

1996 1995

REVENUES AND FINANCING SOURCES

| | | |
|---|---------------------|---------------------|
| 1. Appropriated Capital Used | 56,262,701 | 55,309,619 |
| 2. Revenues from Sales of Goods and Services | | |
| a. To the Public | 227,172 | 191,258 |
| b. Intragovernmental | 2,992,020 | 3,371,274 |
| 3. Interest and Penalties, Non-Federal | 8,934 | |
| 4. Interest, Federal | 47 | |
| 5. Taxes (Note 21) | | |
| 6. Other Revenues and Financing Sources (Note 22) | 372 | 37,226 |
| 7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies | (8,934) | |
| 8. Total Revenues and Financing Sources | <u>\$59,482,312</u> | <u>\$58,909,377</u> |

EXPENSES

| | | |
|--|---------------------|---------------------|
| 9. Program or Operation Expenses (Note 23) | 55,848,245 | 54,629,305 |
| 10. Cost of Goods Sold (Note 24) | | |
| a. To the Public | 227,172 | 191,258 |
| b. Intragovernmental | 2,992,020 | 3,371,274 |
| 11. Depreciation and Amortization | | |
| 12. Bad Debts and Write-offs | 6,548 | 5,937 |
| 13. Interest | | |
| a. Federal Financing Bank/Treasury Borrowing | | |
| b. Federal Securities | | |
| c. Other | 3,172 | 3,460 |
| 14. Other Expenses (Note 25) | 479,589 | 873,497 |
| 15. Total Expenses | <u>\$59,556,746</u> | <u>\$59,074,731</u> |
| 16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items | (74,434) | (165,354) |
| 17. Plus (Minus) Extraordinary Items (Note 26) | | |
| 18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | <u>(\$74,434)</u> | <u>(\$165,354)</u> |

The accompanying notes are an integral part of these statements.

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(in Thousands)

EXPENSES Continued

| | 1996 | 1995 |
|---|----------------------|----------------------|
| 19. Net Position, Beginning Balance, as Previously Stated | \$315,528,856 | \$318,338,519 |
| 20. Adjustments (Note 27) | <u>3,788,199</u> | |
| 21. Net Position, Beginning Balance, as Restated | 319,317,055 | 318,338,519 |
| 22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | (74,434) | (165,354) |
| 23. Plus (Minus) Non Operating Changes (Note 28) | 11,504,254 | (2,644,309) |
| 24. Net Position, Ending Balance | <u>\$330,746,875</u> | <u>\$315,528,856</u> |

The accompanying notes are an integral part of these statements.

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Footnotes

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE AIR FORCE GENERAL FUNDS FY 96

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation:

These financial statements were prepared to report the financial position and results of operations of the Department of the Air Force, as required by the Chief Financial Officers (CFO) Act of 1990, and other appropriate legislation. They were prepared from the books and records of the Air Force in accordance with DoD guidance on the form and content of financial statements (as adopted from OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements"), and DoD's accounting policies which are summarized in this note. These statements, therefore, are different from the financial reports, also prepared by the Air Force pursuant to Office of Management and Budget (OMB) directives, used to monitor and control DoD's use of budgetary resources.

The CFO Act requires the Air Force prepare and submit for audit financial statements for each revolving fund and trust fund of the Department and each fund and account performing substantial commercial functions during the preceding fiscal year. The Comptroller of the Air Force is required to issue two consolidated financial statements for FY 96, which include the Statement of Financial Position and Statement of Operations and Changes in Net Position.

B. Reporting Entity:

The United States Air Force was created on September 18, 1947, by the National Security Act of 1947. The National Security Act Amendments of 1949 established the DoD and made the Air Force a department within DoD. The overall mission of the Air Force is to defend the United States through control and exploitation of air and space.

The accompanying consolidated financial statements of the Air Force include the accounts of the general, special, deposit, and trust funds under the Air Force's control. The consolidated financial statements account for all funds for which the Air Force has responsibility except information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The audited financial statements are presented on the accrual basis of accounting (as required by DoD accounting policies) with the exception of the Gift and Cadet fund accounts and year-end cut-off procedures which are usually immaterial. However, reference Note 31 for problems concerning the Accrued Expenditure Report which could be material. Financial statements and reports are prepared by the Defense Finance and Accounting Service - Denver Center, Directorate of Departmental Accounting (DFAS-DE/AD) based upon data provided by over 100 financial reporting systems, some of which are the General Accounting and Finance System (GAFS), Standard Base Supply System (SBSS), Medical Materiel Accounting System (MMAS), and major command unique systems which feed into general funds. In addition, feeder data are supplied by the Air Force Academy Accounting and Finance Office for the Cadet Fund, and by DFAS-DE/AD for the Gift Fund which is administered by DFAS-DE/AD. Other entities also send data for consolidation such as Army Corps of Engineers and Department of the Navy.

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DFAS-DE/AD uses the Departmental On-Line Accounting and Reporting System (DOLARS) to consolidate and prepare Air Force level budgetary reports. Monthly, file transfer protocol (FTP) is used to transmit data from the base, operating location, or major command, depending on the report. The data are programmatically validated by DOLARS programs and then automatically updated in the departmental database. Data are also updated in the database through manual entries. Appropriation Status of Funds reports are prepared from this single, integrated database, thus enabling consistent, accurate, and timely reporting. All data in the database have readily available audit trails at departmental level.

The financial statements presented herein are prepared by the CFO reporting system using data from DOLARS, records summarized in the Air Force service-unique general ledger, and other external data. A plan to accomplish initial tasks (phase one) required for a conversion to a transaction driven general ledger (using the DoD standard general ledger structure) was approved by DFAS-HQ. Additionally, the Defense Joint Accounting System is in development to blend the Air Force information management and DFAS financial systems into a comprehensive management information system (see Note 1D(2)).

The Air Force incorporates into the accounting systems internal controls, reconciliations, management by exception reports, and other check and balance processes to enhance required general ledger controls.

The following is a list of Air Force account numbers and titles:

| <u>Air Force Account Number</u> | <u>Title</u> |
|---------------------------------|---|
| 57 * 0704 | Military Family Housing (O&M and Construction) |
| 57 * 1999 | Unclassified Receipts and Expenditures, AF |
| 57 * 3010 | Aircraft Procurement |
| 57 * 3011 | Procurement of Ammunition |
| 57 * 3020 | Missile Procurement |
| 57 * 3080 | Other Procurement |
| 57 * 3300 | Military Construction, AF |
| 57 * 3400 | Operations and Maintenance (O&M), AF |
| 57 * 3500 | Military Personnel, AF |
| 57 * 3600 | RDT&E, AF |
| 57 * 3700 | Reserve Personnel, AF |
| 57 * 3730 | Military Construction, Reserve |
| 57 * 3740 | O&M, Reserve |
| 57 * 3830 | Military Construction, ANG |
| 57 * 3840 | O&M, ANG |
| 57 * 3850 | ANG Personnel |
| 57 * 5095 | Wildlife Conservation, Military Reservations, Air Force (Special Fund Accounts) |
| 57 * 8418 | Air Force Cadet Fund |
| 57 * 8928 | Air Force General Gift Fund |
| 57 * 3XXX | Budget Clearing Accounts |
| 57 * 6XXX | Deposit Fund Accounts |

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C. Budgets and Budgetary Accounting:

The Air Force's activities are financed by general, trust, special, deposit, and revolving funds. These notes describe the attributes of these funds.

General fund accounts are used to record the amounts appropriated by Congress and the financial transactions utilizing the funds. The Air Force manages 16 general fund accounts: 7 are funded by annual year appropriations and 9 are funded by multi-year appropriations. The appropriations made available in FY 96 include:

| (Thousands) | |
|---|---------------------|
| (General Funds Only) | |
| Budget Authority | \$74,164,067 |
| Other | (1,461,021) |
| Appropriations Net of Adjustment | 72,702,976 |
| Return of equity to Treasury for closing Accounts | (1,419,044) |
| Net Appropriations Available for FY 96 | <u>\$71,283,932</u> |

Trust fund accounts are used to record the receipt and expenditure of funds held in trust by the Government for use in carrying out specific purposes or programs in accordance with the terms of a trust agreement or statute. Trust accounts include funds collected through gifts and bequests (as well as interest earned on the investments of some of these gifts) and assets held for particular purposes. The Air Force maintains two trust fund accounts totaling \$4.7 million in assets.

Special fund accounts are credited with collections from specific sources that can only be used in accordance with specific provisions of law. The Air Force manages one special fund account, the Wildlife Conservation Program, totaling \$.7 million in assets. This special fund account had appropriations available of \$.6 million.

Deposit funds are generally used to 1) hold funds whose distribution awaits legal determination or for which the Air Force acts as agent or custodian, and 2) account for unidentified remittances. The Air Force expressly requires all check collections to pass under the immediate control of one of these deposit funds upon receipt, regardless of source, if the ultimate recipient is unknown. The Air Force deposit fund accounts total \$45 million in assets.

D. Basis of Accounting:

Transactions are recorded on an accrual basis of accounting, with the exception of the Cadet and Gift Trust Fund accounts (described in detail in a subsequent note) which are on a cash basis. Also see Notes 1D(6) and 31 for other exceptions to the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized when liabilities are incurred without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. All interfund balances and transactions were eliminated.

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Financial Statements and Notes

The financial statements are presented in accordance with the accounting principles and reporting standards contained in the DoD Financial Management Regulation (DoD 7000.14-R Volume I). There are, however, five areas in which the accounting systems do not currently comply with existing DoD accounting standards. These areas include:

(1) Chart of Accounts. Prior to and since being capitalized by DFAS, systems used to account for Air Force funds have not implemented the standard DoD general funds general ledger (GFGL) chart of accounts. DoD directives require a general ledger system be established using the standard DoD chart of accounts to provide primary internal management information. This deficiency has been reported in the Air Force Federal Managers Financial Integrity Act (FMFIA), Section 4, Conformance Review and Evaluation of Accounting Systems.

(2) General Ledger. Prior to and since being capitalized by DFAS, systems used to account for Air Force funds have not implemented a true transaction driven general ledger system to provide a consolidated source of financial management information for either management or financial statement purposes. To account for its resources, the Air Force utilizes an extensive number of external systems to account for, control, and report on the status of resources. Many of these systems are outside the accounting and finance network controlled by DFAS (i.e., budget and property systems) and the general ledger accounting process. This deficiency has been reported in the Air Force FMFIA, Section 4, Conformance Review and Evaluation of Accounting Systems. DFAS has initiated a project to integrate and modernize DFAS accounting systems into a comprehensive management system. The overall goal is to bring financial data for both general funds and Defense Business Operations Fund (DBOF) under general ledger control complying with General Accounting Office (GAO) and OMB mandates. The general ledger system will be transaction driven, and utilize the DoD Uniform Chart of Accounts. On August 31, 1995, DFAS received approval to proceed to the concept exploration and development phase of the program. This phase began in December 1995 and was completed June 12, 1996, with the publication of General Ledger/Funds Control (GL/FC) Concept Design Requirements. During March-May 1996, DFAS accomplished an evaluation of the Corps of Engineers Financial Management System (CEFMS). The result was a recommendation to the Under Secretary of Defense, Comptroller on July 23, 1996, that CEFMS be adopted for Air Force General Funds and be modified to support Air Force customers, replacing the GL/FC project. A CEFMS baseline has named the Defense Joint Accounting System (DJAS) to support General Funds accounting for Air Force customers as well as accounting for Army and Transportation customers. It is anticipated that DJAS will be operational in December 1999.

(3) Government Furnished Material (GFM) Costs. DFAS-DE has identified GFM as a deficiency in the FMFIA, Section 4, Conformance Review and Evaluation of Accounting Systems (see Note 15J(10)).

(4) Inventory/Equipment. The Air Force uses different valuation methods for the various categories of materials and equipment contained in the Air Force inventory. Materials inventory and equipment items accounted for in logistics systems are valued at standard price (latest acquisition cost). Generally, latest acquisition costs are based on prices paid for recently acquired items plus surcharges for handling, distributing and other costs which result in their being higher than historical cost. Real property installed equipment is valued at cost and is included as part of the real property facility cost basis. The valuation system is not in compliance with existing and

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soon-to-be-implemented federal accounting standards. The DoD Comptroller has directed an inventory valuation methodology (which is a departure from generally accepted accounting principles) allowing the Air Force to continue to use latest acquisition costs in logistics systems for equipment valuations and for valuations of inventory for financial statements. The Air Force has implemented this inventory valuation methodology.

(5) Capitalizing Aircraft and Missile GFM and Modifications Cost. The Air Force does not generally capitalize the cost of aircraft and missile contract modifications made after the initial acquisition (see Note 15J(2)).

(6) Overlapping systems and sources sometimes produce data that conflict or appear suspect. Areas where data are not totally reliable are in closed year account balances, separation allowances for foreign nationals, progress payments, and public receivables. Receivables in closed accounts were adjusted departmentally because of missing data. Other unreliable data include the Accrued Expenditure Report provided by DFAS-Columbus. Data from this report are used to migrate obligations from the undelivered orders outstanding stage to the accrued expenditures unpaid stage based on work-in-progress and holdback data available at DFAS-Columbus. This report includes several negative balances that were not included in financial statements (see Note 31).

E. Revenues and Other Financing Sources:

The Air Force is financed primarily through appropriations provided by Congress for annual and multi-year purposes. The following Treasury accounts are used to fund, execute, and report on total financial activity.

(1) General Funds. This grouping contains the bulk of congressional appropriations including operations, research, development, test and evaluation (RDT&E), investment, and construction accounts. Operation accounts represent those funds used for the pay of operating forces. These funds also finance the functional and administrative support needed to operate and maintain Air Force installations.

The Air Force conducts and contracts for RDT&E of advanced weapons systems which are normally expensed. The RDT&E programs support modernization of weapon systems through military research, exploratory development, and the development and testing of prototypes and full-scale preproduction of hardware.

Investment/construction accounts are used for specific purposes approved by and reportable to Congress. These accounts are used for the acquisition or construction of technology, property, and infrastructures.

Revenue and expenses were reduced by \$1.9 billion, and receivables and payables were offset by \$745 million as a result of eliminating intra-Air Force transactions (see Note 29). Also, advances and unearned revenue were reduced to \$112 thousand as a result of eliminating intra-Air Force transactions (see Note 31, Advances and Prepayments).

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(2) Trust Funds. The Air Force trust funds are endowment or revolving funds. These accounts are used to record the receipt and outlay of funds held in trust by the government for use in carrying out specific purposes or programs. The Air Force operates two trust funds.

(a) The Air Force Gift Fund is an endowment fund where donors make conditional monetary gifts to the Air Force. Donations to the Air Force are recognized as a financial source upon acceptance of the donated asset, and a revenue is recorded for the value of the increase to the asset account. Obligations and expenditures are made against the Gift Fund for the purposes specified in the gift offer. The use or obligation of Gift Fund receipts is recorded on a cash basis. When specified in the gift offer, these funds are allowed to be invested in marketable securities. Donated property is disclosed in the financial statements.

(b) The Air Force Cadet Fund operates as a local deposit fund account. It is administered by the Superintendent of the Air Force Academy on behalf of the Academy cadets. Each month, monies are deposited into the account from checks and information provided by the Defense Joint Military Pay System (DJMS). The cadet pay office draws checks on this account to pay the various vendors and contractors at the Academy. The advance education funds, which previously were processed through the Cadet Fund, are now paid directly from the Military Personnel Appropriation (3500) and a repayment of indebtedness is established on the cadet Master Military Pay Account (MMPA) in DJMS.

Trust fund revenue of \$10.5 million includes donations and gifts to the Gift Fund and funds received from cadets to reimburse the Cadet Fund for items paid by the Cadet Fund on behalf of the cadets.

(3) Special Funds Receipt Accounts. These accounts are credited with receipts from specific sources, are earmarked by law for a particular purpose, and none of the funds are generated from operations. Special fund expenditure accounts are used to record appropriated amounts of special fund receipts to be expended for special programs in accordance with specific provisions of law.

(4) Deposit Fund Accounts. These accounts generally are used to 1) hold assets whose distribution awaits legal determination or for which the Air Force acts as agent or custodian, and 2) account for unidentified remittances. The Air Force expressly requires all check collections to pass under the immediate control of one of these deposit funds upon receipt, regardless of source, if the ultimate recipient is unknown.

For financial reporting purposes under accrual accounting, operating expenses for general fund activities are recognized in the period incurred. Expenditures for capital and other long-term assets are not recognized as expenses until consumed in the Department's operations. Unexpended appropriations are recorded as equity of the Air Force.

Certain expenses, such as annual and military leave earned but not taken, are not funded when accrued. Such expenses are financed in the period in which payment is required. Therefore, for the Department's general funds, an amount due from future financing sources (appropriations to be provided) is recognized as an offset to equity in the consolidated statement of financial position which is comprised of the accrued amount of such expenses at year-end.

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Annual and multi-year congressional appropriations are supplemented, when authorized, with revenues generated by sales of goods or services through a reimbursable order process. This process allows the seller to increase funds available by the cost of the supplies and/or services ordered by the customer. The reimbursable order process promotes efficiency in providing products and services and it allows an accurate accounting of resources provided and applied. The authority to obligate is recognized (i.e., obligations may be recorded) when orders from a government entity are accepted or advances from a non-federal entity are received. Obligation authority must be recorded before performance on an order begins. For financial reporting purposes under accrual accounting, revenue is recognized when earned. The cost of goods sold or services provided is recognized when expenses are incurred. Advances received prior to delivery of goods or services are treated as unearned revenue and recorded as a liability of the Air Force.

F. Accounting for Intra-governmental Activities:

The Air Force, as an agency of the Federal government, interacts with and is dependent upon the financial activities of the Federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Air Force as though the Agency were a stand-alone entity.

The Air Force's proportionate share of public debt and related expenses of the Federal government are not included. Debt issued by the Federal government and the related interest costs are not apportioned to Federal agencies. The Air Force's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing may ultimately be obtained through the issuance of public debt, interest costs were not capitalized since the Treasury does not allocate interest costs to the benefiting agencies.

The Air Force civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) which includes the Thrift Savings Plan (TSP). Military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security. The Air Force funds a portion of pension benefits under these retirement systems but does not disclose the assets or actuarial data on the accumulated plan benefits or unfunded pension liabilities of its employees. The Office of Personnel Management (OPM) reports pension benefits and liabilities for CSRS, FERS and TSP, and DoD reports for MRS.

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In FY 96, the Air Force contributed the following amounts to the retirement plans and Social Security.

| | |
|-----------------|------------------------|
| CSRS | \$216,372,215 |
| FERS | 275,866,381 |
| MEDICARE | 265,277,661 |
| TSP | 94,431,471 |
| MRS | 3,105,858,000 |
| Social Security | <u>1,284,334,822</u> |
| Total | <u>\$5,242,140,550</u> |

In FY 96, the Department or its components sold assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance to a trust fund maintained by the Department of the Treasury from which the Military Services are reimbursed for the cost of administering and executing the sales.

G. Funds with the U.S. Treasury and Cash:

The Treasury maintains Air Force appropriations in separate accounts in which it records warrants, receipts, and disbursements. During the fiscal year, the Air Force also has the use of various suspense accounts to record collections and disbursements which are rejected in the report edit process pending further research. Treasury requires suspense accounts be closed at year end, prior to submission of September 30th reports. The Air Force operation and maintenance account is used to close most suspense accounts. Suspense balances of \$118 million are to be reopened at the beginning of the next fiscal year. As of September 30, 1996, the Air Force had \$50.7 billion in entity and non-entity funds with the Treasury.

As agents of the U.S. Treasury Department, disbursing officers (DOs) maintain monthly Standard Form 1219, Statement of Accountability, that portrays their cash accountability to the Treasury. The majority of DOs' cash accountability is actual operating or accommodation/exchange "cash" either acquired by Treasury check issue or by collection from customers. However, portions of the total FY 96 cash accountability shown on the disbursing officer's Statement of Accountability, SF 1219, includes advances to contractors under advance payments pool agreements. These advances do not represent Air Force funds and are reported as non-entity assets, other. The amount of total DO cash accountability included in the FY 96 statement as a liability to Treasury is \$119 million (including advances to contractors).

H. Foreign Currency:

The Air Force purchases foreign currency to use in its operations, when appropriate. The Air Force does not purchase foreign currency for investment purposes.

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The Air Force conducts a significant portion of its operations overseas. Gains and losses from foreign currency transactions occur in four general fund appropriations (operation and maintenance, military construction, family housing operation and maintenance, and family housing construction). These gains and losses are recognized and reported in the statement of operations as current year transactions not reported separately for the operations accounts. The gains or losses are computed as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of the fiscal year. During FY 96, the Air Force recognized a net loss of \$259 million due to foreign currency transactions for the four appropriations. Similar gains and losses from other appropriations are not recognized in the Statement of Operations and Changes in Net Position. They are absorbed by budgetary transactions in which obligations are increased or decreased to reflect foreign currency fluctuations.

I. Accounts Receivable:

As presented in the Consolidated Statement of Financial Position, accounts receivable include accounts, claims, and refunds receivable. Allowances for uncollectible accounts are based upon analysis of collection experience by fund type. During FY 96, the Department wrote off approximately \$12.3 million in uncollectible receivables. See Note 5 for current year receivables and allowances for doubtful accounts.

J. Loans Receivable: Not applicable.

K. Inventories:

Inventories, including operating supplies and nonconsumable items, are valued at latest acquisition cost as required by DoD accounting policies. Although current accounting standards require that inventories be valued at actual cost, the Standard Base Supply System was not designed to do this. Generally, inventory prices are based on prices paid for recently acquired items plus appropriate surcharges. Operating materials and supplies are included in war reserve material (for presentation on the financial statements as required by DoD guidance). No gains or losses are recognized in the Consolidated Statement of Operations as a result of changes in valuation for general fund operating supplies and materials. Such changes are reflected in the asset valuations and related invested capital as reported in the Statement of Financial Position. The Air Force reports no inventory that is held for sale. Inventory reported on the Statement of Financial Position, valued at \$36.5 million, represents operating supplies and materials.

L. Investments in U.S. Government Securities:

The Air Force Gift Fund was established to control and account for the disbursement and use of monies donated to the Air Force and the receipt of interest or dividends arising from investment of such donations. The Gift Fund accepts certain gifts offered by the public. Among these are monetary gifts which are accounted for by DFAS-DE. The amount of investments represents federal securities controlled by DFAS-DE. Related earnings are allocated to appropriate Air Force activities to be used in accordance with the directions of the donor. The intent is to hold investments to maturity unless they are needed to finance purchases in accordance with the donor's intent. No provision is made for unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity. As of September 30, 1996, \$9 million of investments

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at cost (par value less unamortized discount) in U.S. securities were included in the Gift Fund. For FY 95, \$8 million of investments was not separately shown in the financial statements but was included in the fund balance with Treasury.

M. Property and Equipment:

Valuations for equipment, aircraft, missiles, and engines are not based on historical procurement costs. Rather, these assets and weapons systems are valued and reported at latest acquisition procurement costs. Satellite costs or values are obtained from the respective Selected Acquisition Report (SAR) for each satellite accepted from the contractor via the Material Inspection and Receiving Document, DD Form 250 (process/production/storage costs). In addition, the actual launch and operational orbit cost will be added to these costs to obtain full satellite values. Equipment is valued at acquisition cost using federal stock categories. While no gains or losses are recognized in the Statement of Operations and Changes in Net Position for changes in latest acquisition cost or SAR values of equipment, such changes are reflected in asset valuations and related invested capital. Engineering and modification costs incurred subsequent to approval of the basic procurement contracts are valued at the contract price of the engineering change order, value engineering, or modification which extends the life of the asset or capability of the system, and any other cost of materials or services not included in the contract cost.

Land and facilities are valued at cost. Buildings are capitalized when constructed or at the date of acquisition. Improvements to land and buildings costing more than \$25,000 (included in WIMS) are currently being capitalized by the Air Force. This is contrary to DFAS directed policy which requires improvements to be capitalized only if the cost equals or exceeds \$100,000 and extends the useful life by two or more years. The Work Information Management System (WIMS) currently does not identify general funds and DBOF properties when a joint occupant/tenant relationship exists. DoD 7000.14-R Financial Management Regulation, Volume 11B, requires buildings and facilities to be segregated based on preponderant use when a joint occupant/tenant relationship exists. This problem is being corrected in FY 1997. Audits of FY 91 and FY 92 financial statements have shown that documentation to support the recorded acquisition cost of many older properties is no longer available. Obtaining appraisals for older property for which original acquisition records are no longer available is not cost effective, especially considering the number and age of many of DoD's properties. As a reasonable solution to this dilemma, when original records to support the acquisition cost of property are no longer available, recorded valuations of property, or other available information if the value has not been formally recorded, could be permitted for financial statement purposes when such valuation represents the best available information. When records are not available to support the original acquisition cost or value of property, the Notes to the principal statements will disclose the method of valuation and the reason for its use.

Routine maintenance and repair costs are expensed when incurred. No depreciation has been recorded for general fund equipment and buildings (see Note 15).

Capitalization of Assets: The Air Force followed the criteria for capitalization of personal property assets contained in DoD 7000.14-R. This guidance required capitalization of all assets with a useful life of two or more years and an acquisition cost of \$5,000 or more. In September 1992, the Air Force received direction from the Acting Comptroller of the Department of Defense to

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change this requirement (retroactively to October 1, 1991) to capitalize assets with a useful life of two years or more and an acquisition cost equal to or exceeding the expense/investment funding threshold used by Congress for appropriating DoD operating (expense) and procurement (investment) appropriations. With the enactment of the Department of Defense Appropriations Act of 1995, the current acquisition cost has been increased to \$100,000 or more. During FY 96, the Air Force changed the property, plant, and equipment systems (except for WIMS) and regulatory documents to implement the \$100,000 threshold.

Valuation of Assets: All fixed assets, including land held in public domain, are valued at acquisition cost. Acquisition cost includes such costs as purchase price, brokers' commissions, fees for examining and recording the title, surveying, razing and removal costs (less salvage proceeds) of structures on the land, transportation, handling and storage, installation, interest, preparation, labor, engineering, appropriate share of the cost of equipment and facilities used in construction, inspections, supervision, legal recording fees, and other related costs of obtaining the property. When the acquisition cost cannot be determined, fair market value at the time of acquisition is used.

The various criteria used to establish the fair market value are:

- a. Cash realized in transactions involving the same or similar assets,
- b. Quoted market prices,
- c. Fair market value of other assets or services received in exchange of property, or
- d. Independent appraisals.

Routine maintenance and repair costs are expensed when incurred.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), section 120h, implementation continues to hamper the Federal government's ability to deed property. Consequently, only 4,479 acres have been permanently transferred to new civilian owners or other federal agencies. Nonetheless, because of our option to lease property, substantial economic recovery has been achieved. At present, 42,341 acres of the property are under long-term lease and 9,069 acres of property are under interim lease. Two sales were completed during FY 96 which yielded \$334,800. One economic development conveyance was completed during FY 96 at Gentile AFS, OH, covering 161 acres and 35 buildings. Based on the privatization-in-place project at Gentile AFS, there will be no direct cash yield from the transaction. There is, however, expected to be substantial non-cash benefit to the Air Force through contract price stabilization. There are 28 sales pending which are expected to yield in excess of \$25 million as soon as deeds can legally be issued for the properties. Until then, the properties, with minor exception, are being leased to the future owners at no cost. In return, the new owners take over the protection and maintenance of the property which reduces the Air Force operation and maintenance costs. All permanent transfers of property will appear as reductions in the FY 97 Air Force physical inventory (shown in the GSA annual worldwide inventory of property report) due to the necessary lag time in recording inventory adjustments. However, applicable cash transactions involving property were recorded in FY 96 accounting records.

No income from the sale or lease of real or related personal property was deposited into or redistributed from the special Office of the Secretary of Defense Base Closure Account (BCA), Parts I or II during FY 96. The accounts (Part I and II) were created by Public Law 100-526 (1988

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Act) and Public Law 101-510 (1990 Act), respectively, to handle receipts and disbursements in connection with base closure, realignment, and disposal. Financial transactions were initiated in the opening days of FY 97 to transfer \$1.5 million and \$4.2 million to Parts I and II, respectively. In excess of \$2.5 million of earnest money deposits remain in an Air Force suspense account awaiting formal deeding of the properties. Upon closure of the transaction, the earnest money and remaining balance received will be transferred to the BRAC account.

Medical Funding: Beginning in FY 92, funding for all components in DoD was accomplished through the Defense Health Program appropriation with an amount allocated to the Air Force. Any fixed assets purchased with these funds, if they met the capitalization criteria, were commingled with assets purchased with other Air Force appropriations and are included in those amounts. Materiel in stores, real property, and equipment in the medical care program remain on the general funds financial statements.

N. Prepaid and Deferred Charges:

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenditures/expenses when the related goods and services are received.

O. Leases:

All leases are recorded as operating leases, contracted for annually, and paid by the annual operation and maintenance appropriation. The Air Force has no capital leases (see Note 18).

The Air Force owns substantially all of the facilities and real property used in its domestic operations. Capital assets overseas are normally funded with appropriated funds. Title is retained by the host country at the time the treaty expires.

P. Budgetary Contingencies:

By their nature, DoD accounting policies are a blend of budgetary and proprietary rules. Applicable directives require the Air Force to report and disclose contingencies in budgetary and proprietary accounts. Overall, unfunded liabilities cannot be liquidated without the enactment of an appropriation. Budgetary contingencies are indicated below. See Note 31 for proprietary contingencies (contingent liabilities).

Budgetary Contingencies: Air Force budgetary contingencies include undelivered orders outstanding, commitments, and unfilled orders outstanding. See Note 1V for information on undelivered orders outstanding.

The DoD Accounting Manual, in conformance with requirements imposed by OMB, requires that all procurement accounts, military construction and RDT&E accounts report budgetary contingencies meeting the definition of budgetary commitments. Air Force also reports budgetary commitments for operation and maintenance accounts. Budgetary commitments are administrative reservations of appropriated funds. The purpose of budgetary commitments is to improve obligation accounting and reduce the possibility of the overobligation of appropriated funds.

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The Air Force has a total of \$4 billion as commitments at the end of FY 96 in expired, unexpired, and closed accounts. This amount is not reported in financial statements and includes contract award fees, contract disputes, and commitments.

Unfilled orders outstanding represent reimbursable orders received for which supplies or services have not been delivered to the ordering agency. Except for sale from inventory items, unfilled orders at fiscal year end have been obligated. Unfilled orders outstanding at the end of FY 96 totaled \$1.3 billion in unexpired, expired, and closed accounts.

The National Defense Authorization Act for FY 92 enacted Sections 1174a and 1175, Title 10, United States Code which authorized the Special Separation Benefit (SSB) and Voluntary Separation Incentive (VSI) programs. These programs offer eligible military members special benefits associated with separation from active duty and voluntary appointment, enlistment, or transfer to a Reserve component. The SSB transactions are paid from the current military personnel appropriation. All VSI payments made after December 31, 1992, are paid from a "Voluntary Separation Incentive Fund" established by the Department of the Treasury. The fund is used to accumulate amounts needed to finance, on an actuarially sound basis, liabilities accrued under the VSI Program. The DoD Board of Actuaries determines the present value of the future benefits payable to persons who separate under VSI. The Board also determines an amortization schedule for liquidating these new unfunded liabilities. In January 1993, \$391.4 million was transferred to the VSI trust fund, which was expected to cover all VSI expenditures through January 1, 1995.

See Note 31 for FY 96 SSB and VSI payments to military members and voluntary separation incentive payments (VSIP) to civilians.

Q. Accrued Leave:

Civilian annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for annual and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick leave and other types of nonvested leave are expensed as taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates.

R. Equity:

Equity consists of unexpended appropriations, invested capital, donations, and cumulative results of operations less unfunded liabilities (future funding requirements).

Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn, as well as amounts obligated for which neither legal liabilities for payments have been incurred nor actual payments made. See Note 20.G. for fund balance detail.

Invested capital, as presented in the consolidated statement of financial position, represents the value of the Department's capital assets which consists of progress payments (advances), operating materials and supplies (inventory), and property and equipment.

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Donations represent the value of donated assets on hand.

Cumulative results of operations represent the contra to accrued public receivables not included in the appropriated status of funds database less allowance for uncollectible receivables.

S. Aircraft and Satellite Crashes:

The cost of aircraft which were either destroyed or damaged beyond repair due to aviation mishaps in FY 96 involved 20 aircraft valued at \$309.3 million. In FY 95, 29 aircraft valued at \$506.3 million were destroyed. The related FY 96 Air Force cost for flight injuries was \$24.7 million. There were 4 missiles valued at \$5.8 million destroyed in FY 96. No space satellites were destroyed. The associated loss impacted both asset and equity accounts. No loss was separately recognized for aircraft damaged by accidents that were repairable. Costs associated with repair of such aircraft are recorded as operating expenses and generally funded from operation and maintenance appropriations.

T. Treaties for Use of Foreign Bases:

The Air Force has the use of land, buildings, and other facilities which are located overseas and were obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the Air Force continued use of these properties until the treaties expire. Capital investments in buildings, runways, aircraft shelters, and other facilities located on the overseas bases are capitalized. As of September 30, 1996, the Air Force had not finalized the cost values of buildings and facilities located in foreign countries. These fixed assets are subject to loss in the event the treaties are not renewed or other agreements are not reached which allow for continued use by the Air Force. In the event these treaties or agreements are terminated, losses will be recorded for the value of non-retrievable capital assets.

U. Comparative Data. Comparative data is based on prior issued reports and has not been restated for prior period adjustments.

V. Undelivered Orders.

Undelivered orders outstanding represent amounts ordered but not received and thus do not represent a liability for payment. Undelivered orders outstanding at the end of FY 96 totaled \$40 billion in unexpired, expired, and closed accounts.

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Note 2. Fund Balances with Treasury (in thousands)

A. Business Operations Fund (DoD Comptroller) and All Other Funds and Accounts

| | <u>Entity Assets</u> | | |
|-----------------------------------|------------------------|----------------------------|-------------------------------|
| | <u>Trust Funds</u> | <u>Revolving Funds</u> | <u>Appropriated Funds</u> |
| Unobligated Balance Available: | | | |
| Available | \$1,526 | - | \$10,607,288 |
| Restricted | - | - | - |
| Reserve for Anticipated Resources | - | - | - |
| Obligated (but not expensed) | 72 | - | 40,054,385 |
| Unfunded Contract Authority | - | - | - |
| Unused Borrowing Authority | - | - | - |
| Treasury Balance | <u>\$1,598</u> | <u>0</u> | <u>\$50,661,673</u> |

| | <u>Entity Assets</u> | |
|-----------------------------------|---------------------------------|---------------------|
| | <u>Other Fund Types</u> | <u>Total</u> |
| Unobligated Balance Available: | | |
| Available | - | \$10,608,814 |
| Restricted | - | - |
| Reserve for Anticipated Resources | - | - |
| Obligated (but not expensed) | - | 40,054,457 |
| Unfunded Contract Authority | - | - |
| Unused Borrowing Authority | - | - |
| Treasury Balance | <u>0</u> | <u>\$50,663,271</u> |

B. Business Operations Fund Activities Below DoD Comptroller Level

Not applicable

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C. Business Operations Fund Activities and all Other Funds and Accounts (in thousands)

| <u>Non-Entity Assets</u> | | | | | |
|--------------------------|--------------------|------------------------|---------------------------|-------------------------|-----------------|
| | <u>Trust Funds</u> | <u>Revolving Funds</u> | <u>Appropriated Funds</u> | <u>Other Fund Types</u> | <u>Total</u> |
| Beginning Balance | - | - | \$731 | \$53,761 | \$54,492 |
| Funds Collected | - | - | 1,561 | - | 1,561 |
| Funds Disbursed | - | - | - | 8,392 | 8,392 |
| Ending Balance | <u>0</u> | <u>0</u> | <u>\$2,292</u> | <u>\$45,369</u> | <u>\$47,661</u> |

D. Other Information

Note 3. Cash, Foreign Currency and Other Monetary Assets (in thousands)

| | <u>Entity Assets</u> | <u>Non-Entity Assets</u> |
|---|----------------------|--------------------------|
| A. Cash | \$42,437 | \$57,089 |
| B. Foreign Currency | - | 11,637 |
| C. Other Monetary Assets | | |
| (1) Gold | - | - |
| (2) Special Drawing Rights | - | - |
| (3) US Reserves in the International Monetary Fund | - | - |
| (4) Other | - | - |
| (5) Total Other Monetary Assets | - | - |
| D. Total Cash, Foreign Currency and Other Monetary Assets | <u>\$42,437</u> | <u>\$68,726</u> |

E. Other Information: For FY 1996, DoD guidance was changed in regard to the classification of Disbursing Officers' cash. Disbursing Officers' cash not classified as imprest funds is shown as Non-Entity. For FY 1995, all cash was classified as Non-Entity.

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Note 4. Investments (in thousands).

| | (1) | (2) | (3) | (4) | (5) |
|-----------------------------------|--------------|-----------------|-----------------------------|-------------------------------------|--------------------|
| | Cost | Market Value | Amorti- zation Method | Amortized Premium/ (Discount) | Investments Net |
| A. Intragovernmental Securities: | | | | | |
| 1. Marketable | \$863 | | | | \$863 |
| 2. Non-Marketable Par Value | | | | | |
| 3. Non-Marketable Market Based | | | | | |
| Subtotal | <u>863</u> | | | | <u>863</u> |
| B. Governmental Securities: | | | | | |
| 1. | | | | | |
| 2. | | | | | |
| 3. | | | | | |
| Subtotal | | | | | |
| Total | <u>\$863</u> | | | | <u>\$863</u> |

C. Other Information: This amount was reported on a different line item for FY96. See Note 1.L. for further information.

Note 5. Accounts Receivable (in thousands).

| | (1) | (2) | (3) | (4) |
|----------------------------|------------------------|--|--|----------------------|
| | Gross Amount Due | Allowance for Estimated Uncollectibles | Allowance Method Used (see below *) | Net Amount Due |
| A. Entity Receivables: | | | | |
| Intragovernmental | \$1,378,292 | | | \$1,378,292 |
| Governmental | 191,539 | 1,902 | | 189,637 |
| B. Non-Entity Receivables: | | | | |
| Intragovernmental | - | | | - |
| Governmental | 231,952 | 222,542 | | 9,410 |

* The departmental allowance for entity public receivables is computed each year. It is based on the average percent of write-offs to outstanding public accounts receivable for the last five years.

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C. Other Information: For FY 1995, interest on past due receivables was included in Accounts Receivable, Non-Federal Entities. For FY 1996, interest on past due receivables is reflected on Line 2b(2), Interest Receivable, Net. The 99% decrease in Accounts Receivable, Non-Federal, Non-Entity (Line 2b(1)) and the related 91% decrease in Accounts Payable, Federal (Line 4a(1)) reflect the termination of a deferred payment agreement (DPA). This DPA, executed on April 5, 1995, for \$605 million was terminated as a result of a settlement between the Air Force and a contractor. Additionally, a revised method of calculating allowance for interest and late charges (better alignment with allowance for principal) resulted in a \$109 million decrease in net Accounts Receivable, Non-Federal, Non-Entity and the related Accounts Payable, Federal.

As presented in the Consolidated Statement of Financial Position, accounts receivable include reimbursements receivable, and refund receivables such as out-of-service debts (amounts owed by former service members), contractor debt, and unused travel tickets. See Note 29 for amounts associated with intrafund eliminations.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets:
(in thousands)

A. Other Entity Assets

1. Federal (Intragovernmental)

(a)

(b)

(c)

Total

2. Non-Federal (Governmental)

(a)

(b)

(c)

Total

B. Other Information.

C. Other Non-entity Assets

1. Federal (Intragovernmental)

(a)

(b)

(c)

Total

2. Non-Federal (Governmental)

(a) Cash Advances to Contractors

\$7,851

(b)

(c)

Total

\$7,851

D. Other Information.

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Note 7. Loans and Loan Guarantees, Non-Federal Borrowers.

The Air Force did not have loans or loan guarantees to report for FY 96 (see Note 1.J).

Note 8. Inventory, Net.

| | (1) Inventory Amount | (2) Allowance for Losses | (3) Inventory Net | (4) Valuation Method |
|---------------------------------------|----------------------------|--------------------------------|-------------------------|----------------------------|
| A. Inventory Categories: | | | | |
| 1. Held for Current Sale | | | | |
| 2. Held in Reserve for Future Sale | | | | |
| 3. War Reserve Material | 34,318,770 | - | 34,318,770 | Latest Acquisition Cost |
| 4. Excess, Obsolete and Unserviceable | 2,200,522 | - | 2,200,522 | Latest Acquisition Cost |
| 5. Held for Repair | | | | |
| Total | <u>\$36,519,292</u> | | <u>\$36,519,292</u> | |

B. Restrictions on inventories: The value reported for inventories includes War Reserve Material and War Readiness Spare Kits inventories. Standard base supply systems currently do not have the capability to identify inventories held in reserve for future use. Presently, we are unable to separately identify the dollar amount of War Reserve Material from inventory categories. Total inventory, net of excess, obsolete, and unserviceable, is reported as War Reserve Material.

C. Other Information:

As of September 30, 1996, the values reported in Materiel on Hand - Ammunition were obtained from the Combat Ammunition System (CAS-A) Tonnage Report provided to DFAS from Hill AFB, Utah, and were reconciled to the total inventory value of \$17.4 billion. The total dollar amounts for FY 96 in Air Force general ledger subsidiary accounts (GLSAs) 14643 (ammunition, Air Force stored) and 14644 (ammunition stored with other government agencies) were \$12.8 billion and \$4.6 billion, respectively.

The CAS-A system still does not contain the total ammunition administered by the Air Force. Locally purchased ammunition items are not being reported in CAS-A. A current study is being conducted to determine the best method available to obtain this data for future reporting. In addition, Ogden managed depot asset does not include depot storing of CAD/PAD or Maverick

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Missiles, and does not include Depot Asset visibility for depots storing WR-ALC missiles. The dollar value for this ammunition is still undetermined.

For FY 1995, all inventories were reported as Operating Materials and Supplies, Net (see Note 10). The Air Force reported the total value of ammunition at \$6.5 billion. For Air Force GLSAs 14643 - ammunition, Air Force stored, and 14644 - ammunition stored with other government agencies, the values reported were \$5.2 billion and \$1.2 billion respectively. The total ammunition value was later determined to be \$14.9 billion, an increase of \$8.5 billion. Of the total amount, \$3.1 billion was stored with other government agencies, and \$11.9 billion was stored by the Air Force.

The increase in ammunition values for FY 1996 was due in part to correcting a major cataloging error in the system (3B2) handling the unit price on high dollar items and performing a worldwide reconciliation of inventory at all depots and bases. This resulted in an immediate increase of ammunitions in excess of \$8.5 billion. In addition, at least 10 bases were converted from the standard base supply system to CAS-A which also increased the values reported.

Note 9. Work-in-Process (Personal Property).

The Air Force has no work-in-process.

Note 10. Operating Materials and Supplies (OM&S), Net (in thousands).

For FY 1996, the Air Force did not report the OM&S categories including OM&S held for use, held in reserve for future use, and excess, obsolete and unserviceable. Starting with FY 1996, these amounts are reported as Inventories, and for FY 1995, all inventories were reported as Operating Materials and Supplies, Net (see Note 8).

Note 11. Stockpile Materials.

The Air Force did not report stockpile materials.

Note 12. Seized Property.

The Air Force did not report seized property.

Note 13. Forfeited Property, Net.

The Air Force did not report forfeited property.

Note 14. Goods Held Under Price Support and Stabilization Programs, Net.

The Air Force did not report goods held under price support and stabilization programs.

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Note 15. Property, Plant and Equipment, Net (Thousands)

| Classes of Fixed Assets: | (1) Depreciation Method | (2) Service Life | (3) Acquisition Value | (4) Accumulated Depreciation | (5) Net Book Value |
|--|-------------------------------|------------------------|-----------------------------|------------------------------------|-----------------------------|
| A. Land | See | | \$280,514 | \$0 | \$280,514 |
| B. Structures, Facilities, & Leasehold Improvements | Notes 1-D & 1-M | | 39,810,367 | | 39,810,367 |
| C. Military Equipment | | | 201,718,297 | | 201,718,297 |
| D. ADP Software | | | | | |
| E. Equipment | | | | | |
| F. Assets Under Capital Lease | | | | | |
| G. Other | | | | | |
| H. Natural Resources | | | | | |
| I. Construction in Progress | | | 4,249,794 | | 4,249,794 |
| Total | | | <u>\$246,058,972</u> | | <u>\$246,058,972</u> |

J. Other Information:

(1) The increase in the capitalization criteria from \$50,000 to \$100,000 as required by the Department of Defense Appropriations Act of 1996 resulted in decapitalization (decrease) in various property, plant, and equipment assets. This change did not have a material effect on the PP&E valuation.

(2) Weapon System Valuation Project. During FY 92, the Air Force began a project to revalue the recorded costs of weapon systems. The basic thrust of the project was to update the weapon systems listed in the Air Force Materiel Command (AFMC) technical manual, TO 00-25-30, Unit Cost of Aircraft, Guided Missiles, and Engines. This publication was last revised on May 15, 1983. However, as of September 30, 1996, weapon systems still had not been revalued based on actual acquisition costs. Major computer system changes would be required to capture and report actual costs for weapon systems. In November 1995, the Federal Accounting Standards Advisory Board (FASAB) issued its final Statement on Accounting for Property, Plant, and Equipment. According to this publication, weapons systems will be reported through a stewardship report in the future rather than on financial statements required by the CFO Act. This standard will be implemented in FY 98 as required by the FASAB guidance.

(3) Donated Real Property (non-monetary). Donated real property value is the estimated value of any right, title, or interest in land and buildings, fixed improvements, utilities,

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and other permanent type additions to land donated to the Air Force. The balance reported at the end of FY 95 was \$284 million, and \$220 million at the end of FY 96.

(4) Other Donations to the Air Force (non-monetary).

a. Artwork: Air Force physically accounts for approximately 7,700 pieces of artwork. The value of artwork, in most cases, will not exceed the current capitalization criteria of \$100,000.

b. Museum Items: Items donated to the Air Force Museum Program are recorded in the financial records with all other museum items. The Colonel Richard Gimbel Aeronautical Collection at the United States Air Force Academy is separately maintained by the Academy.

c. Foreign Gifts: The value of foreign gifts is not recorded in the financial statements because Air Force ownership of these gifts was not established.

(5) Construction-in-progress (real property) costs are obtained from the Base Civil Engineers (BCE) Current Month Cost Report (for account codes 80010, 80020, 83000, and 84000) and the Allotment Ledger (for Military Family Housing using fund codes 83, project 72291, 72292, and fund code 89, project 711, and 713). Construction-in-progress costs are also collected from the Army Corps of Engineers and the Navy Facilities Engineering Command for Air Force funded projects. These costs are entered into the general ledger by the DFAS-Denver Center.

(6) Aircraft and missiles that have "no operational value" and are awaiting salvage are valued at full cost minus standard price for parts removed. This method establishes aircraft values at various levels from fully operational to scrap, thus reporting more accurate asset values. This valuation method has been implemented for aircraft reported in GLA 147, Excess and Surplus Property.

a. During FY 96, 288 aircraft valued at \$1.03 billion and 898 missiles valued at \$689.3 million were terminated from the Air Force inventory. These inventory terminations include the aircraft and satellite crashes indicated in Note 1S.

b. As of September 30, 1996, the Air Force Material Command had 3,265 aircraft which included 912 aircraft valued at \$4.4 billion in various stages of storage. In addition, AFMC had 1,273 aircraft valued at \$6.8 billion in non-operational status. They also had 1,324 missiles, of which 375, valued at \$305 million were in non-operational use status.

(7) Uninstalled Engines - Aircraft and Guided Missiles: Currently, the values reported for this account are obtained from the Comprehensive Engine Management System (CEMS) located at Tinker AFB. The values are reported by Tinker AFB to DFAS-DE/ADC where they are reviewed for accuracy. An adjustment to the values reported was made by DFAS-DE/ADC based on a letter from SA-ALC/LR Kelly AFB, totaling \$6.2 million, for three T56-9 engine modules (incomplete engines). This amount will continue to be reported as complete aircraft engines until a national stock number can be assigned to each of the three engine modules and accepted by DBOF. A letter provided to DFAS-DE/ANBG by SA/ALC/LR Kelly AFB, Texas, identifies engines that are considered scrap engines (excess, crashed, and cannibalized) and must be

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reported in GLA 147, Excess and Surplus Property. Messages to installations that handle uninstalled propulsion units have been sent directing that intransit engines are to be included in the uninstalled propulsion units account. The method for valuing excess engines is scrap value. CEMS calculates the value of engines and engine modules in the Air Force inventory by multiplying the quantity and unit cost of type-model-series modification. CEMS was found deficient in that unit costs are based on standard costs (latest acquisition costs). This method of valuation is expected to be required by new FASAB standards covering stewardship reporting. Additionally, crashed, cannibalized, and scrap engines were carried at full value in CEMS instead of their decreased value.

(8) Excess and Surplus Property: In FY 1995, the excess and surplus property account (GLA 147) was reported on the balance sheet at a residual value of 2.5 percent of the acquisition cost. This method of reporting excess aircraft created an accounting problem since parts were being removed and credited to the excess account at standard price for parts removed. This method of reporting was discontinued for FY 96. Currently, the aircraft is being reported at full value, and as parts are removed (standard price) the aircraft is reduced accordingly. If the standard price for parts removed exceed the value of the aircraft, the aircraft capitalization is increased. All other excess property is recorded at salvage value.

(9) Government Furnished Property (GFP). Over \$16 billion in GFP is reported this year compared to just \$3 billion for FY 1995. Over \$9.7 billion of GFP is included in military equipment which is now reported in four newly created military property GFP GLAs: Aircraft with contractors (14102), Missiles with Contractors (14202), Uninstalled Engines with Contractors (14302), and Satellites with Contractors (14902). In addition, \$4.5 billion of special tooling and special test equipment (ST/STE) is reported in a new GLA 16802 and \$2.2 billion of government furnished material (GFM) is reported as follows:

a. Special Tool/Special Test Equipment: In FY 96, a new general ledger account, 16802, was created to report special tools and special test equipment in hands of the contractors. The data for this GLA were obtained from the Contract Property Management System (a DLA system) and amounts to \$4.5 billion. Due to unavailability of 1996 data, 1995 data will be used for 1996 reporting. The Air Force is currently in the process of loading a recently developed system (D200J) that will identify not only items in the hands of contractors but also items under Air Force control. This system will be used for future reporting. Data for special tools and special test equipment were not reported for FY 95.

b. GFM: The GFM included in the financial statements are based on data received from the Defense Logistics Agency (DLA) which receives property data annually from defense contractors.

(10) Property, Plant and Equipment Increase of 5% in FY 96: See item (9a) above for explanation of \$4.5 billion increase related to special tool/special test equipment. Other reasons for the increase were 5 additional B-2A aircraft (not previously reported) valued at \$4.5 billion.

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(11) Property, Plant and Equipment not Included on FY 96 Financial Statements.

a. Rocket launching motors were not reported on the FY 96 financial statements. The value of these assets could not be determined before the FY 96 financial statements were issued, but will be included in the FY 97 financial statements.

b. As ALCMs and ICBMs are removed from the inventory in accordance with SALT, START and other treaties, their accountability is removed from EIMSURS. The motors are then included in the Missile Motor Tracking system at Hill AFB, and are categorized as FG-5s in the Army accounting system. The knowledge that these engines were not included in data submitted for the FY 96 financial statements was received too late to investigate and determine a value for inclusion in the financial statements. The assets will be included in the FY 97 financial statements.

Note 16. Debt.

The Air Force did not report borrowing from the Treasury, Federal Financing Bank, or from other Federal agencies, or agency debt issued by Federal Housing Administration or Tennessee Valley Authority bonds.

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Note 17. Other Liabilities (in thousands).

A. Other Liabilities Covered by Budgetary Resources:

| | Non Current Liab. | Current Liab. | Total |
|-----------------------|-------------------------|------------------|------------------|
| 1. Intragovernmental: | | | |
| Unearned Revenue | | \$603,382 | \$603,382 |
| DAO Treasury Cash | | 119,013 | 119,013 |
| Total | | <u>\$722,395</u> | <u>\$722,395</u> |

| | Non Current Liab. | Current Liab. | Total |
|------------------|-------------------------|------------------|----------|
| 2. Governmental: | | | |
| Unearned Revenue | | \$17,113 | \$17,113 |

B. Other Information. The increase in governmental unearned revenues from \$2 million (FY 95) to \$17 million (FY 96) is due to a change in the departmental system selection criteria used in identifying unearned revenue. Unearned revenue is recorded under one of five vendor types.

C. Other Liabilities Not Covered by Budgetary Resources:

| | Non- Current Liab. | Current Liab. | Total |
|----------------------|--------------------------|------------------|-------|
| 1. Intragovernmental | | | |
| Accrued Unfunded Exp | | | - |
| Total | | | - |

| | Non- Current Liab. | Current Liab. | Total |
|---------------------------------------|--------------------------|--------------------|--------------------|
| 2. Governmental: | | | |
| Accrued Unfunded Exp: | | | |
| Accrued Civilian Annual Leave | | \$785,072 | \$785,072 |
| Accrued Military Annual Leave | | 938,838 | 938,838 |
| Accrued Closed Years Accounts Payable | | 225,054 | 225,054 |
| Accrued Environmental Cleanup Costs | \$3,800,360 | 393,640 | 4,194,000 |
| Total | <u>\$3,800,360</u> | <u>\$2,342,604</u> | <u>\$6,142,964</u> |

D. Other Information. The amount included in the FY 97 budget for environmental cleanup costs is reported as current liabilities with the balance reported as non-current liabilities.

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Note 18. Leases. The Air Force has use of leased land, buildings, and other facilities, all of which are leased under operating lease agreements. All Air Force leases are operating leases because they are contracted for annually (with a possible 4 year renewal) and paid for with the annual O&M appropriation. Thus, a capital lease amount is not reported. The figures below represent all Air Force leased facilities in the U.S. and overseas (applicable to active Air Force, Air Force Reserves, and National Guard) including Pentagon and GSA space. The increase in 1998 is due to the Air Force share of the renovation project for the Pentagon. The FY 96 amount is reported as part of current expenses reflected in Note 23.

(Thousands)

| <u>Fiscal Year</u> | <u>Land & Building</u> |
|----------------------|--------------------------------|
| Year 1996 | \$ 43,195 |
| Year 1997 | 37,779 |
| Year 1998 | <u>69,443</u> |
| Total Lease Payments | <u>\$150,417</u> |

Note 19. Pensions and Other Actuarial Liabilities

| | (1) | (2) | (3) | (4) |
|---------------|---------------|----------|-----------|-----------|
| | Actuarial | | Assets | |
| | Present | | Available | Unfunded |
| | Value of | Assumed | to Pay | Actuarial |
| Major Program | Projected | Interest | Benefits | Liability |
| Activities | Plan Benefits | Rate(%) | | |

A. Pension and Health Plans

B. Insurance/Annuity Programs:

| | | | | |
|----------------------------------|--|--|--|-----------|
| 1. Workers Compensation Benefits | | | | \$993,134 |
|----------------------------------|--|--|--|-----------|

C. Other:

| | | | | |
|----------------------|--|--|--|------------------|
| D. Total Lines A+B+C | | | | <u>\$993,134</u> |
|----------------------|--|--|--|------------------|

E. Other Information: Also see Note 1(F). Financial statements for FY 95 did not include actuarial liability of \$1 billion for workers compensation benefits. A prior period adjustment is made in FY 96. Data was not available when the FY 95 financial statements were prepared so an estimated amount was disclosed in the footnotes as a proprietary contingent liability.

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Note 20. Net Position (in thousands)

| | Revolving Trust Fund | Other Trust Funds | Appropriated Funds | Total Funds |
|--|----------------------------|-------------------------|-----------------------|----------------------|
| A. | | | | |
| Unexpended Appropriations | | | | |
| (1)Unobligated | | | | |
| a. Available | | | \$10,607,288 | \$10,607,288 |
| b. Unavailable | | | | |
| (2)Undel Orders | | | 37,696,214 | 37,696,214 |
| B. | | | | |
| Invested Capital | | | 289,574,853 | 289,574,853 |
| C. | | | | |
| Cumulative Result of Operations | | | 2,830 | 2,830 |
| D. | | | | |
| Other | \$1,783 | \$5 | | \$1,788 |
| E. | | | | |
| Future Funding Requirements; See G.(4) below | | | (7,136,098) | (7,136,098) |
| F. | | | | |
| Total | <u>\$1,783</u> | <u>\$5</u> | <u>\$330,745,087</u> | <u>\$330,746,875</u> |

G. Other Information: The Air Force's equity, as presented above, consists of Unexpended Appropriations, Invested Capital, Cumulative Results of Operations, Other Net Position, and Future Funding Requirements:

(1) Unexpended Appropriations and Other represent amounts of funding authority which were not obligated, rescinded, or withheld pending withdrawal, and amounts obligated but unpaid. (More specifically, unexpended appropriation balances are those amounts of currently available funds which are not classified as accrued expenditures unpaid or accrued expenditures paid.)

(2) Invested Capital, as presented in the Consolidated Statement of Financial Position, represents the value of the Air Force's capital assets. These capital assets are classified as work-in-progress (personal property), operating materials and supplies, and property and equipment. Increases to capital assets and invested capital are recorded when such capital assets are acquired or constructed (see Note 15), or when asset valuations increase as a result of increases in standard prices/costs. Decreases occur when such capital assets are consumed in operations or otherwise disposed of. Assets transferred without reimbursement similarly affect capital assets and the contra-invested capital amount.

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(3) Cumulative Results of Operations represents the net contra amount to accrued receivables not in Status of Funds database, less allowance for uncollectible accounts and departmentally computed allowance for uncollectible accounts.

(4) Future Funding Requirements represent the accumulated effect of unfunded expenses.

Future Funding Requirements (in thousands)

| | |
|--|--------------------|
| (a) Actuarial Liabilities | \$993,134 |
| (b) Non-Actuarial Liabilities: | |
| (1) Unfunded Accrued Mil & Civ Leave (see note 17C2) | 1,723,910 |
| (2) Unfunded Liabilities from Closed years | 225,054 |
| (3) Environmental Cleanup | <u>4,194,000</u> |
| (c) Total Future Funding Requirements | <u>\$7,136,098</u> |

NOTE 21. Taxes

The Air Force did not report tax revenues.

Note 22. Other Revenues and Financing Sources (in thousands):

A. Other Revenues and Financing Sources:

| | <u>1996</u> | <u>1995</u> |
|---|--------------|-----------------|
| Increase in Accrued Public Receivables not in Status of Funds Database | N/A | \$36,314 |
| Donations to the Gift Fund and Other Revenue to the Trust Funds | <u>\$372</u> | <u>912</u> |
| Other Revenues and Financing Sources | <u>\$372</u> | <u>\$37,226</u> |
| | ---- | ----- |

B. Other Information: For FY 96, the amount of interest received on Gift Fund investments in marketable securities is reflected on Line 4 rather than Line 6 of the Statement of Operations. See Note 1.E.2.a. for further information on donations to the Gift Fund. An increase in accrued public receivables not in the Status of Funds database is recorded as an other revenue and financing source. A decrease is recorded as an other expense. The FY 95 increase was recorded as an other revenues and financing source, and the FY 96 decrease is recorded as an other expense. See Note 25 for the FY 96 decrease.

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Note 23. Program or Operating Expenses (thousands):

| | 1996 | 1995 |
|--|---------------------|---------------------|
| A. Operating Expenses by Object Classification: | | |
| 1. Personnel Services and Benefits | \$24,852,631 | \$24,898,588 |
| 2. Travel and Transportation | 2,152,830 | 1,965,841 |
| 3. Rental, Communication and Utilities | 1,281,282 | 1,134,738 |
| 4. Printing and Reproduction | 50,782 | 52,838 |
| 5. Contractual Services | 12,403,351 | 10,571,935 |
| 6. Supplies and Materials | 5,239,859 | 5,412,023 |
| 7. Equipment not Capitalized | 1,066,040 | 883,150 |
| 8. Grants, Subsidies, and Contributions | 28,811 | 36,187 |
| 9. Insurance Claims and Indemnities | 48,055 | 52,326 |
| 10. Other | | |
| (a) Unclassified/Unallocated | 8,724,341 | 9,621,137 |
| (b) Land/Structure Maintenance | 810 | 39 |
| (c) Refunds | (892) | 26 |
| (d) Trust Funds | 345 | 477 |
| 11. Total Expenses by Object Class | <u>\$55,848,245</u> | <u>\$54,629,305</u> |
| B. Operating Expenses by Program | | |
| 1. Other Funds and Accounts | | |
| (a) General Funds | \$55,847,406 | \$54,628,419 |
| (b) Special Funds | 494 | 409 |
| (c) Deposit Funds | - | - |
| Subtotal | <u>\$55,847,900</u> | <u>\$54,628,828</u> |
| (d) Trust Funds | | |
| (1) Cadet Funds | - | - |
| (2) Gift Funds | 345 | 477 |
| Subtotal | <u>345</u> | <u>477</u> |
| Total | <u>\$55,848,245</u> | <u>\$54,629,305</u> |

C. Operating expenses reflect "Net Accrued Expenditures" as identified by the element of expense or the budget program. The element of expense or budget program elements were then crosswalked to the general ledger accounts representing the object class categories. When system deficiencies prevented identification of expenses to a specific category, they were reported as unclassified/unallocated. Most of these unclassified amounts are RDT&E expenses that are recorded without an element of expense investment code (EEIC). The object class, Contractual Services, has been reduced by the amount of decrease in the environmental cleanup accrual. The accrual change is equal to the approximately \$81.2 million paid on environmental cleanup in FY96.

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D. The Statement of Federal Financial Accounting Standards (SFFAS) number 3 requires that operating materials and supply expenses (item 6 above) be calculated using the consumption method (beginning inventory + purchases - ending inventory). However, this standard is not followed because computer systems used to obtain necessary data were designed as property systems rather than accounting systems. Therefore, supplies and material expense (as reflected in Note 23) and operating expense (as reflected on Line 9 of the Statement of Operations) are understated. This may or may not be material.

Note 24. Cost of Goods and Services Sold.

The Air Force General Funds does not have cost of goods and services sold to report (according to the normal accounting meaning for cost of goods and services sold). However, the Air Force does have a reimbursable program for services rendered and goods furnished. Reimbursable program costs are shown and are offset by earnings from the reimbursable program on line 2.

Note 25. Other Expenses (in thousands).

| | 1996 | 1995 |
|--|------------------|------------------|
| A. Other Expenses: | | |
| (1) Equipment lost in crashes | \$315,131 | \$663,603 |
| (2) Unfunded expense - accrued leave and closed year payables change | 135,966 | 206,905 |
| (3) Unfunded expense - actuarial liability, workers' compensation claims benefits change | (15,616) | N/A |
| (4) Discounts lost | 2,945 | 2,989 |
| (5) Decrease in accrued public receivables not in Status of Funds database | 44,315 | N/A |
| (6) Correction of reported amount for advances to contractors and suppliers | (3,152) | N/A |
| Total | <u>\$479,589</u> | <u>\$873,497</u> |

B. Other Information: The decrease in accrued public receivables not maintained in the Status of Funds database is recorded as an other expense. An increase is an other revenue and financing source. See Note 22 for the FY 95 increase.

Note 26. Extraordinary Items. Not applicable.

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Note 27. Prior Period Adjustments (in thousands).

Adjustments to Invested Capital:

Inventory

| | |
|---|-------------------|
| Increase in material in storage | \$8,415,989 |
| Increase in excess and surplus property | <u>1,740,343</u> |
| | <u>10,156,332</u> |

Property and equipment

| | |
|---|----------------------|
| Decrease in equipment with contractors | (597,022) |
| Decrease in land | (6,925) |
| Decrease in buildings | (336,949) |
| Decrease in other structures and facilities | <u>(142,635)</u> |
| | <u>(\$1,083,531)</u> |

Net increase in Invested Capital \$9,072,801

Adjustment to Future Funding Requirements:

Record actuarial liability for future workers' compensation claim benefits (\$1,008,750)

Portion of future funding requirements transferred out to cumulative results of operations (items other than unfunded liabilities, amount contra to accrued public receivables not in status of reporting database, net of allowance for uncollectible receivables. With reclassification, liabilities not covered by budgetary resources equals future funding requirements.) (38,814)

Record estimated environmental cleanup costs. (Adjustment is equal to the sum of September 30, 1996, estimate and the amount of FY 96 environmental expense of \$81.2 million. See Note 30). (4,275,200)

Net (increase) in Future Funding Requirements (\$5,322,764)

Adjustment to Cumulative Results of Operations:

Transfer in reclassified amount contra to accrued public receivables not in status of funds reporting database, net of allowance for uncollectible receivables. 38,814

Correction of transportation refunds receivables (652)

Net increase in cumulative results of operations 38,162

Total Prior Period Adjustments \$3,788,199

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Note 28. Non-Operating Changes - (Transfers and Donations)

(Thousands)

| | <u>1996</u> | <u>1995</u> |
|--|---------------------|----------------------|
| A. Increases | | |
| (1) Transfers in | | |
| (2) Unexpended Appropriations | \$72,703,924 | \$74,355,433 |
| (3) Donations received | | |
| (4) Other increases | <u>14,438,752</u> | <u>1,664,620</u> |
| (5) Total increases | \$87,142,676 | \$76,020,053 |
| B. Decreases | | |
| (1) Transfers Out: | | |
| (a) Return of closed year authority | \$1,419,044 | \$993,772 |
| (2) Donations | | |
| (3) Other Decreases | <u>74,219,378</u> | <u>77,670,590</u> |
| (4) Total Decreases | \$75,638,422 | \$78,664,362 |
| C. Net Non Operating Changes | <u>\$11,504,254</u> | <u>(\$2,644,309)</u> |
| D. Other Information: | | |
| Other Increases: | | |
| (1) Net increase in invested capital excluding transfers out (below) and prior period adjustments, see Note 27 | <u>\$14,438,752</u> | <u>\$1,664,620</u> |
| Other decreases includes: | | |
| (1) Transfers out of invested capital | \$ 370,356 | \$ - |
| (2) Current year expenditures | <u>73,849,022</u> | <u>77,670,590</u> |
| (3) Total other decreases | <u>\$74,219,378</u> | <u>\$77,670,590</u> |

As the general fund includes 1 year, 2 year, 5 year, and no year appropriations, there were available unexpended appropriations brought forward from FY 95 to cover the excess of FY 96 expenditures over FY 96 appropriations made available.

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Note 29. Intrafund Eliminations (in thousands).

Schedule A Sales within the General Fund activity by transactions (sales or services rendered).

Selling Activity:

| | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|---------------------------|----------------------------|--------------------|-------------------------|--------------------|
| | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Unearned Revenue</u> | <u>Collections</u> |
| Operation and Maintenance | \$255,624 | \$878,961 | N/A | \$863,010 |
| Procurement | 2,697 | 26,606 | N/A | 66,730 |
| Research and Development | 486,466 | 979,117 | N/A | 882,960 |
| Military Construction | - | - | N/A | - |
| Other funds and accounts | (14) | 2,653 | N/A | 2,672 |
| Unearned Revenue | N/A | N/A | 112 | N/A |
| Total | <u>\$744,773</u> | <u>\$1,887,337</u> | <u>\$112</u> | <u>\$1,815,372</u> |

Customer Activity:

| | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|---------------------------|-------------------------|--------------------|-----------------|----------------------|
| | <u>Accounts Payable</u> | <u>Expenses</u> | <u>Advances</u> | <u>Disbursements</u> |
| Operation and Maintenance | \$235,668 | \$813,013 | N/A | \$792,008 |
| Procurement | 44,031 | 124,774 | N/A | 129,311 |
| Research and Development | 442,962 | 804,927 | N/A | 755,166 |
| Military Construction | 1,150 | 3,884 | N/A | 3,031 |
| Other funds and accounts | 20,962 | 140,739 | N/A | 135,856 |
| Advances | N/A | N/A | \$112 | N/A |
| Total | <u>\$744,773</u> | <u>\$1,887,337</u> | <u>\$112</u> | <u>\$1,815,372</u> |

Schedule B Not applicable.

Schedule C Not applicable.

Schedule D Sales or services between the Air Force and other DoD reporting entities by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity.

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Selling Activity:

| | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|-----------------------------|----------------------------|--------------------|-------------------------|--------------------|
| | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Unearned Revenue</u> | <u>Collections</u> |
| Department of the Air Force | \$1,028,387 | \$2,887,123 | N/A | \$2,530,520 |
| Unearned Revenue | N/A | N/A | \$309,876 | N/A |
| Total | <u>\$1,028,387</u> | <u>\$2,887,123</u> | <u>\$309,876</u> | <u>\$2,530,520</u> |

Customer Activity:

| | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|------------------------------------|-------------------------|--------------------|------------------|----------------------|
| | <u>Accounts Payable</u> | <u>Expenses</u> | <u>Advances</u> | <u>Disbursements</u> |
| Department of the Army | \$59,198 | \$161,557 | N/A | \$165,296 |
| Department of the Navy | 79,934 | 154,319 | N/A | 90,241 |
| Defense Business Operations Fund | 313,881 | 1,078,964 | N/A | 993,031 |
| DoD Military Retirement Trust Fund | N/A | N/A | N/A | N/A |
| National Defense Stockpile | N/A | N/A | N/A | N/A |
| U.S. Army Corps of Engineers | N/A | N/A | N/A | N/A |
| Defense Security Assistance Agency | 124,757 | 464,355 | N/A | 468,933 |
| Other Defense Organizations | 450,617 | 1,027,928 | N/A | 813,019 |
| Advances | N/A | N/A | \$309,876 | N/A |
| Total | <u>\$1,028,387</u> | <u>\$2,887,123</u> | <u>\$309,876</u> | <u>\$2,530,520</u> |

Schedule E Sales or services between the Air Force and other U.S. Government reporting entities by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity.

Selling Activity:

| | <u>Column A</u> | <u>Column B</u> | <u>Column C</u> | <u>Column D</u> |
|-----------------------------|----------------------------|------------------|-------------------------|--------------------|
| | <u>Accounts Receivable</u> | <u>Revenue</u> | <u>Unearned Revenue</u> | <u>Collections</u> |
| Department of the Air Force | \$252,977 | \$104,876 | N/A | \$613,959 |
| Unearned Revenue | N/A | N/A | \$258,275 | N/A |
| Total | <u>\$252,977</u> | <u>\$104,876</u> | <u>\$258,275</u> | <u>\$613,959</u> |

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Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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Customer Activity:

| | Column A | Column B | Column C | Column D |
|----------------------------|------------------|------------------|------------------|------------------|
| | Accounts Payable | Expenses | Advances | Disbursements |
| General Services Admin. | N/A | N/A | N/A | N/A |
| Agriculture | N/A | N/A | N/A | N/A |
| Interior | N/A | N/A | N/A | N/A |
| NASA | \$94,719 | \$141,358 | N/A | \$152,749 |
| State | N/A | N/A | N/A | N/A |
| Transportation | N/A | N/A | N/A | N/A |
| Treasury | N/A | N/A | N/A | N/A |
| Veteran's Affairs | N/A | N/A | N/A | N/A |
| Other US Govt./Non-Defense | 158,258 | (36,482) | N/A | 461,210 |
| Advances | N/A | N/A | \$258,275 | N/A |
| Total | <u>\$252,977</u> | <u>\$104,876</u> | <u>\$258,275</u> | <u>\$613,959</u> |

NOTE 30. Contingencies

Proprietary Contingencies: Proprietary contingencies are commonly referred to as contingent liabilities. If they meet certain requirements, proprietary contingencies are either disclosed in the notes to the financial statements or recorded as liabilities in the principal financial statements. Proprietary contingencies are indicated below. See Note 1P for budgetary contingencies.

Unfunded liabilities from "M" and closed years amount to \$225 million. It is reasonably possible that this liability balance may be incurred.

The Air Force is party to various legal and administrative claims brought against it. Most are tort claims initiated by individuals addressing aircraft and vehicle accidents, medical malpractice, property and environmental damages resulting from Air Force activities, and contract disputes.

Certain legal actions to which the Air Force is named a party are administered and, in some instances, litigated by other Federal agencies. Legal actions to which the Air Force is a litigant are covered by the Federal Tort Claims Act and Chapter 163 (Military Claims) of Title 10, United States Code (U.S.C.). Contingent liabilities under the Tort Claims Act and Chapter 163, Title 10 U.S.C., are \$2,500 and \$100,000 respectively, per occurrence. Settlements in excess of these amounts are paid from the Treasury's Claims, Judgments and Relief Acts Fund. Under these situations the Treasury's Claims, Judgments, and Relief Acts Fund is not reimbursed by Air Force appropriations, and contingent liabilities arising from legal actions against the Air Force will not materially affect its operations or financial condition. However, the Air Force must reimburse the Treasury's Claims, Judgments, and Relief Acts Fund for claims filed under the Contract Disputes Act.

The Air Force's potential liability for all civil law and litigation claims (including claims both over and under \$100 million) outstanding as of September 30, 1996, may amount to over \$22 billion.

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It is uncertain that claims under \$100 million will ever accrue to the Air Force and thus are not reflected in the financial statements. In addition to the fact that many cases simply lack merit, most claims, even if successful, will not be paid from Air Force accounts. Rather, judgments are ordinarily paid from the GAO Judgment Fund, not from Air Force accounts. In many cases involving attorney fees, the amounts are not known until the last appeal is taken.

The Legal Representation Letter describes contingent liabilities over \$100 million, which will probably be paid from the Treasury's Claims, Judgments, and Relief Acts Fund, and thus, are not reflected in the Air Force financial statements. In FY 96, there was one pending case involving more than \$100 million in which the Department of the Air Force was a party. Since Air Force appropriations do not necessarily pay for all judgments or settlements for cases, and the probability of payment is unknown, this pending case is not reflected in the financial statements. This case is presently in litigation, and the total dollar value is unavailable at this time.

As of September 30, 1996, the Air Force was a party to 261 contract appeals before the Armed Services Board of Contract Appeals (ASBCA). The total dollar value of these claims was approximately \$814 million which included \$755 million in contractor claims. Such claims are funded primarily from Air Force appropriations. The contractor claims involve unique circumstances which are considered by the ASBSA in formulating decisions on the cases. The contractor claims are not included in the financial statements because they are not measurable and the probability of payments (or non-payments) to contractors cannot be determined prior to ASBCA decisions on the cases.

The Air Force is responsible for environmental cleanup. This responsibility is programmed into the Air Force six-year defense plan. The total estimated cost to the Air Force to complete environmental cleanup is \$4.194 billion. This liability is included in the financial statements for the first time. It is included in line 5.b(5) as Other Non-Federal (Governmental) Liabilities as a part of Liabilities Not Covered by Budgetary Resources on the statement of financial position and in line 7.e, Future Funding Requirements on the statement of financial position. The September 30, 1995, revised liability of \$4.275 billion has been recorded as a prior period adjustment. The Air Force disbursed approximately \$81.2 million for environmental cleanup in FY 96 and \$367 million in FY 95.

Air Force Civil Engineering - Environmental Restoration (AF/ILEVR) has identified 1,980 sites located on active Air Force installations on which environmental concerns have been raised, but actual testing has not yet been conducted. These sites are known as areas of concern. While historical data has not been maintained, AF/ILEVR estimates approximately 20% of these areas of concern will develop into actual sites. The costs associated with restoring actual sites cannot be reasonably estimated.

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Note 31. Other Disclosures.

Progress Payments: Progress payment accounting data are unreliable due to systems and reporting deficiencies. Air Force and DFAS management is having difficulty identifying progress payments and their related recoupment balances. Unmatched or mismatched recoupment amounts and progress payment amounts withheld have not been researched to determine the impact on the outstanding progress payment balance and other accounting records.

Accrued Expenditure Report: As required by the DoD Accounting Manual, Chapter 27, Accounts Payable, Public includes \$1 billion of Accrued Expenditures Unpaid from the HAF-ACF(M)7152 report received from the Columbus Center relating to central procurement. The report reflects outstanding accounts payable, invoices on hand but unmatched to accounts payable, recoupments of progress payments, and withholding on cost/fee vouchers because of nonreceipt of patent clearances. However, as indicated in audit reports, the report does not accurately indicate accrued expenditures unpaid due to a problem within the Mechanization of Contract Administration Services (MOCAS) system, which is used to compile and report the accrued expenditures unpaid on centrally administered contracts. The report included negative accrued expenditures of \$1.6 billion at the appropriation year level. These negative amounts are not included in financial statements. This results in accounts payable on financial statements being overstated or understated. The 41% decrease in Accounts Payable, Public, is primarily attributable to this report. Applicable personnel at the DFAS-Columbus Center (responsible for MOCAS system) stated that they will finish testing and implementing the necessary systems changes to correct the accrued expenditure unpaid reports by the end of the 1996 calendar year. The Columbus Center has requested that the Defense Logistics Agency, Defense Systems Design Center, make the necessary system changes to correct the system that prepares this report.

Canceled Balances: All unliquidated balances associated with the closed account have been canceled in accordance with Public Law 101-510. Canceled accrued expenditures unpaid are reflected in the financial statements as unfunded liabilities. Canceled undelivered orders outstanding are not included in the financial statements; however, these orders may result in future expenditures. The amount of canceled undelivered orders is included in Note 1V. Canceled receivables are included in the Air Force Statement of Financial Position.

Cadet Fund: The only equity in the Cadet Fund is the Cadet Emergency Leave Fund totaling \$5,000 as of September 30, 1996. The Cadet Emergency Leave Fund receives its money from a one-time collection from each freshman cadet. The Cadet Fund receives a check from DFAS-DE which represents funds from the cadets to pay vendors who perform services for the cadets (e.g., dry cleaning, tailors, and barbers). All dollars received by the Cadet Fund are disbursed out for support of cadets.

FY 96 Payments for Special Separation Benefit (SSB), Voluntary Separation Incentive (VSI), and Voluntary Separation Incentive Payments (VSIP): The FY 96 payments to military personnel for SSB and VSI were \$33,927 and \$29,887, respectively. The FY 96 payments to civilians for VSIP were approximately \$24.2 million.

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Net Change in Invested Capital: The net change in invested capital is computed as the difference between the prior year balance and the current year balance of invested capital. The net change computed from amounts reported on the Statement of Financial Position was an increase of \$23.14 billion. However, the FY 95 balance on the Statement of Financial Position has not been restated for prior period adjustments. Prior period adjustments to FY 95 invested capital were made in the amount of a \$9.07 billion increase and are included in the amount reported on Line 20, Adjustments, on the Statement of Operations (see Note 27). The net change from the adjusted FY 95 balance of invested capital to the FY 96 balance was a \$14.07 billion increase and is included in the amount of non-operating changes reported on Line 23 of the Statement of Operations. The net adjusted \$14.07 billion increase includes transfers of (\$370.4) million and crashes totaling (\$315.1) million.

Invested capital is computed as the sum of progress payments to contractors (reported as advances and prepayments), operating materials and supplies (reported as inventory), and property and equipment. The Air Force general ledger system and property systems from which these values are taken do not allow for detailed tracking and presentation of the various causes of changes in invested capital. Moreover, the present system does not allow for reconciling total expenditures from the capital/procurement appropriations discussed below and the reported capitalized amounts.

The current budgetary and accounting process, under which the Air Force operates, does not distinguish between capital and operating expenses within appropriations. Therefore, appropriations were classified as either operating appropriations or capital appropriations for financial statement reporting purposes. Expenditures from capital appropriations were \$18 billion for the year. Accrued expenditures, by capital appropriation, are as follows (the amounts for appropriations classified as operating appropriations are listed in Note 23):

| | (Thousands) |
|--|---------------------|
| Aircraft Procurement (3010) | \$7,181,629 |
| Procurement of Ammunition, AF (3011) | 176,051 |
| Other Procurement (3080) | 6,577,046 |
| Missile Procurement (3020) | 2,596,425 |
| Military Construction (3300) | 874,236 |
| Military Construction, ANG (3830) | 278,451 |
| Family Housing, Construction (0704) | 274,770 |
| Military Construction, AF Reserve (3730) | <u>55,818</u> |
| Total Capital Accrued Expenditures | <u>\$18,014,426</u> |

This total expenditure amount does not automatically increase invested capital for a like amount. Only expenditures from an appropriation meeting the current capitalization guidelines and dollar threshold of \$100,000 will increase the value of property, plant, and equipment. Only expenditures for items of a nature included in operating material and supplies and not consumed in the current year will increase the value of inventories not held for sale.

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Separation Pay and Separation Allowance (in thousands):

Reported liability includes the accrued amounts for:

| | 1996 | 1995 |
|--|-----------------|-----------------|
| Accrued separation allowance for foreign nationals | \$15,699 | \$16,643 |
| Accrued military separation allowance | <u>1,576</u> | <u>0</u> |
| | <u>\$17,275</u> | <u>\$16,643</u> |

Accrued Salaries and Wages: This item, as reflected on Line 4.b.(2)(a) on the Statement of Financial Position, includes the liability for salaries and wages of civilian personnel that have been earned but are unpaid, and military personnel funded compensation earned but unpaid as of the end of the period. The increase in this amount for FY 96 is primarily attributable to unpaid military personnel compensation. For FY 95, the end of the month September payday was on September 29 because October 1 was on a Sunday. The September 1996 payday was October 1, 1996 (the new fiscal year). An accrual of \$754 million was recorded for FY 96.

Advances and Prepayments: Line 1.a.(5) of the Statement of Financial Position reflects a significant decrease in Advances and Prepayments, Federal. Preliminary analysis of this area identifies possible errors in coding, identifying, or updating the Air Force General Ledger account for Advances and Prepayments, Federal. This amount is a reclassification of Accounts Receivable, Federal, reported on Line 1.a.(2).

Advances and Prepayments, Federal, and Unearned Revenues (included in Line 4.a.(4)) were reduced by \$112 thousand as a result of intra-Air Force eliminations (see Note 29). Unearned Revenues of \$35 million were not eliminated because this amount exceeded federal advances as reported.

Interest Penalties, Non-Federal, as reflected on the Statement of Operations, Line 3, represents the amount of interest and late charges that were collected during the fiscal year on amounts owed by public entities. These collections are transferred to Treasury as reflected on Line 7 of the Statement of Operations. For FY 95, such collections were not reflected on financial statements.

Interest Expenses: Line 13.c. of the Statement of Operations does not include \$2.6 million in interest penalties paid by DFAS-CO on Air Force contracts.

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Unmatched Disbursements, Negative Unliquidated Obligations, and Totals (in thousands):

| | | | | |
|--|-------------------|-------------------|------------|-------------------|
| Treasury Index 57 Air Force Appropriations | September 1995 | September 1996 | Change | Percent Change |
| Unmatched Disbursements | \$766,320 | \$731,575* | (\$34,745) | (4.5%) |
| Negative Unliquidated Obligations | \$325,545 | \$428,612** | \$103,067 | 31.7% |
| Totals | \$1,091,865 | \$1,160,187 | \$68,322 | 6.3% |

* Net total of Contract Payment Notice rejects, intra-service, inter-service, and interfund suspense (>0 days).

** Unobligated NULOs, including those awaiting corrections from paying station. At the end of FY 96, obligated and unobligated NULOs totaling \$594 million were reported at accounting classification reference number (ACRN) level (gross) compared to \$546 million in FY 95. Of the \$594 million in NULOs, \$228 million were 0 to 90 days old, \$45 million were 91 to 180 days old, and \$321 million were over 180 days old.

DFAS and customers are making concerted efforts to reduce problem disbursements, including pre-validation of obligations before disbursements (Public Law 103-335).

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***DEPARTMENT OF THE
AIR FORCE***

GENERAL FUNDS

***SUPPLEMENTAL FINANCIAL
AND MANAGEMENT
INFORMATION***

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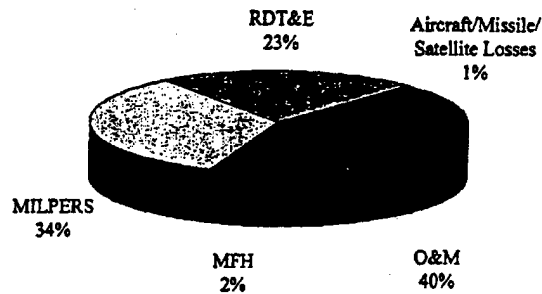
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Statement of Operations (and Changes in Net Position)

Revenues and Financial Sources. Appropriated Capital Used \$56,262,701,000.

Appropriated Capital Used



| Appropriated Capital Used | | |
|--|-------------|------------|
| Line Item - Statement of Operations | | |
| | \$ Billions | Percent |
| 1. Operation & Maintenance (O&M) | 22.8 | 40 |
| 2. Military Personnel Costs (MILPERS) | 19.2 | 34 |
| 3. Research, Development, Test, & Evaluation (RDT&E) | 13.2 | 23 |
| 4. Military Family Housing | 0.8 | 2 |
| 5. FY 96 Aircraft/Missile/Satellite Losses | 0.3 | 1 |
| Total | 56.3 | 100 |

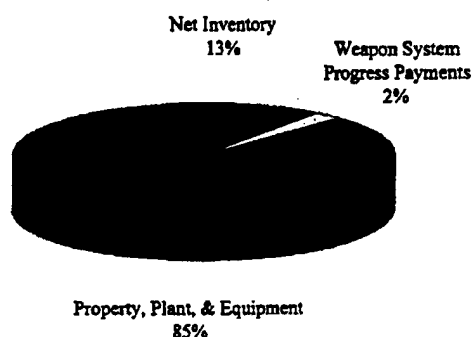
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Invested Capital



| Invested Capital Line To | | |
|------------------------------------|-------------|------------|
| | \$ Billions | Percent |
| 1. Property, Plant, & Equipment | 246 | 85 |
| 2. Net Inventory | 37 | 13 |
| 3. Weapon System Progress Payments | 7 | 2 |
| Total | 290 | 100 |

Invested Capital for Air Force general funds is the net government investment. This amount includes the acquisition cost of capitalized fixed assets financed by appropriations, less the reduction in investment due to sales or exchanges, donations, other disposals, or transfers to another entity.

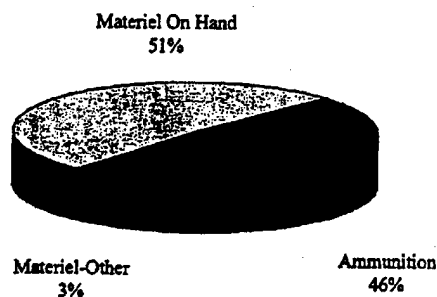
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Net Inventory



| Net Inventory Line 1d | | |
|----------------------------------|--------------------|-------------------|
| | \$ Billions | Percent |
| 1. Materiel On Hand | 19 | 51 |
| 2. Ammunition | 17 | 46 |
| 3. Materiel - Other | 1 | 3 |
| Total | <u>37</u> | <u>100</u> |

The net inventory line item consists of tangible personal property consumed in normal operations. The Air Force includes conventional munitions, nuclear ordnance, guided missiles, medical supplies, war reserve material, and excess and surplus aircraft in this line item.

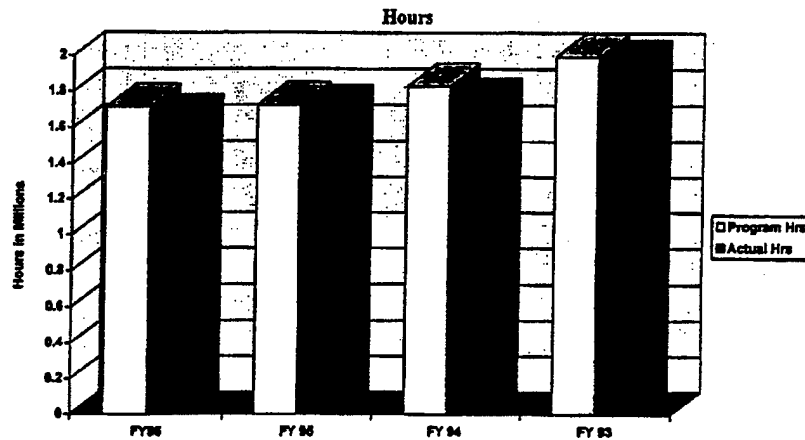
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FLYING HOURS PROGRAM



| Hours in millions | FY96 | FY95 | FY94 | FY93 |
|-------------------|-------|-------|-------|-------|
| Program Hrs | 1.716 | 1.726 | 1.832 | 1.995 |
| Actual Hrs | 1.657 | 1.709 | 1.750 | 1.957 |
| % Complete | 96.6 | 99.0 | 95.5 | 98.5 |

Percent completion varies due to numerous factors such as fact-of-life program changes during the year, support to regional contingencies, weapons systems retirements, conversion of hours between weapons systems, and aircraft groundings.

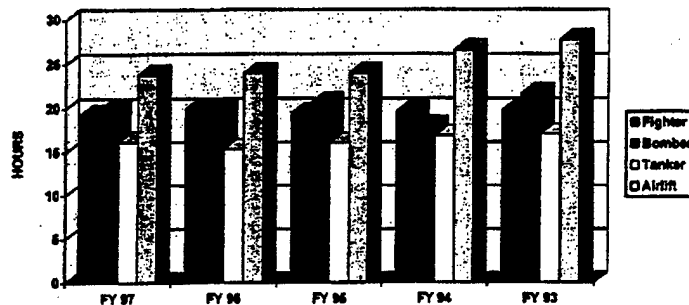
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**HOURS PER CREW PER MONTH (HCM)
(Programmed)**



| | FY97 | FY96 | FY95 | FY94 | FY93 |
|---------|------|------|------|------|------|
| Fighter | 19.3 | 20.0 | 19.9 | 19.7 | 19.8 |
| Bomber | 19.9 | 19.7 | 20.7 | 18.0 | 21.7 |
| Tanker | 16.2 | 15.4 | 16.0 | 15.8 | 17.1 |
| Airlift | 23.8 | 24.0 | 24.0 | 25.5 | 27.8 |

Hours Per Crew Per Month (HCM) is a programmatic indicator to show the impact Planning, Programming, and Budgeting System (PPBS) actions have on combat crews. HCM is an aggregate of different weapon systems in different commands. HCM values vary widely by weapon system and MAJCOM due to differences in mission profiles, crew composition, and training requirements for dissimilar aircraft. HCM includes combat and major combat support weapon systems only. Due to significant differences between categories, HCM values are not aggregated in an overall Air Force composite HCM.

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**OPERATION AND MAINTENANCE FUNDS IN SUPPORT OF
FLYING HOURS PROGRAM**

(000's)

| | FY 95 | FY 96 | Delta |
|----------------------------------|--------------------|--------------------|---------------------------|
| Systems Support | \$ 136,121 | \$ 92,136 | \$ <43,985> |
| General Support | 179,868 | 196,274 | 16,406 |
| Depot Level Reparables (DLRs) | 1,409,725 | 1,261,577 | <148,148> |
| Aviation Fuels | 986,834 | 970,032 | <16,802> |
| TOTAL | \$2,712,548 | \$2,520,019 | \$ <192,529> |

- FY96 System Support decrease due to 21.6% price decrease and shift of items from Systems Support to General Support
- FY96 General Support increase due to price change and transfer in of sales from Systems Support
- FY96 Depot Level Reparables decrease due to 16.8% price decrease

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ANALYSIS OF HEALTH CARE STANDARD

The Air Force Medical Service continues to expand and modify the manner in which both medical care is provided to our beneficiaries, and resources are provided to our health facilities. We are implementing world-class programs from both clinical and financial perspectives. The measure of an effective health care system is its ability to prevent disease, disability, and mortality associated with lifestyle choices. No less important, this includes workplaces or community environments – places where people have little life style choices. Our civilian colleagues have proven prevention is the cornerstone of cost-effective health care. Prevention of disease is a force multiplier. Successful health promotion strategies, whether in the workplace, home, or the health care environment, strive to redirect traditional disease-based treatment protocols towards a proactive, prevention-based lifestyle for all. Lastly, health consumer knowledge building provides education and health empowerment which offers alternative levels of care for certain concerns. Health advice services and proactive communication for required preventive services provide opportunities to better manage our population's health. In short, our goal is to ensure total support to the operational forces, deliver compassionate care with fiscal resolve, and carry out a health care strategy of "keep 'em flying, not return 'em to flying".

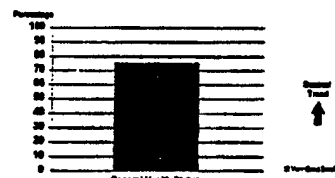
The following are indicators of the general health status of Air Force active duty personnel which signify successful efforts in our implementation of a world-class clinical health care environment:

**Active Duty Air Force
Fitness Status**



Source: Fitness Standard 1995 Survey by HQ AFMHS/AFMHS-11796 data available in Jan 97
Comment: Fitness Standard Survey of Active Duty Personnel Among Military Personnel
GPO: HQ AFMHS/AFMHS-11796

**Active Duty Air Force
Self-Described General Health Status**



Source: Survey for Active Duty Personnel Fitness Questionnaire Survey
GPO: HQ AFMHS/AFMHS-11796 (data available in PWS in FY96)

The percentage of active duty members meeting Air Force fitness standards continues to increase. The redirection of health and wellness efforts toward prevention is a contributing factor to the high percentage of individuals who feel they are in very good or excellent health.

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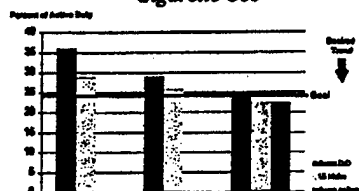
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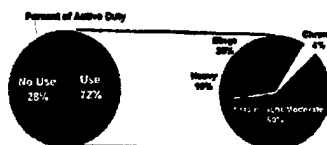
One of the goals of health promotion activities is to minimize negative personal health habits and activities that can degrade an individual's health. The following two indicators measure these efforts. The first shows a decrease in cigarette use among active duty Air Force members. The "alcohol use" indicator is new so no comparisons can be made.

**Active Duty Air Force
Cigarette Use**



Source: Annual Air Force Personnel Risk Factor Surveillance System and National Health Survey of Youth Related Behaviors Among Military Personnel (under review). 1995 results available as of 10/95.
GPO: HQ AFPM-0007

1995 Air Force Alcohol Use



Source: Annual Air Force Personnel Risk Factor Surveillance System and National Health Survey of Youth Related Behaviors Among Military Personnel (under review). 1995 results available as of 10/95.
GPO: HQ AFPM-0007

If our health care system falls short of its goals in preventing disease or injury, appropriate strategies to manage disease must be developed to make the most efficient use of our resources by using quality, customer sensitive, and market driven factors as guides. Demand management and utilization management (UM) strategies are tools which can optimize resource utilization. A systematic evaluation of the necessity, appropriateness, and efficiency of the use of health care services, procedures, and facilities is essential. UM can reduce the length of, or prevent inpatient stays. UM can reduce costs and increase capacity. Key elements of an effective UM process provide a basic foundation for evaluation of care and services and for development of best clinical practices such as practice guidelines, critical pathways, and clinical outcome improvements. It is essential that UM results be analyzed and used as a basis for resource reallocation decisions in order to provide the most cost effective health care. Resources used in providing both inpatient and outpatient medical care can be optimized with timely use of this UM information.

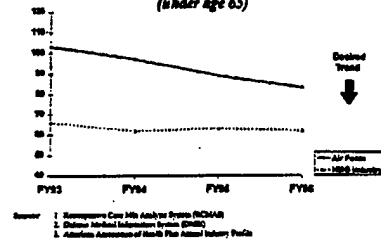
Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Financial Statements and Notes

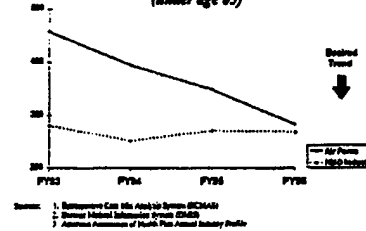
Project 96053001

Supplemental

**Utilization Management -
Dispositions per 1,000 Beneficiaries
(under age 65)**



**Utilization Management -
Bed Days per 1,000 Beneficiaries
(under age 65)**



Air Force medical facilities have continued to dramatically decrease their inpatient utilization, with even further reductions projected in FY97. However, we have yet to attain the same efficiencies realized by the U.S. managed care industry in general.

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

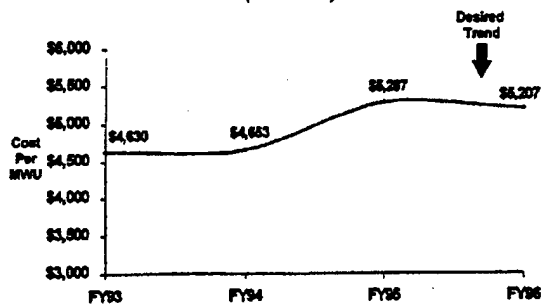
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The proper application of strategic resourcing tools and business case decision making ensures the most efficient use of scarce medical resources. Air Force Medical Service resourcing intends to take advantage of key financing opportunities, goals, deployment and implementation plans, and performance measures, with the end goal of reducing the total cost of health care.

O&M Cost Per Medical Work Unit (MWU)



Sources: 1. Defense Medical Information System (DMIS)
2. Defense Accounting and Finance Service (DAFS)

The current trend in Cost per MWU begins to reflect efficiencies introduced into health care delivery management such as the transition to ambulatory procedure units and other outpatient health care settings, Prime Vendor arrangements requiring less investment in inventory, and arrangements leading to better health care delivery settings such as right sizing and resource sharing programs. As these programs mature in FY97, a further reduction in cost will be realized.

Appendix B. AFMA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

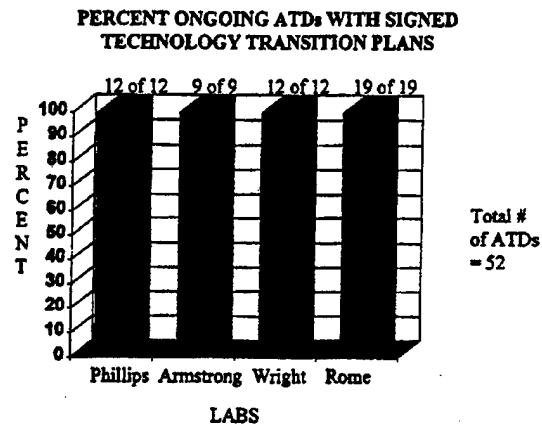
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The following information defines the current status of the Air Force Advanced Technology Demonstrations (ATDs). A critical step in successfully transitioning ATDs is to obtain a signed Technology Transition Plan (TTP) between the sponsoring laboratory and the user (i.e., Air Combat Command (ACC), Air Mobility Command (AMC), etc.) These TTPs define the laboratory's demonstration requirements and the user Command's commitment to employ the technology once it is successfully demonstrated. There are a total of 52 on-going ATDs, all of which have signed TTPs.

Since DoD ATDs are relatively new, the ATDs have not reached the technology transition point. As the ATDs are completed, the Air Force will review how best to qualitatively assess the success and payoffs of these technology transitions to user acquisition programs.



Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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Financial Statements and Notes

Supplemental

AF FORCE STRUCTURE

The following indicates the programmed force structure for FY 96, along with the end of year force structure:

| | Programmed FY96 | Actual FY 96 |
|----------------------------|-----------------|--------------|
| Fighter Wing Equivalents | 20 | 20 |
| Active Military Personnel | 388,200 | 389,001 |
| Active Civilian Personnel | 184,647 | 183,724 |
| Reserve Military Personnel | 73,969 | 73,668 |
| Guard Military Personnel | 109,821 | 109,771 |

PERSONNEL READINESS AND SUSTAINABILITY

| AF FORCE GOALS AND PERFORMANCE MEASURES | FY96 GOAL | FY96 ACTUAL | COMMENTS |
|---|-----------|-------------|--|
| Combined Planning and Exercises - Number of combined (including bilateral) exercises DoD has engaged in with foreign countries | 20 | 27 | |
| Port called Visits and Demonstrations - Number of times senior DoD counterparts visit or make (includes military-to-military contacts between senior level US military personnel and foreign counterparts (i.e. staff talks)) | 22 | 23 | SECAF - 5 CSAF - 28 Future activities at all levels of DoD will likely increase as the US nurtures relationships with coalition partners and prospective partners. |
| International Military, Education, and Training (IMET) - Number of foreign soldiers educated or trained by the US military | 870 | 1019 | It is in line with a steady annual increase since 1993 and is forecast to continue to rise. We are actively reaching out to potential coalition partners and working to promote democracies worldwide through mil-to-mil contacts and education. |
| Schools of Other Nations - Number of US military personnel sent and trained by foreign military | 120 | 135 | We have increased the number of USAF students attending Schools of Other Nations in FY 1996 with efforts already in place to expand the program further. |

**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
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Financial Statements and Notes

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Supplemental

GENERAL FUNDS:

**Financial Obligations Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|---------------------------|--------------|--------------|--------------|
| Total Current Assets | \$61,030,660 | \$57,218,047 | \$52,271,157 |
| Total Current Liabilities | 7,516,495 | 8,281,553 | 4,255,574 |
| Current Ratio | 8.12 | 6.91 | 12.28 |
| Total Quick Assets | 61,030,660 | 57,218,047 | 52,271,157 |
| Total Current Liabilities | 7,516,495 | 8,281,553 | 4,255,574 |
| Acid Test Ratio | 8.12 | 6.91 | 12.28 |

**Operating Results Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|---------------------------------|--------------|--------------|--------------|
| Revenues: | | | |
| Appropriations Realized | \$60,851,876 | \$55,309,619 | \$56,262,701 |
| Federal Sources | 5,013,414 | 3,371,274 | 2,992,020 |
| Public Sources | 219,755 | 219,941 | 217,077 |
| Total Revenues | 66,085,045 | 58,900,834 | 59,471,798 |
| Expenses and Losses | 60,128,956 | 59,066,623 | 59,556,746 |
| Net Operating Surplus <Deficit> | 5,956,089 | <165,789> | < 74,434> |

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

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Financial Statements and Notes

Supplemental

GENERAL FUNDS:

**Financial Condition Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|-------------------|---------------|---------------|---------------|
| Total Assets | \$330,922,062 | \$323,808,695 | \$342,136,759 |
| Total Liabilities | 7,516,495 | 8,281,553 | 11,391,672 |
| Ratio | 44.02 | 39.10 | 30.03 |

**Operating Costs Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|-----------------------------|------------------|------------------|------------------|
| Current Dollars: | | | |
| Total Costs and Expenses | \$60,129,886 | \$59,066,623 | \$59,556,746 |
| Revenues and Reimbursements | <u>5,234,737</u> | <u>3,591,215</u> | <u>3,209,097</u> |
| Net Operating Costs | 54,895,149 | 55,475,408 | 56,347,649 |
| Annual Percentage Change | | 1.1% | 1.57% |

1994 Constant Dollars:

| | | | |
|--------------------------|--------------|--------------|--------------|
| Net Operating Costs | \$54,895,149 | \$54,441,028 | \$54,232,577 |
| Annual Percentage Change | | <0.83%> | <0.38%> |

**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

Financial Statements and Notes

Project 96053001

Supplemental

TRUST FUNDS:

**Operating Results Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|---------------------------------|-------------|-------------|-------------|
| Revenues: | | | |
| Appropriations Realized | - | - | - |
| Federal Sources | - | - | \$ 47 |
| Public Sources | \$6,184 | \$8,543 | 10,467 |
| Total Revenues | 6,184 | 8,543 | 10,514 |
| Expenses and Losses | 6,648 | 8,108 | 10,440 |
| Net Operating Surplus <Deficit> | <464> | 435 | 74 |

**Financial Obligations Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|---------------------------|-------------|-------------|-------------|
| Total Current Assets | \$2,650 | \$3,760 | \$3,343 |
| Total Current Liabilities | 1,371 | 2,046 | 2,922 |
| Current Ratio | 1.93 | 1.84 | 1.14 |
| Total Quick Assets | 2,650 | 3,760 | 3,343 |
| Total Current Liabilities | 1,371 | 2,046 | 2,922 |
| Acid Test Ratio | 1.93 | 1.84 | 1.14 |

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

Financial Statements and Notes

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TRUST FUNDS:

**Operating Costs Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|-----------------------------|-------------|-------------|-------------|
| Current Dollars: | | | |
| Total Costs and Expenses | \$ 6,648 | \$8,108 | \$10,440 |
| Revenues and Reimbursements | 6,184 | 8,543 | 10,514 |
| Net Operating Costs | 464 | <435> | <74> |
| Annual Percentage Change | | <194.75%> | 83.99% |

**Financial Condition Attribute
FY 1996
(\$ Thousands)**

| | <u>1994</u> | <u>1995</u> | <u>1996</u> |
|-------------------|-------------|-------------|-------------|
| Total Assets | \$2,650 | \$3,760 | \$4,710 |
| Total Liabilities | 1,371 | 2,046 | 2,922 |
| Current Ratio | 1.93 | 1.84 | 1.61 |

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

VERBATIM MANAGEMENT COMMENTS



Office of the Assistant Secretary

DEPARTMENT OF THE AIR FORCE
WASHINGTON, DC

07 FEB 1997

MEMORANDUM FOR SAF/AG

FROM: SAF/FM

SUBJECT: Management Comments to the Air Force Audit Agency (AFAA) Draft Report of Audit, Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements (Project 96053001)

We appreciate the opportunity to review and comment on this report. Our comments here are limited to this consolidated opinion report; we will provide you appropriate comments on other reports as we review them.

We accept that you are unable to express an opinion on the reliability of the Air Force financial statements for fiscal year 1996. Further, we recognize you cannot issue an unqualified audit opinion on our financial statements until the Air Force and the Defense Finance and Accounting Service (DFAS) improve a number of accounting systems and resolve other accounting related issues. Even though the systems issues will take a number of years to resolve, we believe we are making steady progress and will continue to do so in the future.

As you summarized in paragraph 6 of your opinion and detailed in paragraph 4 of Tab A, the Air Force, DoD, and DFAS are aggressively working a number of management initiatives to correct the existing problems and improve our accounting processes. We remain firmly committed to auditable financial statements. We will continue to work with AFAA, DFAS, and other groups to improve the accounting systems and resolve related accounting issues as quickly as possible in order to bring about those improvements.

Robert F. Hale

ROBERT F. HALE
Assistant Secretary of the Air Force
(Financial Management and Comptroller)

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

Verbatim Management Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-8291

FEB 12 1997

DFAS-HQ/AFB


MEMORANDUM FOR AUDITOR GENERAL OF THE AIR FORCE

SUBJECT: Management Comments to the Air Force Audit Agency
(AFAA) Draft Report of Audit, Opinion on Fiscal Year
(FY) 1996 Air Force Consolidated Financial Statements
(Project 96053001)

We have reviewed the subject report and are providing the attached interim management comments. Again this year we had less than a week to review this draft report. We are concerned that the current audit review process results in DFAS responding to an opinion report before reviewing the component reports upon which this opinion is based. After we receive and review all of the component reports, we will provide additional overall and specific comments addressing any recommendations.

Although the AFAA continues to disclaim an opinion for the FY 1996 General Funds Chief Financial Officers (CFO) Act Financial Statements, our joint and focused efforts on several key areas during FY 1996 definitely improved the overall quality of the statements. As recognized by the AFAA, we took numerous actions in concert with the Air Force and the AFAA to improve financial reporting for the Air Force. We remain firmly committed to aggressively pursuing significant issues during the balance of FY 1997.

My point of contact for this matter is Mr. Charles McIntosh on (703) 607-5105.


Thomas F. McCarty
Deputy Director for
Accounting

Attachment:
As stated

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APPENDIX IV

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Verbatim Management Comments

Project 96053001

Subject: Management Comments to the Air Force Audit Agency (AFAA) Draft Report of Audit, Opinion on Fiscal Year (FY) 96 Air Force Consolidated Financial Statements (Project 96053001)

The following comments outline actions taken during FY 1996 to improve the Air Force financial statements. Some actions involved the Air Force and the AFAA. Because we have not been afforded the opportunity to review the component reports, we cannot be assured that the summarized presentation of some issues in the opinion report is consistent with those presented in the individual reports. In some areas, we do not agree with some specific conditions cited in the report.

1. FY 96 actions: We are pleased with the results of the combined efforts of DFAS-DE accountants and AFAA auditors working with the Air Force functional managers to provide material balances on the financial statements. In addition to the areas noted in the "Management Actions" section of the report, additional efforts included the following:

a. We worked with the Air Force civil engineering community and for the first time reported the liability, expense, and future funding requirements for the estimated \$4.1 billion cost to the Air Force to complete environmental cleanup.

b. We also established an actuarial liability estimate of \$993 million for Federal Employee Future Workers' Compensation Benefits.

c. We included footnote disclosure of data used in statements that does not meet our standards as fully supportable. For example, we disclosed the nature of accrued expenditure data for accounts payable.

2. Areas where summarized issues do not accurately describe the problem:

a. The issue of unreported negative unliquidated obligations (NULOs) identified by the AFAA does not fully describe the issue. While we agree the overall value of NULOs was understated, we did report the rejected disbursements as unmatched, another category of problem disbursements.

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

Verbatim Management Comments

b. We are also concerned that the AFAA believes the problem with underreported construction-in-progress balances stems from DFAS-DE personnel not establishing procedures to reconcile the general ledger with the civil engineer work-in-progress records. In reality, the civil engineering cost accountants are responsible for reporting reliable construction-in-progress balances to DFAS-DE for inclusion in the general ledger. Other than high-level sanity checks, such as abnormal balances or unusual fluctuations, DFAS-DE personnel are not responsible for reconciling reported balances to source records maintained by civil engineering personnel.

c. The AFAA stated DFAS-DE incurred penalties and interest payments because disbursing offices did not always pay Air Force debts promptly as intended by the Prompt Pay Act (PPA). While we did not make all payments on time, our FY 1996 PPA statistics indicate we made over 93 percent of the payments subject to the PPA on time. We disagree with the AFAA statement that we are not complying with the intent of the PPA. Further, the presentation of the condition in the report does not indicate DFAS-DE statistics on PPA interest met the goals established by DFAS-HQ and those results are the culmination of extensive coordination between DFAS-DE and the Air Force financial management community. Finally, on the basis of materiality, we question the appropriateness of including this issue in the opinion report.

3. Areas of disagreement:

a. We do not agree that unmatched recoupments of progress payments should be treated as recommended by the AFAA. The report infers that unmatched recoupments may be invalid but does not support this view with any evidence. We do not believe that a significant amount of the unmatched recoupments are invalid. The AFAA also did not provide any evidence that progress payments were understated on the financial statements. Because we recouped progress payments at the Air Force level, progress payments overall should be reduced.

b. We do not believe the presentation of inaccurate government furnished property (GFP) accurately describes the condition. The report states that "neither the Air Force nor DFAS-DE can identify the reason(s) for the \$20.4 billion difference between that amount of GFP included on the financial

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Verbatim Management Comments

Project 96053001

statements and the value of GFP in the Contractors Property Management System (CPMS)."

(1) We agree with the need to reconcile the differences between CPMS and the values reported in the financial statements. We disagree that DFAS has responsibility for this reconciliation. Until the CPMS capitalization reporting threshold is corrected, an adequate reconciliation is not feasible except at extraordinary cost. For example, CPMS reported \$5.5 billion in total special tooling and special test equipment (ST/STE). Using data from CPMS and applying the prior and current years capitalization criteria to the asset values reported, the amount DFAS-DE reported for ST/STE in the hands of contractors decreased by \$1.0 billion to \$4.5 billion. This problem was discussed at length with the AFAA and was also part of our response to the FY 1995 GFP report (Project 96053011). This CPMS capitalization issue needs to be addressed before this condition can be corrected.

(2) We also take exception to the statement "DFAS-DE must create GFP balances manually by extracting partial data from a number of automated systems which were designed for other purposes." This statement can be said for all PP&E systems that were designed as inventory systems. We, however, believe that the Equipment Inventory, Multiple Status, and Utilization Reporting (EIMSUR) system can be used to report the value of aircraft and intercontinental ballistic missiles (ICBMs) in the Air Force financial statements. The EIMSUR system identifies and reports each class of aircraft and ICBMs by location code and dollar value. In the FY 1996 financial statements, DFAS-DE used the location code to identify those aircraft and ICBMs in the hands of contractors. To check the validity of the EIMSURS location codes, we extracted a sample of aircraft in the hands of the contractors from CPMS and compared the results to EIMSURS. Although we found differences in the unit cost values used for the aircraft, we found no significant differences in the types of aircraft reported. It also should be noted that the unit cost differences were a major issue that was also discussed in the FY 1995 GFP report (Project 96053011).

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**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

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LAWS AND REGULATIONS

We reviewed significant provisions of the laws and regulations listed below.

Public Laws

Antideficiency Act, ch. 510 3, 34 Stat. 49 (codified as amended in 31 U.S.C. ss1341, 1342, 1349-1351, 1511-1519 [1988]).

Budget and Accounting Procedures Act of 1950, ch. 946, 64 Stat. 832 (codified as amended in various sections of 31 U.S.C.).

Civil Service Reform Act of 1978, Pub. L. No. 95-454, 92 Stat. 1111 (codified in various sections of 5 U.S.C., 10 U.S.C., 15 U.S.C., 28 U.S.C., 38 U.S.C., 39 U.S.C., 42 U.S.C.).

Civil Service Retirement Act of 1930, ch. 34 1-18, 46 Stat. 468, as renumbered 31 July 1956, ch. 804, title IV, §401 70 Stat. 743 (codified as amended in 5 U.S.C. ss1308, 3323, 8331-8348 [1988]).

Dual Compensation Act of 1964, Pub. L. No. 88-488, 19 August 1964.

Fair Labor Standards Act of 1938, ch. 676, 52 Stat. 1060 (codified as amended in 29 U.S.C. ss201-219 [1988]).

Federal Debt Collection Procedures Act of 1990, Pub. L. No. 101-647, Title XXXVI, Subtitle A, ss3611, 104 Stat. 4933 (codified in various sections of 28 U.S.C.).

Federal Employees' Compensation Act, ch. 458, 39 Stat. 742 (codified as amended in various sections of 5 U.S.C.).

Federal Employees' Group Life Insurance Act of 1980, Pub. L. No. 96-427, 94 Stat. 1831 (codified in various sections of 5 U.S.C.).

Federal Employees Health Benefits Act of 1959, Pub. L. No. 86-382, 73 Stat. 708 (codified as amended in various sections of 5 U.S.C.).

Federal Managers' Financial Integrity Act of 1982, Pub L. No. 97-255, 96 Stat. 814, 31 U.S.C. ss1105, 1113, 3512 (1988).

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Laws and Regulations

Government Management Reform Act of 1994, Pub. L. No. 103-356, 13 October 1994, 108 Stat. 3412-3416.

Prompt Payment Act, Pub. L. No. 97-177, 96 Stat. 85, 31 U.S.C. ss3901-3906 (1988).

Federal Guidance

Federal Acquisition Regulation, Part 52, Solicitation Provisions and Contract Clauses, 1 January 1995.

OMB Bulletins and Circulars

OMB Bulletin 93-06, Audit Requirements for Federal Financial Statements, 8 January 1993.

OMB Bulletin 94-01, Form and Content of Agency Financial Statements, 16 November 1993.

OMB Bulletin 97-01, Form and Content of Agency Financial Statements, 16 October 1996.

OMB Circular A-11, Preparation and Submission of Budget Estimates, 13 June 1996.

OMB Circular A-34 (Revised Transmittal Number 13), Instructions on Budget Execution, 26 December 1995.

OMB Circular A-123, Management Accountability and Control, 21 June 1995.

OMB Circular A-125 (Revised), Prompt Payment, 12 December 1989.

OMB Circular A-127, Financial Management Systems, 23 July 1993.

Treasury Guidance

Treasury Financial Manual, Volume 1, Bulletin 96-03, Year-End Closing, 17 July 1996.

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Federal Accounting Standards

**Statement of Federal Financial Accounting Standards Number 1, Accounting for
Selected Assets and Liabilities, 30 March 1993.**

**Statement of Federal Financial Accounting Standards Number 3, Accounting for
Inventory and Related Property, 27 October 1993.**

DoD Guidance

**DoD 4161.2-M, DoD Manual for the Performance of Contract Property
Administration, December 1991.**

DoD 5010.38, Internal Management Control Program, 14 April 1987.

**DoD 7000.14-R, Financial Management Regulation, Volume 1, General Financial
Management Information, Systems, and Requirements, May 1993.**

**DoD 7000.14-R, Financial Management Regulation, Volume 4, Accounting
Policies and Procedures, January 1995.**

**DoD 7000.14-R, Financial Management Regulation, Volume 5, Disbursing Policy
and Procedures, December 1993.**

**DoD 7000.14-R, Financial Management Regulation, Volume 6, Reporting Policy
and Procedures, February 1996.**

**DoD 7000.14-R, Financial Management Regulation, Volume 7A, Military Pay
Policy and Procedures Active Duty and Reserve Pay, July 1996.**

**DoD 7000.14-R, Financial Management Regulation, Volume 8, Civilian Pay
Policy and Procedures, January 1995.**

**DoD 7000.14-R, Financial Management Regulation, Volume 10, Contract
Payment Policy and Procedures, February 1996.**

**DoD 7000.14-R, Financial Management Regulation, Volume 14, Administrative
Control of Funds and Antideficiency Act Violations, August 1995.**

DoD Directive 7200.1, Administrative Control of Appropriations, 7 May 1984.

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Laws and Regulations

DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity, October 1996.

Defense Finance and Accounting Service Directives

DFAS-DER 170-9, Fiscal Year-End Certification of Appropriation and Fund Balances, 30 June 1995.

DFAS-DER 177-102, Commercial Transactions at Base Level, 31 January 1996.

DFAS-DER 177-104, Civilian Pay Transactions at Base Level, 30 August 1993.

DFAS-DE Manual 177-373, DJMS-AC Financial Services Offices (FSO) Procedures, 1 November 1994.

Air Force Directives

Air Force Instruction (AFI) 16-402, Aerospace Vehicle Assignment, Distribution, Accounting and Termination, 26 April 1994.

AFI 21-103, Equipment Inventory, Status, and Utilization Reporting, 25 July 1994.

AFI 21-104, Selective Management of Selected Gas Turbine Engines, 17 June 1994.

AFI 21-202, Combat Ammunition System Procedures, 1 July 1995.

AFM 23-110, Volume 2, USAF Supply Manual, April 1996.

AFI 23-111, Management of Government Property in Possession of the Air Force, 1 February 1996.

AFI 24-301, Vehicle Operations, 10 April 1995.

AFI 25-201, Support Agreement Procedures, 10 June 1994.

AFM 30-130, Base-Level Military Personnel System Users Manual, Volume I, 1 September 1992.

AFI 32-9005, Real Property Accountability and Reporting, 30 September 1994.

**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
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AFI 33-112, Automatic Data Processing Equipment (ADPE) Management, 6 May 1994.

AFI 51-601, Gifts to the Department of the Air Force, 19 July 1994.

AFI 65-201, Internal Management Controls Program, 1 July 1994.

AFI 65-503, US Air Force Cost and Planning Factors, 4 February 1994.

AFI 65-601, Volume I, Budget and Guidance Procedures, 21 October 1994.

AFM 67-1, USAF Supply Manual, Volume I, Part One, Basic Air Force Supply Procedures, 16 September 1996.

AFM 67-1, USAF Supply Manual, Volume I, Part Three, Air Force Stock Fund and DPSC Assigned Item Procedures, 26 June 1995.

AFM 136-824, Combat Ammunition System-Base, Volume I, 31 March 1995.

AFR 170-8, Accounting for Obligations, 15 January 1990.

AFR 170-13, Accounting for Commitments, 30 July 1990.

AFR 177-11, Accounting and Reporting for Accrued Expenditures and Revenues, 1 September 1985.

AFR 177-16, Administrative Control of Appropriations, 30 November 1988.

AFP 177-31, General Funds General Ledger Accounting Procedures, 31 December 1991.

AFR 177-101, General Accounting and Finance Systems at Base Level, 15 August 1994.

AFR 177-120, Central Procurement Transactions, 17 February 1988.

AFM 177-206, Automated Materiel Accounting System Integrated Within Standard Base Supply System: D00A/GV Users Manual, 1 October 1994.

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Laws and Regulations

AFM 177-370, USAF Standard Base-Level General Accounting and Finance System: H069/BQ, 5 February 1994.

AFM 177-372A, Volume I, Air Force Standard Civilian Automated Pay System (PA) Users Manual, 1 May 1995; and Volume II, Time and Attendance Reporting Civilian Pay System, 31 December 1994.

AFM 177-373, Volume III, Defense Joint Military Pay System-Reserve Component Pay Manual, 1 January 1994.

AFR 177-390, Volume 4, Disbursing Officers Database Management System (DMS) Security H121H/TZ, 1 June 1995.

AFSSI 5103, Computer Security (COMPUSEC) For Operational Systems, 15 March 1993.

Technical Order (TO) 00-25-254-1, Comprehensive Engine Management System Engine Configuration, Status, and TCTO Reporting Procedures, 1 October 1992.

**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

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ASSOCIATED AIR FORCE REPORTS OF AUDIT

| <u>Report Title</u> | <u>Report Number</u> <u>Date Issued</u> |
|--|--|
| Federal Mission Property, Plant, and Equipment, Fiscal Year 1996 Air Force Consolidated Financial Statements | **96053002 3 Feb 97 |
| Fund Control Process, Fiscal Year 1996 Air Force Consolidated Financial Statements | **96053003 7 Feb 97 |
| Civilian Pay, Fiscal Year 1996 Air Force Consolidated Financial Statements | **96053004 7 Feb 96 |
| Operating Materials and Supplies, Fiscal Year 1996 Air Force Consolidated Financial Statements | **96053005 30 Jan 97 |
| Weapon System Progress Payments, Fiscal Year 1996 Air Force Consolidated Financial Statements | *96053006 X Xxx XX |
| Military Pay, Fiscal Year 1996 Air Force Consolidated Financial Statements | **96053015 7 Feb 97 |
| Government Furnished Property, Fiscal Year 1996 Air Force Consolidated Financial Statements | *96053017 X Xxx XX |
| Real Property and Nonmilitary Equipment, Fiscal Year 1996 Air Force Consolidated Financial Statements | **96053019 11 Feb 97 |
| Eliminating Entries and Nonoperating Changes, Fiscal Year 1996 Air Force Consolidated Financial Statements | **97053011 30 Jan 97 |
| Contingent Liabilities, Fiscal Year 1996 Air Force Consolidated Financial Statements | **97053012 17 Jan 97 |

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 96053001

Associated Air Force Reports of Audit

Report Title

Report Number
Date Issued

**Invested Capital, Fiscal Year 1996 Air Force Consolidated
Financial Statements**

***97053013
X Xxx XX**

- * Report not yet issued to management for comments.**
- ** The report of audit was released to management.**

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"

Project 96053001

**ACTIVITIES CONTACTED
DURING THE AUDIT**

Organization

Headquarters United States Air Force

Assistant Secretary of the Air Force
(Financial Management and Comptroller)
(SAF/FM)

Assistant Secretary of the Air Force
(Acquisition)
(SAF/AQ)

Office of the Air Force General Counsel
(SAF/GC)

Deputy Chief of Staff, Installations and Logistics
(AF/IL) (formerly AF/LG)

Deputy Chief of Staff, Installations and Logistics
Office of the Civil Engineer
(AF/ILE) (formerly AF/CE)

Deputy Chief of Staff, Plans and Programs
(AF/XP) (formerly AF/PE)

Air Force Field Operating Agencies/Direct Reporting Units

Air Force Base Conversion Agency (AFBCA)
Arlington VA

Air Force Legal Services Agency (AFLSA)
Bolling AFB DC

US Air Force Academy (USAFA)
Colorado Springs CO

Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements"

Project 86053001

Activities Contacted During the Audit

Army Audit Agency

US Army Audit Agency Field Office
Rock Island IL

Defense Contract Audit Agency

Lockheed Martin Mount Laurel Resident Office
Lockheed Martin, Astro Systems Division, East Windsor NJ
Lockheed Martin, Valley Forge PA

Rockwell International Corporation Resident Office
Rockwell International Space Systems Division
Downey CA

Silicon Valley Resident Office
Lockheed Martin Missiles and Space Company
Sunnyvale CA

TRW Resident Office
TRW, Redondo Beach CA

Defense Contract Management Command (DCMC)

DCMC Atlanta, Atlanta GA

DCMC Birmingham, Birmingham AL

DCMC Boeing Wichita, Wichita KS

DCMC Dallas, Dallas TX

DCMC Denver, Denver CO

DCMC Downey, Downey CA

DCMC Lockheed Martin-Ft Worth, Fort Worth TX

DCMC Lockheed Martin-Marietta, Marietta GA

**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
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Activities Contacted During the Audit

Project 96053001

Defense Contract Management Command (DCMC) (Cont'd)

DCMC Raytheon, Bedford MA

Defense Finance and Accounting Service (DFAS)

DFAS Headquarters

DFAS-Columbus Center

DFAS-Denver Center

Office of Inspector General-Department of Defense

Office of the Assistant Inspector General
for Auditing (OAIG-AUD)

Office of the Assistant Inspector General
for Auditing, Finance and Accounting
Directorate (OAIG-AUD-FA)

Office of the Assistant Inspector General
for Auditing, Finance and Accounting
Directorate, Denver and Columbus Field Offices
(OAIG-AUD-FD and OAIG-AUD-FC)

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**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

Project 96053001

MAJOR CONTRIBUTORS TO THIS REPORT

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**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
Consolidated Financial Statements"**

Project 96053001

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| AF/CVA | AFRES |
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| DFAS-DE | AMC |
| DFAS-HQ | ANGRC |
| NGB/CF | PACAF |
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| Naval Audit Service | |
| OAIG-AUD | |
| OAIG-P&O | |
| OAIG-AUD-FA | |
| OAIG-AUD-FC | |
| OAIG-AUD-FD | |
| OAIG-AUD-APTS | |

FREEDOM OF INFORMATION ACT

The disclosure/denial authority prescribed in AFPD 65-3 will make all decisions relative to release of this report to the public.

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**Appendix B. AFAA Report, "Opinion on Fiscal Year 1996 Air Force
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**To request copies of this report or to suggest audit topics
for future audits, contact the Assistant Auditor General,
Operations, at (703) 696-8026 (DSN 426-8026) or e-mail to
reports@af.pentagon.mil. You may also mail requests to:**

**Air Force Audit Agency
Assistant Auditor General (Operations)
1125 Air Force Pentagon
Washington DC 20330-1125**

Appendix C. Audit Process

Audit Work Performed. To fulfill our responsibilities under the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management of 1994, for determining the accuracy and completeness of the independent audit conducted by the AFAA, we reviewed the AFAA audit approach and planning and monitored audit progress at key points.

Reviewing AFAA Audit Approach and Planning. We used the President's Council on Integrity and Efficiency "Federal Financial Statement Audit Manual" as the criterion for reviewing the AFAA audit approach and planning. Specifically, we reviewed the opening conference documentation, strategy formulation, general risk analysis, audit programs, and cycle memorandums.

We reviewed additional documentation as deemed necessary to accomplish the audit objective.

Monitoring Audit Progress at Key Points. Through the IG, DoD, Integrated Audit Process Team and the Executive Steering Committee, we provided a forum for a centrally managed exchange of guidance and information leading to a focused DoD-wide effort to audit the DoD consolidated financial statements, to include the supporting financial statements of major DoD Components. Audit initiatives for monitoring the progress of the audit at key points also involved reviewing and commenting on AFAA draft audit reports, including the audit opinion report.

In addition to the oversight procedures, we performed other procedures deemed necessary to determine the fairness and accuracy of the AFAA audit approach and conclusions.

Audit Period and Standards. We performed this financial statement audit from May 17, 1996, through March 1, 1997. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit.

Contacts During the Audit. We visited or contacted individuals and organizations in the DoD audit community. Further details are available on request.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Intelligence Agency

Non-Defense Federal Organizations

Inspector General, Department of Education
Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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