Audit Report

MAJOR DEFICIENCIES PREVENTING FAVORABLE AUDIT OPINIONS ON THE FY 1997 DOD FINANCIAL STATEMENTS

Report No. 98-208 September 23, 1998

Office of the Inspector General
Department of Defense

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Acronyms

CEFMS	Corps of Engineers Financial Management System
CFO	Chief Financial Officers
DBOF	Defense Business Operations Fund
DeCA	Defense Commissary Agency
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DJAS	Defense Joint Accounting System
DLA	Defense Logistics Agency
DSAA	Defense Security Assistance Agency
FASAB	Federal Accounting Standards Advisory Board
GAO	General Accounting Office
IG	Inspector General
JLSC	Joint Logistics Systems Center
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards
USD(C)	Under Secretary of Defense (Comptroller)

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

September 23, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE COMMISSARY AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY
DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY
CHIEF, U.S. ARMY CORPS OF ENGINEERS
AUDITOR GENERAL, DEPARTMENT OF THE ARMY
COMMANDER, JOINT LOGISTICS SYSTEMS CENTER

SUBJECT: Audit Report on Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements (Report No. 98-208)

We are providing this audit report for your information and use. It identifies and summarizes the major deficiencies that prevented favorable audit opinions on the FY 1997 DoD Financial Statements. It also identifies and summarizes actions taken or under way to correct these deficiencies. Although comments on the draft report were not required, the Defense Finance and Accounting Service provided comments. These comments were considered in preparing the final report. The complete text of the comments is in Part III.

Comments on this report met the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. Questions about this audit should be directed to Mr. Richard B. Bird at (703) 604-9175 (DSN 664-9175, e-mail rbird@dodig.osd.mil); or Mr. John J. Vietor at (317) 510-3855 (DSN 699-3855, e-mail jvietor@dodig.osd.mil). The report distribution is listed in Appendix E. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-208 **September 23, 1998**
(Project No. 7FI-2031.03)

Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements

Executive Summary

Introduction. This report summarizes the major deficiencies preventing favorable audit opinions on the FY 1997 DoD Financial Statements. This report gives Congress, the Secretary of Defense, the DoD Chief Financial Officer, financial managers, and the audit community an assessment of progress made in attaining auditable DoD financial statements. In FY 1997, DoD prepared and submitted for audit the DoD Consolidated Financial Statements and 15 other financial statements. The FY 1997 DoD Consolidated Financial Statements reported $1.3 trillion in total assets and $270.4 billion in total revenues. This is the fourth year in which we have issued a summary report on the major deficiencies preventing favorable audit opinions on the DoD financial statements.

Audit Objective. The audit objective was to identify and summarize the major deficiencies that prevented favorable audit opinions on the FY 1997 DoD Financial Statements, and to identify the actions taken or under way to correct these deficiencies.

Audit Results. Auditors identified and DoD financial managers acknowledged major deficiencies that prevented favorable audit opinions on most FY 1997 DoD Financial Statements. The overarching deficiency continues to be the lack of adequate accounting systems for compiling accurate and reliable financial data. Specifically, auditors were unable to render favorable audit opinions on the FY 1997 DoD Consolidated Financial Statements and supporting financial statements prepared for 14 of the 15 DoD reporting entities. The reasons were deficient accounting systems, insufficient audit trails, delays in providing auditors with final versions of the financial statements and management and legal representation letters, lack of effective internal management controls, and the consequent scope limitations that prevented auditors from auditing material lines on the DoD financial statements. Except for the unqualified audit opinions rendered on the DoD Military Retirement Trust Fund Financial Statements, which accounted for 10.8 percent of DoD Consolidated assets and 4.4 percent of DoD Consolidated revenues in FY 1997, auditors have been disclaiming opinions on major DoD financial statements since FY 1988.

Since FY 1988, the General Accounting Office; the Inspector General, DoD; and the Military Department audit agencies have issued several hundred audit reports questioning DoD financial management. In response, DoD financial managers have acknowledged significant problems with financial data and have been attempting to correct the problems. Although DoD continues to evaluate its options for achieving adequate and

compliant DoD accounting systems, progress in correcting deficiencies in accounting systems has been slow and has had mixed results. For example, DoD recently completed deployment of a new accounting system, the Corps of Engineers Financial Management System, throughout the U.S. Army Corps of Engineers. However, the Defense Property Accountability System, which was proposed as the answer to unreliable reporting of DoD real and personal property, has fallen short of expectations. Until DoD deploys accounting systems that comply with the "Federal Financial Management Improvement Act of 1996," auditors will not be able to perform sufficient audit work on material financial statement line items to warrant favorable audit opinions on the DoD financial statements.

Management Comments. We issued a draft of this report on June 30, 1998, which contained no recommendations subject to resolution under DoD Directive 7650.3. Therefore, management comments were not required. However, we received comments from the Defense Finance and Accounting Service (DFAS). DFAS stated that the report did not distinguish between accounting systems and other DoD management or feeder systems. DFAS also nonconcurred with several conclusions about the Fund Balance With Treasury line item of the Army General Fund and undistributed disbursements of the Defense Information Systems Agency and DFAS Working Capital Funds. See Part I for a discussion of the management comments and Part III for the text of the comments.

Audit Response. The issues raised by DFAS comments were not material to the major theme of this report: auditors identified and DoD financial managers acknowledged major deficiencies preventing favorable audit opinions on DoD financial statements. In the draft report, we used the term accounting systems as a broad descriptive term. DFAS emphasized a distinction between the accounting systems and the other DoD management or feeder systems used to compile information for the DoD financial statements. That distinction is valid, but not particularly relevant to our conclusion that compliant accounting systems and compliant feeder systems are necessary to compile accurate, reliable, and auditable financial data. The owners of the feeder systems need to work with DFAS to improve the prospects for favorable audit opinions on DoD Financial Statements.

We have been working closely with the Office of Management and Budget, the Principal Deputy Under Secretary of Defense (Comptroller), DFAS, and the General Accounting Office to develop a strategy for achieving DoD compliance with applicable laws and standards across the range of topics discussed in this report, including Fund Balance With Treasury. The FY 1998 audits will address the Fund Balance With Treasury issues identified by DFAS.

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Part I - Audit Results

Audit Background

Public Law. Public Law 101-576, the "Chief Financial Officers (CFO) Act of 1990," November 15, 1990, requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments. The CFO Act requires the Inspectors General (IGs) or appointed external auditors to audit the financial statements in accordance with generally accepted Government auditing standards and other standards established by the Office of Management and Budget (OMB). The IG, DoD, and the auditors of the Military Departments, under the cognizance of the IG, DoD, conduct these audits within DoD. Public Law 103-356, the "Government Management Reform Act of 1994," October 13, 1994, requires DoD to prepare and submit to the Director, OMB, an audited financial statement for the preceding fiscal year for each DoD office, bureau, and activity.

Magnitude of Assets. In FY 1997, DoD prepared and submitted for audit the DoD Consolidated Financial Statements and 15 other financial statements for the Army, Navy, and Air Force General Funds; the U.S. Army Corps of Engineers, Civil Works Program (the Corps); the Army, Navy, and Air Force Working Capital Funds; the Defense Logistics Agency (DLA) Working Capital Fund; the Defense Information Systems Agency (DISA) Working Capital Fund; the Defense Finance and Accounting Service (DFAS) Working Capital Fund; the Joint Logistics Systems (JLSC) Center Working Capital Fund; the Defense Commissary Agency (DeCA) Working Capital Fund; the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; and the Defense Security Assistance Agency (DSAA). Although auditors reviewed the data on the Other Defense Organizations column of the DoD Consolidating Financial Statements, DoD did not prepare individual audited financial statements for the Other Defense Organizations. DoD prepared financial statements for the U.S. Transportation Command Working Capital Fund; however, the Under Secretary of Defense (Comptroller) [USD(C)] did not submit those financial statements for audit. In addition, although DoD prepared financial statements for DSAA, the statements were not included in the DoD Consolidated Financial Statements. The DoD FY 1997 Consolidated Financial Statements included total assets of more than $1.3 trillion and total revenues of $270.4 billion. The figures on the next page show the magnitude of the assets and revenues reported in the FY 1997 DoD Consolidated Financial Statements.

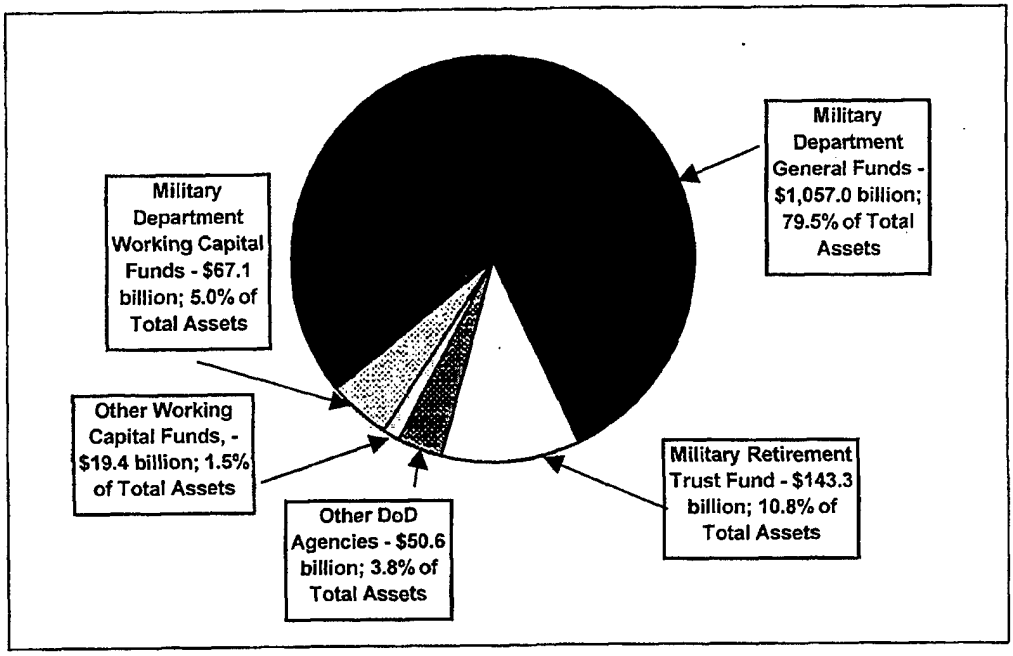

Figure 1. FY 1997 DoD Consolidated Assets ($1,330.2 billion)

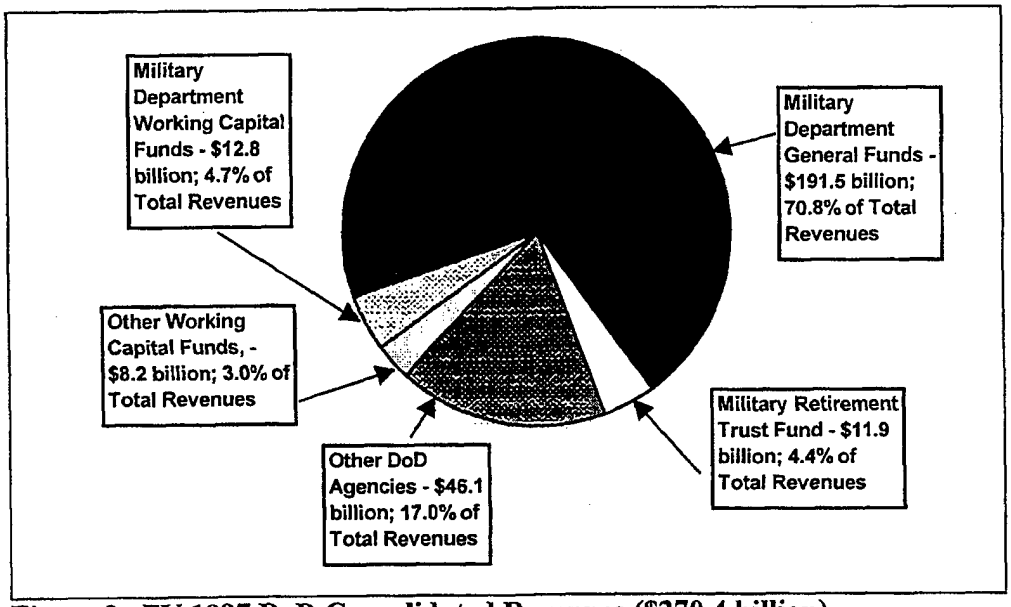

Figure 2. FY 1997 DoD Consolidated Revenues ($270.4 billion)

In Figure 1 on the previous page, the DoD Components' asset totals add up to more than the DoD Consolidated asset total because some receivables and advances for the DoD Military Department General Funds were eliminated from the DoD Consolidated asset total. In Figure 2 on the previous page, DoD Components' revenues are shown after eliminating entries were made to remove intra-DoD transactions. DSAA, which accounts for $27.9 billion of DoD assets and $4.6 billion of DoD revenues, was not included in the DoD Consolidated Financial Statements. However, DSAA was included in our review of "Other DoD Agencies."

Appendix C shows FY 1997 total DoD assets and revenues for FY 1997, by reporting entity, before eliminations.

Audit Opinions. The objective of a financial statement audit by an independent auditor is to render an audit opinion. The opinion is based on the auditor's determination of whether or not the financial statements present fairly, in all material respects, the financial position, results of operations, and the cash flows of the audited organization. The auditors review the financial statements for conformity with generally accepted accounting principles. Auditors render an opinion, or if required, disclaim an opinion. Auditors can render three types of audit opinions.

- An unqualified opinion states that the financial statements are fairly presented.
- A qualified opinion states that, except for stated qualifications, the financial statements are fairly presented.
- An adverse opinion states that the financial statements are not fairly presented.

When auditors cannot conduct an audit, they issue a disclaimer of opinion. A disclaimer states that the auditors are not rendering an opinion on the financial statements. A disclaimer is appropriate when auditors have not performed an audit sufficient in scope to allow them to form an opinion on the financial statements. Restrictions on the scope of an audit, whether imposed by the client or by circumstances, may result from limitations on the timing of work, the inability to obtain sufficient evidence, or the inadequacy of accounting records.

Previous Audits of DoD Financial Statements. Audits of the DoD financial statements have been performed since FY 1988, when the General Accounting Office (GAO) attempted to audit the Air Force General Fund. Except for unqualified opinions rendered on the DoD Military Retirement Trust Fund, auditors have rendered disclaimers of opinion on all significant DoD financial statements. Table 1 below lists the audit opinions rendered on the FY 1997 DoD Financial Statements.

Table 1. Audit Opinions on the FY 1997 DoD Financial Statements

Title	Audit Organization	Opinion
Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1997	OIG, DoD	Disclaimer
Army's Principal Financial Statements for Fiscal Years 1997 and 1996	Army Audit Agency	Disclaimer
Army Working Capital Fund Principal Financial Statements for FY 1997	Army Audit Agency	Disclaimer
FY 97 Financial Statements Opinion Report: U.S. Army Corps of Engineers, Civil Works	Army Audit Agency	Disclaimer
Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Report on Auditor's Opinion	Naval Audit Service	Disclaimer
Independent Auditor's Opinion on the Statement of Financial Position of the FY 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements	Naval Audit Service	Disclaimer
Report of Audit, Opinion on Fiscal Year 1997 Air Force Consolidated Financial Statements	Air Force Audit Agency	Disclaimer
Report of Audit, Opinion on Fiscal Year 1997 Air Force Working Capital Fund Financial Statements	Air Force Audit Agency	Disclaimer
Audit Opinion on the Defense Logistics Agency Working Capital Fund Financial Statements for FY 1997	OIG, DoD	Disclaimer
Disclaimer of Opinion on the Defense Information Systems Agency Defense-Wide Working Capital Fund Financial Statements for FY 1997	OIG, DoD	Disclaimer
Disclaimer of Opinion on the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1997	OIG, DoD	Disclaimer
Disclaimer of Opinion on the Defense Commissary Agency Financial Statements for FY 1997	OIG, DoD	Disclaimer
Audit Opinion on the Military Retirement Trust Fund Financial Statements for FYs 1997 and 1996	OIG, DoD	Unqualified
Disclaimer of Opinion on the National Defense Stockpile Transaction Fund Financial Statements for FY 1997	OIG, DoD	Disclaimer
Disclaimer of Opinion on the Defense Security Assistance Agency Financial Statements for FY 1997	OIG, DoD	Disclaimer
Disclaimer of Opinion on the Joint Logistics Systems Center Working Capital Fund Financial Statements for FY 1997	OIG, DoD	Disclaimer
Other Defense Agencies[1]	OIG, DoD	—

[1]No formal CFO financial statements are produced, but data are part of the FY 1997 DoD Consolidated Financial Statements.

See Appendix B for a list of prior audit reports issued by GAO; the IG, DoD; and the Military Department audit agencies on the DoD financial statements.

Audit Objectives

The objectives of the audit were to identify and summarize the major deficiencies that prevented favorable audit opinions on the FY 1997 DoD Financial Statements, and to identify actions taken or under way to correct the deficiencies. See Appendix A for a discussion of the audit process and Appendix B for a list of prior audit reports on the DoD financial statements.

Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements

Auditors continue to identify and report numerous long-standing deficiencies preventing favorable audit opinions on the FY 1997 DoD Financial Statements, which reported $1.3 trillion in total assets and $270.4 billion in total revenues. Among the reasons for disclaimers of opinion on the FY 1997 DoD Financial Statements were deficient accounting systems, insufficient audit trails, untimely submission of the final versions of the financial statements to the auditors, untimely submission of management and legal representation letters, lack of effective internal controls, and the consequent scope limitations that prevented auditors from auditing material line items on the DoD financial statements. DoD financial managers continue to acknowledge deficiencies and have been making corrections for several years. However, since 1990, when auditors first issued a disclaimer of opinion on the FY 1988 Air Force Consolidated Financial Statements, DoD has made little progress toward achieving auditable financial data. As a result, auditors disclaimed opinions on all FY 1997 financial statements of the major DoD funds, except for an unqualified opinion on the Military Retirement Trust Fund. This finding summarizes the reported deficiencies and discusses actions taken or under way to correct them.

DoD Consolidated Financial Statements

Although progress continues, auditors were unable to render an opinion on the DoD Consolidated Financial Statements for FYs 1997 and 1996. The FY 1997 financial statements reported $1,330.3 billion in DoD Consolidated assets and $270.4 billion in DoD Consolidated revenues, and the FY 1996 financial statements reported $1,311.5 billion in DoD Consolidated assets and $301.9 billion in DoD Consolidated revenues. Auditors continue to find significant deficiencies in the accounting systems and internal controls that prevent the preparation of accurate financial statements. The accounting data were not reliable, and the auditors were unable to satisfy themselves that the data were accurate and complete. Further, the auditors did not receive the FY 1997 DoD Consolidated Financial Statements in a timely manner, and DoD did not provide management and legal representation letters. The auditors identified significant deficiencies in the accounting systems, and the lack of sound internal controls prevented the preparation of accurate financial statements. The accounting data were not reliable; therefore, the auditors were unable to satisfy themselves that the data were accurate and complete.

FY 1997 Financial Statements of the Military Department General Funds

The accounting systems that support the Military Department General Funds, which represent $1,057 billion of DoD Consolidated assets and $191.5 billion of DoD Consolidated revenues, do not have integrated, double-entry, transaction-driven general ledgers to compile and report reliable and auditable financial data. The reported assets and revenues for the Military Department General Funds represent 79.5 percent of DoD Consolidated assets and 70.8 percent of DoD Consolidated revenues (some revenues are eliminated from the DoD Consolidated total because they represent transactions between DoD activities). Thus, the four Military Department General Funds, the Army, the Navy, the Air Force, and the Corps, account for about three-fourths of the assets and revenues reported by the 15 DoD Components. The financial data are not auditable because accounting systems do not produce an audit trail from the occurrence of a transaction through its recognition in accounting records, and ultimately to the General Fund financial systems. Because of inadequate accounting systems, auditors have been unable to obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the financial statements. Until accounting systems with integrated, double-entry, transaction-driven general ledgers are developed to compile and report financial data, auditors will be unable to determine whether valid transactions are properly recorded, processed, and summarized. This is a significant long-standing scope limitation that is likely to continue to cause disclaimers of opinion on the Military Department General Fund financial statements. The following is a discussion of the reasons for disclaimers on the financial statements of the Army, Navy, and Air Force General Funds and the U.S. Army Corps of Engineers, Civil Works Program.

Army General Fund. Auditors were unable to render a favorable opinion on the FY 1997 Army General Fund Financial Statements. The main reasons for the disclaimer of opinion were inadequate accounting systems and audit trails, and unreliable amounts for several material line items in the financial statements.

Accounting Systems. Deficiencies in the Army accounting systems were the major reason the auditors were unable to render a favorable audit opinion. Army accounting systems and the systems that interface with them were not designed for financial statement reporting. Therefore, the Army accounting systems produced unreliable and unauditable financial statements.

Financial Statement Amounts. To compute and report the amounts for several material line items in the financial statements, the Army used processes that produced unreliable and unauditable numbers.

Fund Balance With Treasury. Because of discrepancies and a lack of data, the auditors were unable to attest to the reasonableness of the total reported for Fund Balance With Treasury. The auditors found approximately $4.4 billion in unresolved discrepancies between the Department of the Treasury (the Treasury) records and the disbursing officers' statements of accountability for checks issued. About $2.9 billion of the discrepancies favored the Army, and about $1.5 billion favored the Treasury. If all discrepancies were resolved, the amount reported by the Army for Fund Balance With Treasury and Appropriated Capital may have been understated by about $1.4 billion.

Property, Plant, and Equipment, Net. Auditors were unable to attest to the $132.0 billion value for Property, Plant, and Equipment, Net, because the Army misstated the values by unknown, but probably material, amounts. The misstated values were caused by reporting problems in the following subelements, which account for over 98 percent of the total amounts reported for Property, Plant, and Equipment, Net.

Military Equipment. The Army misstated Military Equipment by an unknown amount because prices used to value Military Equipment were not current; because reported values did not include the value of items accepted at contractors' plants but not yet received by the using units; because contractor reports, which account for equipment held by the contractors, were incomplete and inaccurate; because the reported values did not provide assurance that all units had reported their property, or that the Army based the reported values on DoD thresholds for the reporting of assets; and because the Army valued Military Equipment at standard prices rather than actual cost.

Real Property. The Army misstated the $34.3 billion value for Real Property by an unknown amount because Army and DoD reporting guidance was unclear, and the Army implemented the guidance inconsistently. The reported values for Real Property included land, structures, facilities, and leasehold improvements. The auditors found specific problems, including duplicate reporting of commissary and nonappropriated fund assets, and incomplete reporting of construction.

Construction-in-Progress. The Army misstated the value for Construction-in-Progress by an unknown amount because the Army based the amount of Government-furnished materiel on contractors' reports that were inaccurate or incomplete. In addition, for FY 1996, the $1.7 billion amount reported by the Army National Guard for Construction-in-Progress included an unknown amount for completed projects. For FY 1997, the auditors were unable to verify whether the Army National Guard removed all completed projects from Construction-in-Progress for FY 1996.

War Reserves. The Army misstated the $46.8 billion value for War Reserves by an unknown, but probably material, amount because the Army improperly valued excess assets and assets in an unknown condition at full standard price.

Other Entity Assets. The Army misstated the zero value for Other Entity Assets by an unknown amount. Because the Army derived the amount reported for Other Entity Assets in FY 1996 from contractors' reports that were incomplete and inaccurate, the Army did not include data from those reports in FY 1997.

Accounts Receivable. The $1.2 billion reported for Accounts Receivable was unreliable, and existing accounting systems and procedures prevented auditors from determining the reliability of account balances. Instead of using the Army general ledger as the source of reported balances, DFAS made unsupported corporate-level adjustments that forced the general ledger to agree with data on the status of funds. Auditors did not verify the amounts reported for Accounts Receivable because the accounting systems lacked subsidiary ledgers.

Accounts Payable. For Federal and non-Federal entities, the $2.3 billion reported for Accounts Payable that were covered by budgetary resources were unreliable, and the existing accounting systems and procedures prevented auditors from determining the reliability of account balances. The Army frequently did not record Accounts Payable when Army activities received goods or services; for year-end unpaid invoices on Defense-administered Army contracts; and for progress payment holdbacks. Also, DFAS made corporate-level adjustments to Army Accounts Payable to make the general ledger equal the data on the status of funds, which the Army considered reliable. However, because of procedural problems, the adjustments distorted the reported value for Accounts Payable.

Other Liabilities. Auditors could not attest to the $319.1 million reported for other non-Federal liabilities that were not covered by budgetary resources because of internal control weaknesses at the activities responsible for tracking and valuing those liabilities. The internal control weaknesses existed because the Army did not have controls to ensure that Army organizations disclosed all liabilities.

Total Expenses. The Army accounting systems lacked subsidiary ledgers that provided detailed transactions. The detailed transactions make up the summary amounts reported for expenses in the Army financial statements. The auditors did not attempt to audit the $65.4 billion in Total Expenses reported in the Army financial statements because of the lack of an audit trail.

Navy General Fund. Auditors were unable to render an opinion on the FY 1997 Navy Principal Financial Statements. The main reason for the disclaimer of

opinion was that the Navy lacked transaction-driven, standard general ledger accounting systems that could accurately report the value of assets and liabilities, including the status of appropriated funds. Auditors could not ascertain the reliability of the financial statements because of the lack of subsidiary ledgers, which are necessary for maintaining accurate financial records and providing an audit trail.

Fund Balance With Treasury. Auditors found that DFAS needs to make more progress in reporting unreconciled differences and in documenting adjustments to Budget Clearing Account F3879 balances (undistributed and letters of credit differences).

Accounts Receivable, Net, Federal and Non-Federal. Auditors noted understatements totaling approximately $430 million related to negative balances in appropriations. The understatements occurred because the Navy credited unearned revenue to Accounts Receivable rather than a separate Unearned Revenue liability account. For Accounts Receivable, Net, Non-Federal, the Navy included $1.4 billion in contractor debt for which a contingency loss existed. Reporting the $1.4 billion contingency as Accounts Receivable prevented the Accounts Receivable, Net, Non-Federal, balance from being a useful indicator of collectibles for financial reporting. The method used to estimate the uncollectible portion of the Navy FY 1997 Accounts Receivable, Net, Non-Federal, balance did not produce an allowance for uncollectible amounts that was reliable for either financial reporting or debt management.

War Reserves. On the Navy FY 1997 Statement of Financial Position, War Reserves were understated by at least $8.5 billion. The $8.5 billion included items on ships. Navy management believed these items did not need to be reported. For two reasons, auditors were unable to further assess the accuracy of the $54.6 billion of War Reserves that the Navy reported on the FY 1997 Navy Statement of Financial Position. First, the manual data call process did not provide a final balance for War Reserves in a timely manner for review before the final financial statements were issued. Second, documentation to support the $54.6 billion was not available for review before the Navy issued the final financial statements.

Property, Plant, and Equipment, Net. The Navy understated, overstated, and inaccurately reported the Marine Corps investment in Military Equipment for the Navy FY 1997 balance for Military Equipment. Also, auditors were unable to assess the accuracy of the amount reported in Government Property Held by Contractors for FY 1997.

Military Equipment. The Navy understated the Navy FY 1997 balance for Military Equipment by at least $10.8 billion. The balance consisted of $6.1 billion in satellites, $2.5 billion in specific items that management procured and issued to Fleet Commands and Navy activities, and $2.2 billion in 74 stricken

aircraft. The Navy overstated the FY 1997 balance for Military Equipment by $354 million by reporting items that did not meet the capitalization threshold. The accuracy of the Marine Corps reported investment in Military Equipment was not verifiable because the auditors could not reconcile the central Marine Corps database for Military Equipment to the supporting property records maintained by individual units.

Government Property Held by Contractors. Auditors were unable to assess the accuracy of the $17.7 billion in Government Property Held by Contractors, as reported on the FY 1997 Navy Statement of Financial Position, because the auditors received information that included FY 1996 data. The FY 1997 data from the DoD Contract Property Management system were not available for auditors to review before the final financial statements were issued.

Accounts Payable, Federal. Auditors found that one Navy command did not accrue Accounts Payable for work performed as of July 31, 1997. By the end of FY 1997, the failure to accrue such liabilities could significantly understate the Accounts Payable, Federal, balance and overstate the Undelivered Order balance by the same amount.

Accounts Payable, Non-Federal. The Navy understated Accounts Payable, Non-Federal, by about $322 million and had overstated Undelivered Orders by the same amount. The misstatements occurred because the Standard Accounting and Reporting System/Headquarters Claimant Module could not convert an undelivered order entry to an Accounts Payable entry when accounting technicians received evidence of work performed.

Program or Operating Expenses. The Navy did not properly record $62 billion of Program or Operating Expenses on the FY 1997 Statement of Operations and Changes in Net Position. The Navy derived individual amounts by using predetermined percentages of the total for each individual outlay, rather than by determining actual amounts.

Air Force General Fund. Auditors were unable to obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to whether the FY 1997 Air Force Consolidated Financial Statements fairly presented the financial position of the Air Force. As a result, they were unable to render an opinion on the reliability of the FY 1997 Air Force Consolidated Financial Statements. The systems and processes used to consolidate data into the Air Force Financial Statements, as well as the associated internal controls, did not produce reliable financial information.

The Statement of Financial Position and the Statement of Operations and Changes in Net Position contained material misstatements before DFAS made auditor-recommended adjustments. Although all appropriate adjustments were

made, uncertainties in other amounts prevented the auditors from rendering an opinion on the financial statements. The auditors could not verify the acquisition cost of assets valued at $293 billion because the Air Force lacked:

- a transaction-driven general ledger;
- systems that could provide the required financial data;
- the use of the consumption method to recognize expenses for Operating Materials and Supplies; and
- documentation to support the data on the financial statements.

The auditors found significant conditions that adversely affected four of the five management assertions defined by generally accepted Government auditing standards.

Valuation or Allocation. The auditors identified several conditions related to the appropriateness of amounts in the financial statements for asset, liability, revenue, and expense accounts.

Operating Materials and Supplies. The Air Force valued Operating Materials and Supplies at the latest acquisition cost rather than historical cost, as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property," October 27, 1993. The Air Force accounting method did not account for holding gains and losses that resulted from significant cost changes because the Air Force lacked a financial accounting system designed to accumulate, account for, and report historical costs. As a result, the Air Force may have materially misstated the reported $40.3 billion of Operating Materials and Supplies included in the FY 1997 Air Force Consolidated Financial Statements as War Reserves and Inventory.

Military Equipment. To track Military Equipment, the Air Force used inventory systems that applied standard values to like items rather than applying acquisition costs, as required by current accounting standards. As with Operating Materials and Supplies, the Air Force lacks a financial accounting system designed to accumulate, account for, and report the acquisition costs of Military Equipment items. As a result, the Air Force may have materially misstated the $182 billion of Military Equipment reported in the FY 1997 Air Force Consolidated Financial Statements.

Accounts Payable. The auditors were 95-percent confident that Accounts Payable at operating locations were materially accurate. However, auditors could not determine the accuracy of Accounts Payable that the DFAS Columbus Center reported to the DFAS Denver Center on the Accrued

Expenditure Report. Duplicate reporting resulted in a $604 million overstatement of Accounts Payable. Also, because Accounts Payable originating at the DFAS Columbus Center were not reported to the DFAS Denver Center for inclusion in the financial statements, Accounts Payable were understated by $117 million. Finally, a statistical sample of 108 Accounts Payable transactions at the DFAS Columbus Center identified 95 unsupported or inaccurate transactions valued at $118 million.

Existence or Occurrence. The auditors could not determine whether all assets and liabilities included in the financial statements as of September 30, 1997, existed on that date, and whether all recorded transactions had occurred within the fiscal year ending on that date.

Ammunition. Because of a $2 billion reporting difference, the auditors were unable to confirm the existence of Air Force munitions stored at Army locations. The Air Force showed $4.5 billion as the total value of Air Force munitions stored at 15 Army locations, as reported in the Combat Ammunition System - Air Force-Wide, compared to the $2.5 billion reported in the Army Commodity Command Standard System. The auditors determined that $864 million of the $2 billion difference related to nonexistent munitions; the remaining $1.1 billion was a potential discrepancy.

Accounts Receivable. In performing a sample of Accounts Receivable, the auditors found monetary errors of less than 3 percent when accounting personnel had supporting documentation available. However, at all 10 operating locations and regional accounting and finance offices, accounting personnel could not provide adequate documentation to support $16 million of $36 million in the Accounts Receivable tested.

Completeness. The auditors identified the following significant conditions related to whether the financial statements dated September 30, 1997, included all assets and liabilities.

Launch Vehicles. In a footnote to the financial statements, the DFAS Denver Center disclosed that the Air Force did not recognize Air Force-owned launch vehicles, valued at $6.1 billion, as assets on the Statement of Financial Position.

Litigation Liabilities. The DFAS Denver Center was unable to recognize a probable litigation liability for 224 contractor appeals totaling $602 million because the Air Force Materiel Command Law Office did not project a probable loss liability for these appeals.

Presentation and Disclosure. The DFAS Denver Center incorrectly presented $40.3 billion of Operating Materials and Supplies on the FY 1997 Air Force Consolidated Financial Statements. Because of guidance from USD(C)

and Headquarters, DFAS, the DFAS Denver Center reported $38.7 billion of Operating Materials and Supplies as War Reserves. Headquarters, DFAS, also directed the DFAS Denver Center to report $1.6 billion of Operating Materials and Supplies as Inventory. In the opinion of the Air Force Audit Agency, this reporting conflicts with the Statements of Federal Financial Accounting Standards.

U.S. Army Corps of Engineers, Civil Works Program. Auditors were unable to render an opinion on the FY 1997 Financial Statements of the Corps, because they found fundamental weaknesses in the Corps legacy financial system and because the Corps has not fully implemented its new financial management system. Also, auditors were not able to apply other procedures to satisfy themselves as to the fairness of the presentation of the statements. A brief discussion of each of the main reasons for disclaimers follows.

Financial Management Systems. Auditors continued to have material uncertainties about the reasonableness of amounts reported on the financial statements because 40 of 62 Corps activities were using the Corps legacy financial system during FY 1997. The Corps legacy financial system has fundamental weaknesses that prevent the Corps from reporting reliable financial information. Specifically, the system is not based on the U.S. Government Standard General Ledger, has an inaccurate crosswalk, lacks revenue and expense accounts, and is not integrated with other Corps systems. The auditors had reported these inadequacies in previous reports. The Corps is aware of these problems and plans to complete the deployment of a new financial management system in FY 1998.

Legacy System Deficiencies. The Corps legacy financial system is not based on the U.S. Government Standard General Ledger and is not integrated with other Corps systems.

Standard General Ledger. The Corps did not base its legacy financial system on the U.S. Government Standard General Ledger. The legacy financial system required a crosswalk between its ledger accounts and the standard ledger account. However, the crosswalk was inaccurate because the old system lacked key accounts, including revenue and expense accounts. The Corps compensated for these deficiencies by using budgetary accounting information, external sources, and manual calculations to compile its financial statements. The result was inaccurate and unreliable statements. This deficiency is expected to disappear with the full deployment of the Corps of Engineers Financial Management System to all Corps activities by the end of FY 1998.

System Integration. The Corps legacy financial system lacked integration with other automated systems to simultaneously update general and subsidiary ledger accounts. OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, requires integrated systems as an important feature in

any financial management system because they reduce errors and save valuable time.

Summary for Military Department General Funds. The accounting systems that support the Military Department General Funds account for about three-fourths of DoD Consolidated assets and revenues. Therefore, DoD should focus its corrective actions on the timely development and implementation of compliant accounting and feeder systems that support the Army, Navy, Air Force, and Corps General Funds. Developing and implementing compliant accounting and feeder systems will allow the production of useful financial information that DoD financial managers need to effectively and efficiently manage about 75 percent of DoD financial resources. In addition, the by-product of these compliant accounting and feeder systems, accessible audit trails, will eliminate the major scope limitation that prevents auditors from performing sufficient audit work and prevents favorable opinions on the financial statements of the Military Department General Funds.

FY 1997 Financial Statements of the Military Department Working Capital Funds

Because of deficient accounting systems, insufficient audit trails, and unreliable amounts for several material lines, auditors were unable to render favorable opinions on the FY 1997 Military Department Working Capital Funds. The reported assets and revenues for these financial statements represented 5 percent of DoD Consolidated assets and 4.7 percent of DoD Consolidated revenues (most of the revenues were eliminated from the DoD Consolidated total because they represented transactions between DoD activities). Procedural and compliance problems also contributed to the unreliable amounts on the financial statements. Consequently, auditors could not obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the FY 1997 Financial Statements of the Military Department Working Capital Funds.

Army Working Capital Fund. Because of insufficient audit trails and unreliable amounts for several types of assets and liabilities, auditors were unable to render an opinion on the Army Working Capital Fund Principal Financial Statements for FY 1997. Procedural and compliance problems also contributed to the unreliable amounts on these financial statements.

Assets. The Statement of Financial Position, with $14.5 billion in total assets, had five asset line items with unreliable amounts. The five asset line items totaled $13.3 billion. The most significant problems are described below.

Fund Balance With Treasury. Auditors could not attest to the reported value of $405.8 million for Fund Balance With Treasury because they could not substantiate adjustments with an absolute value of approximately $899.5 million.

Accounts Receivable, Federal. Auditors could not substantiate adjustments with an absolute value of about $214.2 million because personnel at the DFAS Indianapolis Center made the adjustments without reconciling differences, without documentation, and without realizing the effect on Accounts Receivable in the financial statements. Therefore, the auditors could not attest to the correctness of the $278.5 million reported for Accounts Receivable.

Advances and Prepayments, Federal. DFAS misstated the FY 1997 reported value of advances and prepayments by an unknown, but probably material amount, because progress payments were not always paid and liquidated at the rate authorized by the contract.

Inventory, Net. The FY 1997 inventory of $10.2 billion was misstated by an unknown, but probably material amount, because auditors could not attest to the value in the general ledger accounts for Inventory Held for Repair, Government Furnished Material, and Inventory in-Transit from procurement.

Inventory Held for Repair. The Army improperly reported Inventory Held for Repair at zero dollars, which caused the misstatement of two line items – Inventory, Net, and Excess of Revenue and Other Financing Sources Over Total Expenses – by unknown but material amounts.

Government-Furnished Material. Auditors found that the Army misstated the value of the Government-Furnished Material account, which was $534 million for FY 1997, because of a scope limitation on the ability of logistical or financial management systems to accurately identify consumable material in the possession of contractors.

Inventory in Transit From Procurement. The Army misstated the reported account value of $598 million reported for Inventory in-Transit from procurement, by an unknown but material amount. The misstatement occurred because the automated systems rejected receipts, personnel did not always reconcile the rejected transactions, and personnel received but did not properly record inventory classified as in-transit.

Property, Plant, and Equipment, Net. Auditors were not able to attest to the reported value for Property, Plant, and Equipment, Net, because the Army misstated the value of Real Property by unknown amounts. The misstatement of Real Property occurred because the Army depot maintenance

activities did not have a standard financial system that provided the data needed for accurate financial accounting of Real Property.

Liabilities. Of $1.9 billion in total liabilities, two Accounts Payable line items on the Statement of Financial Position had unreliable amounts totaling $0.7 billion. Auditors found that the reported balances of Accounts Payable for Federal and non-Federal entities were not reliable because procedures prevented the determination of reliable values for these accounts. Inadequate or no documentation for adjusting entries at the DFAS Indianapolis Center and procedural weaknesses at finance activities also caused the amounts to be unreliable.

DFAS Adjustments. Auditors could not attest to the reported value for Accounts Payable because they could not substantiate adjustments with an absolute value of $1.2 billion. Personnel at the DFAS Indianapolis Center made adjustments to general ledger information so that it agreed with other reports, but did not reconcile the differences. They also made other adjustments without documentation or without realizing the effect of the adjustments on the financial statements.

Finance Activities. Auditors found that the finance activities did not have detailed transactions to support the $373.3 million for Accounts Payable because:

- Accounts Payable were not established in accordance with Federal accounting standards with the acceptance of goods or passage of title;
- subsidiary ledgers did not support general ledger balances;
- accounting activities made adjustments to general ledgers without supporting detailed transactions; and
- the accounting activities allowed the automated system to automatically delete rejected receipt transactions from the accounting records without review or correction.

Navy Working Capital Fund. Auditors were unable to render an opinion on the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996 because the Navy did not provide the auditors with sufficient information to evaluate management assertions. Specific accounts for which sufficient information was not provided included:

- Accounts Receivable, Net, Non-Federal ($285.5 million);

- Inventory, Net ($13.1 billion);
- Work in Process ($1.3 billion);
- Operating Materials and Supplies, Net ($592.1 million);
- Property, Plant, and Equipment, Net ($4.6 billion);
- Accounts Payable, Federal ($844.3 million);
- Other Federal (Intragovernmental) Liabilities ($1.4 billion);
- Accounts Payable, Non-Federal (minus $35.1 million);
- Other Non-Federal (Governmental) Liabilities ($2.9 billion);
- Invested Capital ($23.5 billion);
- Cumulative Results of Operations (minus $5.8 billion); and
- Other (Net Position) (minus $816.1 million).

Also, the auditors did not observe physical inventories and were unable to satisfy themselves regarding the quantities reported.

Air Force Working Capital Fund. Auditors were unable to render an opinion on the reliability of the Air Force Working Capital Fund Financial Statements for FY 1997 because they were unable to obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the financial statements. The conditions that prevented rendering an opinion in past audits still exist, and significant conditions adversely affected four of the five management assertions in the financial statements.

Valuation or Allocation. Auditors identified significant conditions in the valuation and allocation of amounts reported for Inventories and Cost of Goods Sold in the Supply Management Activity Group. As a result, the auditors could not validate $11 billion of inventories at contractor repair facilities and in transit between contractors and Air Force installations. Consequently, the Air Force does not know the accurate value of inventory balances in the FY 1997 financial statements.

Existence or Occurrence. Auditors identified significant conditions as to whether all assets and liabilities in the Air Force Working Capital Fund Financial Statements for FY 1997 existed as of September 30, 1997, and whether all recorded transactions had occurred during FY 1997. As a result, the auditors determined that during 1996, the depot accounting system recorded nonpurchase

receipt transactions as purchases, and overstated the supply management Purchases at Standard Price account by approximately $763.6 million.

Completeness. Auditors identified significant conditions in the completeness of data in the Air Force Working Capital Fund Financial Statements for FY 1997. As a result, in the Depot Maintenance trial balance for March 31, 1997, Accounts Receivable was overstated by $96.7 million, Progress Billings was understated by $91.2 million, and Unearned Revenue was understated by $3.1 million.

Presentation and Disclosure. Auditors identified significant conditions related to the method used by the Air Force to classify, describe, and disclose the amounts in the financial statements. The use of this method caused Air Force assets and liabilities to be overstated by $534 million.

Summary for Military Department Working Capital Funds. The problems in the recording and reporting of accurate and reliable financial data on the financial statements of the Working Capital Funds reflect the problems of the Military Department General Funds. These problems are:

- accounting system deficiencies,
- insufficient audit trails, and
- unreliable amounts for several material line items on the Working Capital Fund financial statements.

However, the Military Department Working Capital Funds account for only 5 percent of DoD Consolidated assets and 4.7 percent of DoD Consolidated revenues.

Financial Statements of Other DoD Working Capital Funds

Auditors were unable to render favorable audit opinions on the financial statements of the other DoD Working Capital Funds that were subject to audit in FY 1997. The financial statements were those of the:

- Defense Logistics Agency Working Capital Fund,
- Defense Information Systems Agency Working Capital Fund,
- Defense Commissary Agency Working Capital Fund,

- Defense Finance and Accounting Service Working Capital Fund, and
- Joint Logistics Systems Center Working Capital Fund.

DoD did not prepare audited financial statements for the U.S. Transportation Command Working Capital Fund. The other DoD Working Capital Fund financial statements listed above accounted for 1.4 percent of DoD Consolidated assets and 3 percent of DoD Consolidated revenues (most other DoD Working Capital Fund revenues were eliminated when preparing the DoD Consolidated Financial Statements because the revenues represent activity between DoD entities). The main reasons for disclaimer on the other DoD Working Capital Fund Financial Statements were significant deficiencies in the accounting systems and internal controls that prevented auditors from verifying balances for material lines on the financial statements.

Defense Logistics Agency (DLA) Working Capital Fund. Auditors were unable to render an opinion on the DLA Working Capital Fund Financial Statements for FYs 1996 and 1997 because their limited audit work disclosed additional scope limitations. DFAS was late in providing the auditors with the final version of the DLA Working Capital Fund financial statements, and DLA was late in providing the management and legal representation letters and logistics data needed to support the reported inventory balances. In addition, the auditors had difficulty in gaining access to financial data in the DLA automated systems; and because of significant deficiencies in the accounting systems and internal controls, they were unable to verify the inventory balances on the FY 1997 financial statements. For the following reasons, auditors could not verify the $9.8 billion inventory balances on the DLA financial statements.

- The DLA sampling plans, used to measure inventory record accuracy at the DLA distribution depots, did not meet the requirements of the CFO Act. Therefore, the results of physical inventories taken during the year could not be used for that purpose.
- DLA made inventory adjustments of about $1.1 billion when reconciling the accountable records of distribution depots with the financial records of inventory control points.
- DLA improperly classified, described, and disclosed inactive inventory in the financial statements.

- The Financial Inventory Accounting report, which supported the reported fuel inventory balance, contained negative inventory quantities and dollar amounts.

- DFAS made unsupported adjustments to reconcile the Financial Inventory Accounting report with the trial balance.

Defense Information Systems Agency Working Capital Fund. Auditors were unable to render an opinion on the FY 1997 Consolidated Financial Statements of the Defense Information Systems Agency Working Capital Fund because:

- deficiencies in DoD accounting systems resulted in substantial undistributed collections and undistributed disbursements for the Defense Megacenters;

- auditors were unable to reconcile the beginning ($305.2 million) and ending ($226.7 million) consolidated balances for the Property, Plant, and Equipment account; and,

- at the auditors' request, personnel at the Defense Information Systems Agency attempted to reconcile the changes in the financial statements with the beginning and ending balances, but were unable to do so.

Defense Commissary Agency (DeCA) Working Capital Fund. Auditors were unable to render an opinion on the DeCA Consolidated Financial Statements for FYs 1997 and 1997, which consisted of the statements for the DeCA Operations Fund and the DeCA Resale Stock Fund. Auditors did not audit the financial statements for DeCA Operations. Because the auditors did not receive the financial statements in a timely manner, they were unable to determine the accuracy and completeness of the data reported. In addition, the scope of the auditors' work was limited because they were unable to observe a physical inventory at any commissary. For the FY 1997 Financial Statements of the DeCA Resale Stock Fund, the auditors concluded that significant deficiencies in the accounting systems and the lack of sound internal controls prevented the preparation of accurate financial statements.

Defense Finance and Accounting Service (DFAS) Working Capital Fund. Auditors were unable to render an opinion on the FY 1997 Financial Statements of the DFAS Working Capital Fund. Because of deficiencies in accounting systems, the DFAS Working Capital Fund had substantial undistributed collections and disbursements. The undistributed amounts materially affected the balances for Fund Balance With Treasury ($53.4 million), Accounts Receivable ($29.8 million), and Accounts Payable ($163.7 million). Also, on a quarterly basis, DFAS removed from the general ledger accounting system the accounting transactions that DFAS had disbursed and finalized. DFAS could not restore these transactions. Therefore, the auditors could not verify the balances for

expenses. The deficiencies in accounting systems and control procedures also resulted in misreported Property, Plant, and Equipment and unrecorded adjustments to the financial statements and prevented the auditors from verifying the balances.

Joint Logistics Systems Center (JLSC) Working Capital Fund. The auditors were unable to render an opinion on the FYs 1997 and 1996 Financial Statements of the JLSC Working Capital Fund. They were unable to perform sufficient audit work because JLSC began terminating its operations in October 1997. During their limited audit work, the auditors found significant deficiencies in the JLSC accounting systems and internal controls and concluded that the financial statements for FYs 1997 and 1996 were unreliable.

Other DoD Working Capital Fund Summary. Because of significant deficiencies in the accounting systems and weak internal control procedures, the auditors could not verify the balances for material lines on the financial statements of the other DoD Working Capital Funds. However, the six other Working Capital Funds represent only 1.4 percent of DoD Consolidated assets and 3 percent of DoD Consolidated revenues.

Other DoD Agency Financial Statements

The auditors rendered an unqualified opinion on the FY 1997 Financial Statements of the Military Retirement Trust Fund, but were unable to render favorable audit opinions on the statements of the National Defense Stockpile Transaction Fund and the Defense Security Assistance Agency. DoD auditors reviewed but did not render an audit opinion on the data for the Other Defense Organizations on the FY 1997 DoD Consolidating Financial Statements. DoD did not prepare financial statements for the Other Defense Organizations. The National Defense Stockpile Transaction Fund and the Other Defense Organizations account for $50.6 billion of DoD Consolidated assets and $46.1 billion of DoD Consolidated revenues. This represents 3.8 percent of DoD Consolidated assets and 17 percent of DoD Consolidated revenues (some revenues are eliminated from the DoD Consolidated total because they represent transactions between DoD activities). Although the Defense Security Assistance Agency is not included in the DoD Consolidated Financial Statements, it accounts for $27.9 billion of DoD assets and $4.6 billion of DoD revenues. The main reasons for the disclaimers of opinion were deficient accounting systems, weak internal control procedures, and the consequent scope limitations that prevented auditors from auditing material line items on the other DoD agency financial statements.

National Defense Stockpile Transaction Fund. Auditors were unable to render an opinion on the FY 1997 Financial Statements of the National Defense

Stockpile Transaction Fund because they could not verify the inventory valuation (zero dollars) or confirm Accounts Receivable ($35 thousand). Because the results of bulk commodities measurements were unavailable by the date of the auditors' opinion, the auditors could not verify the inventory valuation of zero dollars. Therefore, they could not evaluate and project the results of the entire sample of Stockpile Materials and could not determine whether the quantities of Stockpile Materials on hand, which account for 80 percent of total assets of $4.1 billion, were accurate. In addition, the auditors were unable to verify Accounts Receivable, which accounts for 7 percent of total assets. This was because the attempt to confirm the Accounts Receivable balances resulted in a 60 percent customer response rate; in 42 percent of the responses, the Government's balances differed from the customers', indicating errors.

Defense Security Assistance Agency (DSAA). Auditors were unable to render an opinion on the DSAA Financial Statements for FYs 1997 and 1996 because of deficiencies in accounting systems and internal control procedures that prevented DSAA from providing reasonable assurance that the financial statements were reliable. Specifically:

- DSAA did not account for revenues and expenses from the sales of goods and services to foreign customers;
- DSAA overstated Accounts Receivable ($21.5 million) and did not record inventories; and
- DSAA and DFAS provided management representation letters, but did not attest to the accuracy or completeness of the financial statements.

Other Defense Organizations. The FY 1997 DoD Consolidated Financial Statements include financial statements for the Other Defense Organizations. This reporting classification consolidates financial information from various Defense organizations, including the Military Departments, that use Treasury Index 97 funds. During FY 1997, the 44 Defense organizations and funds included in the Other Defense Organizations had total assets of $46.4 billion and total revenues of $50 billion. Although DFAS does not prepare the financial statements for the Other Defense Organizations, auditors review the data for Other Defense Organizations in the DoD Consolidating Financial Statements. In FY 1997, auditors identified deficiencies in the Other Defense Organizations that reflect DoD-wide problems. Among these deficiencies is the lack of transaction-driven general ledger accounting systems for the Other Defense Organizations and the lack of audit trails.

Summary for Other DoD Agencies. Deficiencies in accounting system and internal controls prevented auditors from auditing material lines on the other DoD agencies' financial statements that account for 3.8 percent of DoD Consolidated

assets and 17 percent of DoD Consolidated revenues. As a result, auditors were unable to render favorable audit opinions on Other DoD Agency financial statements.

Corrective Actions Taken or Under Way

DoD managers have acknowledged significant long-standing problems that prevent favorable audit opinions on the DoD financial statements, and agree that a top priority for DoD is to improve its financial management. In response to financial statement audits and congressional and public concerns, DoD managers have begun numerous actions to address the problems reported.

DoD-Wide Corrective Actions. The following are actions that have been taken or are under way to correct DoD-wide deficiencies.

DoD Joint Working Groups. Several joint working groups have been established to allow the DoD financial and audit communities to coordinate their efforts to correct major deficiencies.

- **Joint Financial Management Issues Resolution Group.** This working group was established to solve problems in meeting the President's Priority Management Objectives. It includes representatives from the OMB; the GAO; the IG, DoD; the USD(C); and DFAS.

- **DoD Federal Financial Management Act Executive Committee (Audit Committee).** This committee provides a forum for DoD management, accountants, and auditors to conduct research and to recommend and issue guidance on accounting and auditing issues.

- **Executive Steering Committee.** This committee provides direction for the CFO and supporting financial statement audits performed by the IG, DoD, and the Military Department audit agencies.

- **Other DoD Joint Working Groups.** Other DoD joint working groups include the Defense Management Council, the Intelligence Audit Committee, the DFAS Standards Group, and an Ad Hoc Working Group on Inventory and Real Property.

Accounting Systems. DoD has made progress in reducing and improving its accounting systems. Because of the complexity of DoD accounting operations and the wide variety of automated information systems in use, DoD needs to

reduce and improve its accounting systems and migrate to standard DoD accounting systems. DoD reduced the number of accounting systems from 197 in FY 1991 to 122 by the end of FY 1997; the goal is to have 23 DoD accounting systems by FY 2003.

Deployment of Compliant Accounting Systems. Since August 1991, DoD has been evaluating solutions to the noncompliance problems associated with existing DoD accounting systems. However, progress has been slow and has achieved only mixed results. For example, DoD successfully deployed a new accounting system, the Corps of Engineers Financial Management System, throughout the Corps. However, the Defense Property Accountability System, which was proposed as the answer to unreliable reporting of DoD real and personal property, has fallen short of expectations. The Defense Property Accountability System captures only about one-fourth of real and personal property and does not completely address the systemic weaknesses it was intended to correct. In addition, for FY 1996, the IG, DoD, reported that the DFAS solution to fixing the noncompliant accounting systems that compile the General Fund financial statements for the Army and Air Force was the Defense Joint Accounting System (DJAS). A year later, DoD is no closer to a viable solution. The Defense Accounting System Project Management Office recently completed a feasibility assessment that concluded that an Air Force legacy system, the General Accounting and Finance System, not DJAS, would be the DFAS solution to noncompliant accounting systems for the Air Force General Fund. This decision was made because a major redesign would be needed to implement DJAS in the Air Force, and the project management office considered the General Accounting and Finance System the most feasible, cost-effective solution.

Inventory Valuation. DoD is improving its methods of accounting for inventory. DoD is converting inventories from the DoD standard (selling) price to latest acquisition cost, or historical cost, as prescribed by Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," October 27, 1993. In addition, DoD is working to improve its inventory management systems to collect the proper accounting information.

Accounting for Government Property in the Hands of Contractors. USD(C) and the Principal Deputy Under Secretary of Defense (Acquisition and Technology), with assistance from the DoD audit community, began an effort to develop the appropriate accounting treatment and providing the necessary instructions for controlling Government-owned property to the owning activities or DoD property administrators. However, the initiative has stalled.

DoD Financial Management Guidance. DoD is continuing to simplify and standardize financial management guidance by consolidating financial management policies and procedures into the 15-volume "DoD Financial

Management Regulation," DoD 7000.14-R. The "DoD Financial Management Regulation" replaces several thousand pages of regulations from separate DoD Components.

Reporting of Environmental Liabilities. This is still a difficult area, although progress has been made regarding the criteria and methodology for estimating and reporting liabilities. This area is especially important because the disclosure of liabilities has practical applications for DoD program and budget planning.

Corrective Actions for the Army General Fund. The auditors verified some positive conditions and determined that the Army General Fund has made progress in resolving some previously reported problems.

Equipment Reporting Systems. The Army chartered the General and Mission Equipment Workgroup in July 1997. The overall objective of the Workgroup was to review financial reporting for Army equipment and assess the capabilities of current and future systems to meet reporting requirements. The Workgroup is also ensuring that during system development, the project office for the Global Combat Service Support System-Army identifies the financial reporting requirements for equipment.

Unserviceable Equipment. In previous years, the Army reported unserviceable equipment at full value, which overstated the value of Military Equipment in the financial statements. For FY 1997, the U.S. Army Materiel Command:

- reduced the reported value of unserviceable equipment to more closely reflect its actual value;
- reduced the value of repairable equipment to allow for potential repair costs; and
- reduced the value of nonrepairable equipment to its salvage value.

Equipment in-Transit From Customers. For Equipment in-Transit From Customers, in previous years, the Army Commodity Command Standard System issued a field return authorization and classified the equipment as in-transit. Simultaneously, units continued to report Equipment in-Transit from customers through the property book system, which created duplicate reporting and overstated the equipment balances. The U.S. Army Materiel Command made a $550 million adjustment to correct the overstatement.

Equipment Held by Project Managers. In previous years, the Army Commodity Command Standard System understated the reported balances for equipment by omitting Army-owned equipment held by project managers. For FY 1997, the U.S. Army Materiel Command modified the system to include the value of this equipment.

Natural Resources. The Army reduced the value of reported timber from $1.7 billion in FY 1996 to $17 million in FY 1997 so that the balance would reflect only the estimated timber sales for the next year and not the reported value for all timber, regardless of whether it would be harvested. This conservative approach is more reasonable until further guidance is issued.

Other Liabilities. The Army has continued to make progress in reporting liabilities not covered by budgetary resources and in internal controls over identifying and reporting liabilities. For FY 1997, the Army recognized these additional liabilities for the first time:

- $10.6 billion for chemical demilitarization programs,
- $972 million for environmental restoration at installations that were closing,
- $414 million for the Voluntary Separation Incentive Program, and
- $185 million for claims and litigation.

Corrective Actions for the Navy General Fund. The Navy and DFAS are working together to plan and involve others in producing auditable financial statements.

The Navy Chief Financial Officers Act Core Group. The Navy Chief Financial Officers Act Core Group has been established to address issues related to preparing the financial statements required by the CFO Act. The group has representatives from the Navy; the Naval Audit Service; DFAS; the IG, DoD; and GAO.

CFO Act Private Sector Council. The Navy established the CFO Act Private Sector Council to give advice to the private sector on the Navy implementation of the CFO Act.

Initiatives at the DFAS Cleveland Center. To improve financial management and reporting, the DFAS Cleveland Center:

- prepared a midyear financial statement for training DFAS personnel and for identifying procedural and data weaknesses in the preparation of reports;
- began documenting journal vouchers for all adjustments to the financial statements;
- developed instructions for an automated CFO Act program that identifies and standardizes the sequence of steps in producing the financial statements;
- issued instructions for preparing financial statements below the department level;
- reduced significant differences in the Navy Budget Clearing Accounts;
- formed a working group on Federal generally accepted accounting principles to provide a forum for identifying, discussing, and resolving financial statement and accounting policy issues in implementing Federal generally accepted accounting principles and standards; and,
- developed and planned corrections to the Standard Accounting and Reporting System, including conversion to the DoD Standard General Ledger and implementing Accounts Receivable and Accounts Payable modules.

Corrective Actions for the Air Force General Fund. The Air Force, DoD, and DFAS are working to improve and accuracy of data and reporting for the Air Force General Fund financial statements.

Reporting of the Statement of Budgetary Resources. Beginning in FY 1998, OMB will require the reporting of budgetary resources. The Air Force implemented this requirement early and included the Statement of Budgetary Resources in the Air Force Consolidated Financial Statements for FY 1997.

Financial Improvement Policy Council. In FY 1994, the Secretary of the Air Force established a Financial Improvement Policy Council for coordination between Air Force information systems that interface with DFAS accounting systems. This council continues to meet as needed to address financial issues that affect both Air Force and DFAS functions.

Posting of DoD Standard Transactions. The Air Force financial management community and DFAS are developing DoD standard transaction postings for the processing of generic and detailed accounting events for budgetary and financial accounting. The standard postings should allow the Air Force to improve financial management and compliance with Federal laws and financial accounting standards.

Transfer of Management Responsibility Review. Air Force Audit Agency auditors are working with a contractor to review 11 legacy mixed systems to determine what the systems need for compliance with accounting standards. The Assistant Secretary of the Air Force (Financial Management and Comptroller) and the auditors have established a schedule to review all functional feeder systems for compliance with Federal requirements for financial management systems.

Development or Modification of Four Major Logistics Systems. The Air Force is pursuing system development or modification of four major logistics systems:

- the Global Combat Support System-Air Force (Standard Base Supply System),
- the Ammunition Management Standard System,
- the Automated Civil Engineer System, and
- the Integrated Maintenance Data System.

The four systems account for 85 percent of the Air Force inventory of Property, Plant, and Equipment.

Departmental Cash Management System. The DFAS Denver Center is developing the Departmental Cash Management System to meet departmental accounting requirements and increase productivity while reducing costs. The system should correct material weaknesses and reduce the outstanding balances of undistributed disbursements, negative unliquidated obligations, and problem disbursements.

Contingent Liabilities Reporting Improvements. Officials of DFAS and the Air Force continue to improve the reporting of contingent liabilities. Air Force financial managers have worked with the Air Force Legal Services Agency and the Air Force Audit Agency to develop procedures for reporting claims against the Air Force. The Air Force has also submitted information to USD(C) on contingent liability issues that require guidance. DoD is expected to incorporate guidance on contingent liabilities in the "DoD Financial Management Regulation."

U.S. Army Corps of Engineers, Civil Works Program, Corrective Actions. The Corps recognized that its legacy financial system, the Corps of Engineers Management Information System, had many inadequacies. In 1988, the Corps began developing a replacement system, the Corps of Engineers Financial Management System (CEFMS).

Corps of Engineers Financial Management System. Since FY 1995, auditors have worked with the Corps to ensure that CEFMS produces timely and reliable financial information. The Corps plans to complete deployment of the system in all districts, divisions, and activities in FY 1998.

Integration with Other Automated Systems. The Corps developed CEFMS to ensure integration with other automated systems. Integration with other automated systems will then allow for one-keyed transaction entries.

Enhanced Management Controls. The Corps incorporated several key internal controls into CEFMS that will eliminate most of the internal control weaknesses found in the old Corps system. For example, CEFMS:

- provides selective permissions to users, based on management approval and using an access control matrix;
- requires signature cards and passwords that give responsible personnel access to the system and allow electronic signatures; and
- performs financial accounting in the background, based on established correlation tables.

Southwestern Division. The U.S. Army Corps of Engineers, Civil Works, Southwestern Division, was the first Corps division to fully implement CEFMS. As a result, the Corps, with support from the Army Audit Agency, produced and audited the FY 1997 Financial Statements of the Southwestern Division. The effort proved successful, as the auditors rendered an unqualified opinion on the financial statements and on the management assertion that the division maintained effective internal controls over financial reporting. With CEFMS deployed and implemented throughout the Corps by mid-FY 1998, FY 1999 will be the first full year in which the Corps will produce financial statements based entirely on data collected and processed using a new accounting system.

Corrective Actions for the Army Working Capital Fund. The Army and DFAS are working to improve the Army Working Capital Fund financial statements.

Inventory on Hand. The Army has two initiatives that should improve internal controls. First, the "Approved Military Standard Transaction Reporting and Accounting Procedures Change Letter 8a" will transfer accountability for assets to the DLA depots, simplifying the inventory and reconciliation process. Second, the Single Stock Fund will combine wholesale and retail supply into one operation, which will make the Supply Management business area more visible and simplify the preparation and presentation of financial statements.

Real Property Integrated Process Team. The Army established a DoD-wide Real Property Integrated Process Team with the following objectives:

- defining data elements needed in real property systems for financial reporting,
- recommending needed policy changes to DoD, and
- identifying the process for integrating the Defense Property Accountability System with the various real property management systems.

The team's goal is to transfer data on real property to the Defense Property Accountability System by the end of FY 1998.

Rule Book. The DFAS Indianapolis Center published a rule book with procedures and practices for its Operating Locations. The topics covered include:

- financial accountability for real and personal property;
- the operation of standard financial systems;
- guidelines for researching and correcting unmatched disbursements and negative unliquidated obligations; and
- monthly financial reporting.

Corrective Actions for the Navy Working Capital Fund. The Navy has initiatives to improve its accounting systems and develop a model for the valuation of inventory and cost of goods sold.

Improvements in Accounting Systems. The Navy has:

- consolidated 4 of the projected 13 systems into the Defense Industrial Financial Management System, a migratory finance and accounting system for the Depot Maintenance and Research and Development activity groups of the Navy Working Capital Fund;

- begun consolidating 2 existing systems and replacing 10 operational databases with the Defense Working Capital Accounting System, which is an interim migratory system for the Base Support activity group of the Navy Working Capital Fund; and

- converted two of the scheduled five shipboard systems with the Material Financial Control System, an interim migratory financial system for the Supply Management activity group of the Navy Working Capital Fund, to be used for wholesale and retail inventory.

Valuation of Inventory and Cost of Goods Sold. With support from the Navy staff and the Naval Audit Service, the Office of the USD(C) and DFAS have begun developing a new model to calculate the value of inventory and cost of goods sold. The model uses the general ledger from the Supply Management activity group. Difficulties were encountered in producing reliable values for Allowance and Cost of Goods Sold accounts because:

- the Supply Management general ledger does not conform to the current DoD Standard General Ledger;

- accounting practices developed more than 15 years ago necessitate the development of work-around methodologies;

- information needed for calculations is not in the general ledger and must be produced; and

- the financial systems do not receive all transactions needed by the latest-acquisition-cost method.

Corrective Actions for the Air Force Working Capital Fund. The Air Force, DoD, and DFAS have initiated actions to address the problems reported.

Supply Systems. The Air Force is designing new base-level and depot-level supply systems that will provide the data needed to account for inventory at cost. The Air Force plans to implement the Integrated Logistics System-Supply at all Air Force Bases by FY 1999 and the Seamless Supply System at all Air Logistics Centers by FY 2000. When implemented, these systems will provide the data needed to account for inventory at cost.

Depot Maintenance Systems. In FY 1999, the Air Force Materiel Command will implement the Defense Industrial Financial Management System, which will be transaction-driven and will provide a standard financial and cost accounting system for the Depot Maintenance Activity Group.

Additional Challenges. DoD financial managers should also be aware of external challenges, such as:

- implementing the new Statements of Federal Financial Accounting Standards,
- complying with the requirements of the Federal Financial Management Improvement Act of 1996, and
- ensuring that DoD finance and accounting systems, and all systems with which they exchange data, can process Year 2000 data.

For example, for FY 1998, the Statements of Federal Financial Accounting Standards increased the number of financial statements to be provided for each fund from three to eight statements, as identified in Table 2 below.

Table 2. Required Financial Statements

Required Statements Prior to FY 1998	Required Statements for FY 1998
Statement of Financial Position	Balance Sheet
Statement of Operations and Changes in Net Position	Statement of Changes in Net Position
Statement of Cash Flows	Statement of Cash Flows
	Statement of Net Cost
	Statement of Budgetary Resources
	Statement of Financing
	Statement of Custodial Activity
	Supplemental Stewardship Information

This will create new challenges to both preparers and auditors of the new statements. Appendix D lists the Statements of Federal Financial Accounting Standards and Concepts and other FASAB pronouncements.

Conclusion

DoD financial managers have acknowledged that the accounting systems supporting DoD financial data do not have integrated, double-entry, transaction-driven general ledgers to compile and report reliable and auditable information. The information is not auditable because the accounting systems cannot produce an accessible audit trail of information from the occurrence of a transaction through its recognition in the accounting records and ultimately to the DoD financial statements. With the enactment of the Federal Financial Management

Improvement Act of 1996, auditors concluded that DoD accounting systems did not substantially comply with applicable accounting standards, Federal requirements for financial management systems, and the U.S. Government Standard General Ledger at the transaction level. Because DoD accounting systems were both inadequate and noncompliant, auditors could not obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the financial statements.

Until compliant DoD accounting systems with integrated, double-entry, transaction-driven general ledgers are developed and implemented, auditors cannot determine whether transactions are properly recorded, processed, and summarized. This presents a significant scope limitation and will prevent favorable audit opinions on the DoD financial statements. Audits have confirmed that DoD accounting systems were not designed to produce auditable financial statements and that these accounting systems will require years to correct. However, these audits have also demonstrated that actions have been taken or are under way to correct the deficiencies in accounting systems.

Management Comments on the Finding and Audit Response

Although no comments were required, DFAS responded to the report. Specifically, DFAS did not agree with our use of the term "accounting system". DFAS also nonconcurred with three audit conclusions. The noncuncurrences were not material to the finding of the draft audit report: auditors identified and DoD financial managers acknowledged major deficiencies preventing favorable audit opinions on the FY 1997 DoD Financial Statements. At issue is an IG, DoD, audit report discussing the Fund Balance With Treasury line item of the Army General Fund and two other IG, DoD, reports discussing undistributed disbursements of the DISA and DFAS Working Capital Funds (WCFs). See Part III for the text of the DFAS comments.

Management Comments on Accounting Systems. DFAS stated that in the discussion of accounting system weaknesses, the auditors did not distinguish between DoD accounting systems and DoD management or feeder systems. DFAS also stated "other DoD management or feeder systems" is a broader and more accurate description of the automated and manual systems that process financial and financial-related data for DoD. DFAS also stated that discussing problems with feeder systems is essential to fully presenting DoD compliance with the CFO Act.

Audit Response. The DFAS comments on accounting systems is not relevant to the overarching deficiency of accounting systems that are inadequate for compiling accurate and reliable financial data. However, we agree with the DFAS comment that it is essential to fully present the status of DoD compliance with the

CFO Act. Without full compliance with the CFO Act, especially the implementation of compliant DFAS-owned and Military Service-owned accounting and feeder systems in DoD, it will be difficult for auditors to render favorable audit opinions on DoD financial statements. We acknowledge the weaknesses in the nonfinancial feeder systems. However, distinguishing between accounting and feeder systems is not relevant to our conclusion that compliant accounting and feeder systems are necessary to compile accurate, reliable, and auditable financial data. We considered accounting systems as the entire range of DoD financial and non-financial systems used to prepare the DoD financial statements. This includes the systems that DFAS defines as management or feeder systems. The discussion in this audit report covers all DFAS-owned and Military Service-owned financial and nonfinancial systems that feed financial and financial-related information to the DoD financial statements.

Management Comments on the Fund Balance With Treasury of the Army General Fund. DFAS nonconcurred with the audit conclusion that the $4.4 billion in check issue discrepancies were directly related to the Fund Balance With Treasury line item of the Army General Fund.

Audit Response. The problem of check issue discrepancies was addressed by the Army Audit Agency in its opinion report: Report No. AA 98-104, "Auditor's Report, Army's Principal Financial Statements for Fiscal Years 1997 and 1996," February 13, 1998. Details on the $4.4 billion check issue discrepancy issue were published in an IG, DoD, draft report for Project No. 7FI-2031.02, "Compilation of the FY 1997 Army General Fund Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," July 15, 1998. DFAS management comments on the draft audit report should give reasons for the nonconcurrence stated in its comments to this report. Any open issues will be resolved during the audit report processing phase. In addition, we have been working closely with the OMB, the Principal Deputy Under Secretary of Defense (Comptroller), DFAS, and the GAO to develop an implementation strategy for Fund Balance With Treasury. The FY 1998 audits will address the Fund Balance With Treasury issues identified by DFAS.

Management Comments on Undistributed Disbursement of the DISA WCF. DFAS nonconcurred with the auditor conclusion that undistributed disbursements prevent an audit of the Fund Balance With Treasury line item and are the basis for a disclaimer of opinion on the FY 1997 DISA WCF Financial Statements.

Audit Response. The issue of undistributed disbursements was one of several reasons for a disclaimer of opinion on the FY 1997 DISA WCF Financial Statements. This report summarizes the major deficiencies preventing favorable audit opinions within DoD. The DISA WCF accounts for only 0.1 percent of DoD assets and 0.9 percent of DoD revenues. This audit conclusion was published on February 27, 1998, in the disclaimer of opinion on the FY 1997 DISA WCF Financial Statements. DFAS did not address the issue of

undistributed disbursements when the disclaimer of opinion was published or in response to IG, DoD, Report No. 98-162, "Internal Controls and Compliance With Laws and Regulations for the FY 1997 Defense Information Systems Agency Working Capital Fund Financial Statements," June 24, 1998. Report No. 98-162 also contained the audit conclusions on undistributed disbursements; however, it made no reference to the Fund Balance With Treasury line item. DFAS did not comment on Report No. 98-162. If DFAS still nonconcurs with the audit conclusion for Report No. 98-162, it should state its reasons during the audit of the FY 1998 DoD Financial Statements. In addition, we have been working closely with the OMB, the Principal Deputy Under Secretary of Defense (Comptroller), DFAS, and the GAO to develop an implementation strategy for Fund Balance With Treasury. The FY 1998 audits will address the Fund Balance With Treasury issues identified by DFAS.

Management Comments on Undistributed Disbursements of the DFAS WCF. DFAS nonconcurred with the audit conclusion that undistributed disbursements adversely affect the Fund Balance With Treasury line item. DFAS also disagreed that the effect of the undistributed amounts on Accounts Payable and Accounts Receivable is a basis for a disclaimer of opinion on the FY 1997 DFAS WCF Financial Statements.

Audit Response. The issue of undistributed disbursements was only one of several reasons for a disclaimer of opinion on the DFAS WCF financial statements. This report summarizes major deficiencies preventing favorable audit opinions within DoD. The DFAS WCF accounts for only 0.1 percent of DoD assets and 0.7 percent of DoD revenues. This audit conclusion was published on February 27, 1998, in the disclaimer of opinion on the FY 1997 DFAS WCF Financial Statements. DFAS did not address the issue of undistributed disbursements when the disclaimer of opinion was published or in response to IG, DoD, Report No. 98-151, "Internal Controls and Compliance With Laws and Regulations for the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1997," June 12, 1998. Report No. 98-151 also contained the audit conclusion on undistributed disbursements and Fund Balance With Treasury. However, DFAS did not comment on Report No. 98-151. If DFAS still nonconcurs with this audit conclusion, DFAS should state its reasons during the audit of the FY 1998 DFAS WCF Financial Statements. In addition, we have been working closely with the OMB, the Principal Deputy Under Secretary of Defense (Comptroller), DFAS, and the GAO to develop an implementation strategy for Fund Balance With Treasury. The FY 1998 audits will address the Fund Balance With Treasury issues identified by DFAS.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology. We reviewed the results of all audits of the FY 1997 DoD financial statements.

DoD Financial Statement	Auditor
DoD Consolidated	IG, DoD
Army General Fund	Army Audit Agency
Navy General Fund	Naval Audit Service
Air Force General Fund	Air Force Audit Agency
U.S. Army Corps of Engineers, Civil Works Program	Army Audit Agency
Army Working Capital Fund	Army Audit Agency
Navy Working Capital Fund	Naval Audit Service
Air Force Working Capital Fund	Air Force Audit Agency
Defense Logistics Agency Working Capital Fund	IG, DoD
Defense Information Systems Agency Working Capital Fund	IG, DoD
Defense Finance and Accounting Service Working Capital Fund	IG, DoD
Joint Logistics Systems Center Working Capital Fund	IG, DoD
Defense Commissary Agency Working Capital Fund	IG, DoD
DoD Military Retirement Trust Fund	IG, DoD
National Defense Stockpile Transaction Fund	IG, DoD
Defense Security Assistance Agency	IG, DoD
Other Defense Organizations	IG, DoD

See the table on page 5, "FY 1997 CFO Audit Opinions," for a list of the FY 1997 audit reports we reviewed. This audit was limited to identifying and summarizing the major deficiencies that prevented favorable audit opinions on the FY 1997 DoD Financial Statements. We defined "major deficiency" as a reason that auditors could not render an audit opinion, as reported in their FY 1997 audit reports. We further limited the audit to identifying the actions taken or under way to correct or remove these deficiencies. We defined "corrective actions" as

actions taken or under way on the major deficiencies preventing favorable audit opinions on the FY 1997 DoD Financial Statements. The IG, DoD; the Army Audit Agency; the Naval Audit Service; and the Air Force Audit Agency reported corrective actions in FY 1997 audit reports such as the opinions on the financial statements, reports on internal controls and compliance, and supporting reports on functional audit areas. DoD also identified corrective actions in published planning documents.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of Defense has established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting these objectives. This report pertains to the achievement of the following objectives and goals.

- **Objective:** Fundamentally reengineer the Department and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established objectives and goals for performance improvement reform. This report pertains to achievement of the following functional area objectives and goals.

- **Financial Management Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the FMFIA. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Audit Period and Standards. We performed this financial-related audit from February through May 1998 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 to conduct this audit.

Contacts During the Audit. We visited or contacted individuals and organizations that produced and audited the DoD financial statements. Further details are available on request.

Appendix B. Summary of Prior Coverage and Audit Reports on DoD Financial Statements

Summary of Prior Coverage

IG, DoD, Report No. 98-002, "A Status Report on the Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund for FY 1996," October 3, 1997.

IG, DoD, Report No. 97-225, "Major Deficiencies Preventing Favorable Audit Opinions on FY 1996 DoD General Fund Financial Statements," September 30, 1997.

IG, DoD, Report No. 97-026, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on FY 1995 DoD General Fund Financial Statements," November 19, 1996.

IG, DoD, Report No. 97-006, "Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995," October 15, 1996.

IG, DoD, Report No. 95-301, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995.

IG, DoD, Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," August 18, 1995.

Audit Reports on DoD Financial Statements

Report No.	Title	Date
General Accounting Office		
GAO/AIMD-98-40	Financial Management: Seven DoD Initiatives That Affect the Contract Payment Process	January 30, 1998
GAO/AIMD-98-35	Defense Computers: Air Force Needs to Strengthen Year 2000 Oversight	January 16, 1998
GAO/AIMD-98-32	DoD's Liability for the Disposal of Conventional Ammunition Can Be Estimated	December 19, 1997
GAO/AIMD-98-25	Financial Management: Issues to Be Considered by DoD in Developing Guidance for Disclosing Deferred Maintenance Aircraft	December 30, 1997
GAO/AIMD-98-16	Financial Reporting: DoD's Fiscal Year 1996 Financial Statements Inventory Reporting Does Not Meet Standards	December 24, 1997
GAO/AIMD-98-9	Financial Management: DoD's Liability for Aircraft Disposal Can Be Estimated	November 20, 1997
GAO/AIMD-97-150	Financial Management: DoD's Approach to Financial Control Over Property Needs Structure	September 30, 1997
GAO/AIMD-97-117	Defense Computers: DFAS Faces Challenges in Solving the Year 2000 Problem	August 11, 1997

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GAO/NSIAD-97-71	Defense Logistics: Much of the Inventory Exceeds Current Needs	February 28, 1997
GAO/AIMD/ NSIAD-97-61	Financial Management: An Overview of Finance and Accounting Activities in DoD	February 19, 1997
GAO/AIMD-97-45	Financial Management: Improved Management Needed for DoD Disbursement Process Reforms	March 31, 1997
GAO/AIMD-97-29	Financial Management: DoD Inventory of Financial Management Systems Is Incomplete	January 31, 1997
GAO/AIMD-96-99	DoD Accounting Systems: Efforts to Improve System for Navy Need Overall Structure	September 30, 1996
GAO/AIMD-96-94	Navy Financial Management: Improved Management of Operating Materials and Supplies Could Yield Significant Savings	August 16, 1996
GAO/AIMD-96-65	CFO Act Financial Audits: Navy Plant Property Accounting and Reporting Is Unreliable	July 8, 1996
GAO/AIMD-96-54	Defense Business Operations Fund (DBOF): DoD Is Experiencing Difficulty in Managing the Fund's Cash	April 10, 1996

Inspector General, Department of Defense

Report No. 98-108	Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 1997 Air Force Working Capital Fund Financial Statements	April 7, 1998

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Report No. 98-107	Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 1997 Air Force General Fund Financial Statements	April 7, 1998
Report No. 98-106	Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996	April 7, 1998
Report No. 98-105	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 1997 Army Working Capital Fund Financial Statements	April 7, 1998
Report No. 98-104	Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Navy General Fund Financial Statements for FYs 1997 and 1996	April 7, 1998
Report No. 98-103	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FYs 1997 and 1996 Financial Statements of the U.S. Army Corps of Engineers, Civil Works Program	April 7, 1998
Report No. 98-102	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the Army General Fund Financial Statements for FYs 1997 and 1996	April 7, 1998
Report No. 98-077	Year 2000 Computing Problems Reports: August 1997 Report	February 18, 1998

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Report No. 98-073	Defense Finance and Accounting Service Work on the Navy General Fund FY 1996 Financial Statements	February 12, 1998
Report No. 98-062	Compilation of the FY 1996 Financial Statements for Other Defense Organizations	February 4, 1998
Report No. 98-060	Joint Logistics Systems Center Reporting of Systems Development Costs	February 3, 1998
Report No. 98-059	Financial Accounting for the Defense Investigative Service	February 3, 1998
Report No. 98-058	Payroll Expenses Reported in FY 1996 for the Office of the Secretary of Defense	February 2, 1998
Report No. 98-056	Controls Over Presenting Expense Account Line Items on the FY 1996 Statement of Operations for the Air Force Supply Management Business Area	January 27, 1998
Report No. 98-054	Compilation of FY 1996 Air Force Consolidated Financial Statements at the Defense Finance and Accounting Service Denver Center	January 23, 1998
Report No. 98-052	Defense Logistics Agency Past Due Federal Accounts Receivable	January 22, 1998
Report No. 98-050	Defense Business Operations Fund Adjustments at the Defense Finance and Accounting Service Denver Center	January 20, 1998

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Report No. 98-048	Travel and Transportation Expenditures Reported on the Consolidated FY 1996 Financial Statements of the "Other Defense Organizations" Receiving Department 97 Appropriations	January 16, 1998
Report No. 98-046	Military Traffic Management Command Financial Reporting of Property, Plant, and Equipment	January 14, 1998
Report No. 98-042	Financial Reporting by Selected Defense Agencies of Government Property in the Custody of Contractors	December 16, 1997
Report No. 98-040	Air National Guard Financial Reports on the National Guard and Reserve Equipment Appropriation	December 16, 1997
Report No. 98-039	Cash Management in the Defense Working Capital Funds	December 15, 1997
Report No. 98-028	Personal Services and Benefits Expenses in the FY 1996 Statement of Operations and Changes in Net Position of the "Other Defense Organizations"	December 2, 1997
Report No. 98-027	Comprehensivness of the FY 1996 "Other Defense Organizations" Financial Statements	November 28, 1997
Report No. 98-022	Reporting of Contract Holdbacks on the DoD Financial Statements	November 17, 1997
Report No. 98-019	Inventory Record Accuracy and Management Controls at the Defense Logistics Agency Distribution Depots	November 10, 1997

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Report No. 98-014	The Working Capital Funds Interim Migratory Accounting Strategy	October 24, 1997
Report No. 98-008	Financial Reporting of Defense Business Operations Fund FY 1996 Property, Plant, and Equipment	October 9, 1997
Report No. 98-002	A Status Report on the Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund for FY 1996	October 3, 1997
Report No. 97-227	Foreign Military Sales Administrative Surcharge Fund	September 30, 1997
Report No. 97-225	Major Deficiencies Preventing Favorable Audit Opinions on the FY 1996 DoD General Fund Financial Statements	September 30, 1997
Report No. 97-224	Presentation of Accrued Leave in the FY 1996 Defense Agency Financial Statements of the Defense Business Operations Fund	September 30, 1997
Report No. 97-223	Recording and Reporting Expenses of the Defense Commissary Agency	September 30, 1997
Report No. 97-215	Reporting of Accounts Payable for the National Guard and Reserve Equipment Appropriation on the "Other Defense Organizations" Portion of the FY 1996 Financial Statements	September 18, 1997
Report No. 97-212	FY 1996 DoD Superfund Financial Transactions	September 4, 1997

Report No. 97-206	Defense Finance and Accounting Service Acquisition Strategy for a Joint Account System Initiative	August 22, 1997
Report No. 97-202	Financial Reporting of Government Property in the Custody of Contractors	August 4, 1997
Report No. 97-201	Navy and Marine Corps Reserve Financial Reports on the National Guard and Reserve Equipment Appropriation	July 30, 1997
Report No. 97-194	Evaluation of Management Controls at the Disbursing Office, Naval Surface Warfare Center, Dahlgren, Virginia	July 23, 1997
Report No. 97-183	Uncataloged Material at Research, Development, Test, and Evaluation Installations	June 30, 1997
Report No. 97-178	Internal Controls and Compliance With Laws and Regulations for the Defense Business Operations Fund Consolidated Financial Statements for FY 1996	June 26, 1997
Report No. 97-177	Internal Controls and Compliance With Laws and Regulations for the DoD Military Retirement Trust Fund Financial Statements for FY 1996	June 25, 1997
Report No. 97-176	Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996	June 25, 1997
Report No. 97-171	Internal Controls and Compliance With Laws and Regulations for the FY 1996 Financial Statements of the Defense Security Assistance Agency	June 19, 1997

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Report No. 97-163	Financing Computer Systems and Other Equipment at the Defense Contract Management Command	June 16, 1997
Report No. 97-160	Financial Accounting for the Chemical Agents and Munitions Destruction, Defense Appropriation	June 13, 1997
Report No. 97-159	Inventory Accuracy at the Defense Depot, Susquehanna, Pennsylvania	June 12, 1997
Report No. 97-155	Internal Controls and Compliance With Laws and Regulations for the FY 1996 Financial Statements of the " Other Defense Organizations" Receiving Department 97 Appropriations	June 11, 1997
Report No. 97-151	The Fund Balance With Treasury Account for the Research, Development, Test, and Evaluation Appropriation, Department 97	June 4, 1997
Report No. 97-148	Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting	May 29, 1997
Report No. 97-141	Financial Management at the Uniformed Services University of the Health Sciences	May 9, 1997
Report No. 97-140	Financial Management at the American Forces Information Service	May 7, 1997
Report No. 97-131	Financial Management at the Department of Defense Education Activity	April 17, 1997
Report No. 97-129	Financial Accounting at the On-Site Inspection Agency	April 15, 1997

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Report No. 97-125	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the U.S. Army Corps of Engineers, Civil Works Program, FY 1996 Financial Statements	April 10, 1997
Report No. 97-124	Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Fiscal Year 1996 Navy General Fund	April 10, 1997
Report No. 97-123	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the Army Financial Statements for Fiscal Years 1996 and 1995	April 10, 1997
Report No. 97-122	Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 1996 Air Force Consolidated Financial Statements	April 10, 1997
Report No. 97-117	Eliminating Entries	March 31, 1997
Report No. 97-116	Allegations of Improper Accounting for the National Guard and Reserve Equipment Appropriation at the Army National Guard	March 31, 1997
Report No. 97-112	Air Mobility Command Financial Reporting of Property, Plant, and Equipment	March 19, 1997
Report No. 97-110	Material Accounting and Management Control Weaknesses in the Defense Agencies' FYs 1995 and 1996 Financial Information	March 17, 1997
Report No. 97-107	Defense Contract Management Command Capitalization of Fixed Assets	March 10, 1997

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Report No. 97-100	Asset Presentation on Military Department General Fund Financial Statements	February 25, 1997
Report No. 97-073	Reliability of the FY 1995 Financial Statements for the Defense Logistics Agency General Fund	January 15, 1997
Report No. 97-051	Corps of Engineers Financial Management System	December 18, 1996
Report No. 97-047	Consolidated Financial Report on the National Guard and Reserve Equipment Appropriation for the Army National Guard	December 13, 1996
Report No. 97-044	Army National Guard Military Equipment	December 11, 1996
Report No. 97-026	Major Deficiencies Preventing Auditors From Rendering Audit Opinions on FY 1995 DoD General Fund Financial Statements	November 19, 1996
Report No. 97-025	Consolidated Financial Report on the National Guard and Reserve Equipment Appropriation for the Army Reserve	November 19, 1996
Report No. 97-020	Capitalization of Defense Technology Security Administration Equipment	November 4, 1996
Report No. 97-017	Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations	October 31, 1996
Report No. 97-008	Summary Report on the FY 1994 Financial Statement Audits of Defense Agencies	October 25, 1996

Report No. 97-006	Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995	October 15, 1996
Report No. 96-161	Compilation of FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service Indianapolis Center	June 13, 1996
Report No. 95-301	Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements	August 29, 1995
Report No. 95-294	Major Accounting Deficiencies in the DBOF in FY 1994	August 18, 1995
Report No. 95-267	DBOF Consolidated Statement of Financial Position for FY 1994	June 30, 1995

Army Audit Agency

Report No. AA 98-174	Financial Reporting of Real Property, Natural Resources, and Leases	May 11, 1998
Report No. AA 98-173	Financial Reporting of Environmental Liabilities	May 11. 1998
Report No. AA 98-172	Accountability for Army Mission Equipment	May 4, 1998
Report No. AA 98-171	Report on Internal Controls and Compliance With Laws and Regulations	April 8, 1998
Report No. AA 98-157	Financial Reporting of Wholesale Equipment	March 31, 1998
Report No. AA 98-144	Financial Reporting of Accounts Receivable	March 30, 1998

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Report No. AA 98-124	Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Report on Internal Controls and Compliance With Laws and Regulations	March 19, 1998
Report No. AA 98-113	Financial Reporting of Fund Balance With Treasury – DFAS Columbus Center	February 10, 1998
Report No. AA 98-112	U.S. Army Corps of Engineers, Civil Works: FY 1997 Opinion Report	February 19, 1998
Report No. AA 98-111	Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Auditor's Report	February 13, 1998
Report No. AA 98-104	Army's Principal Financial Statements for Fiscal Years 1997 and 1996: Auditor's Report	February 13, 1998
Report No. AA 98-98	Financial Reporting of Wholesale Munitions	February 5, 1998
Report No. AA 98-95	Proposed Adjustments and Comments Regarding Army's Draft FY 1997 Annual Financial Report	January 30, 1998
Report No. AA 98-91	Recommended Adjustments to Draft Financial Statements, Audit of Army Working Capital Fund FY 97 Financial Statements	January 23, 1998
Report No. AA 98-79	Army Working Capital Fund FY 1997 Financial Statements: U.S. Army Communications - Electronics Command, Fort Monmouth, New Jersey	January 23, 1998
Report No. AA 98-60	Army Working Capital Fund FY 1997 Financial Statements: Work In Process	January 21, 1998

Report No. AA 98-57	Financial Reporting of Section 801 Family Housing Leases	December 23, 1997
Report No. AA 98-46	Army Working Capital Fund Supply Management FY 1997 Statement of Financial Position: U.S. Army Air Defense Artillery Center and Fort Bliss	December 17, 1997
Report No. AA 98-32	Army Working Capital Fund FY 1997 Financial Statements: Crane Army Ammunition Activity, Crane, Indiana	November 17, 1997
Report No. AA 98-12	Army Working Capital Fund FY 1997 Financial Statements: Anniston Army Depot, Anniston, Alabama	October 20, 1997
Report No. AA 97-293	Army Working Capital Fund FY 1997 Financial Statements: Rock Island Arsenal, Rock Island, Illinois	September 26, 1997
Report No. AA 97-283	Army Working Capital Fund Supply Management, FY 1997 Financial Statements: U.S. Army Missile Command	August 25, 1997
Report No. AA 97-188	FY 96 Army Defense Operations Fund Financial Statements	May 16, 1997
Report No. AA 97-147	Financial Reporting of Asset Values	July 28, 1997
Report No. AA 97-146	Financial Reporting of Wholesale Asset Balances	June 23, 1997
Report No. AA 97-145	Report on Internal Controls and Compliance with Laws and Regulations	June 30, 1997
Report No. AA 97-144	Proposed Adjustments and Comments Regarding Army's FY 96 Annual Financial Report	June 23, 1997

Appendix B. Summary of Prior Coverage and Audit Reports on DoD Financial Statements

Report No. AA 97-136	FY 96 Financial Statements: U.S. Army Corps of Engineers, Civil Works	February 28, 1997
Report No. AA 97-133	Army's Principal Financial Statements for FYs 1996 and 1995	February 21, 1997
Report No. AA 96-155	Financial Reporting of Wholesale Munitions	April 19, 1996
Report No. AA 96-154	Examinations of the Army's Financial Statements for Fiscal Years 1995 and 1994: Report on Internal Controls and Compliance With Laws and Regulations	July 11, 1986
Report No. AA 96-152	Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994: Auditor's Report	March 15, 1996
Report No. AA 96-73	DBOF, FY 95 Financial Statements -- Supply Management, Revenues and Expenses: U.S. Army Missile Command	February 15, 1996

Naval Audit Service

Report No. 025-98	Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Report on Auditor's Opinion	February 27, 1998
Report No. 024-98	Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund	February 27, 1998
Report No. 046-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Government-Furnished Property Held by Contractors	August 14, 1997

Report No. 045-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Accounts Receivable	August 12, 1997
Report No. 040-97	Fiscal Year 1996 Consolidating Financial Statements of the Department of the Navy Defense Business Operations Fund	June 16, 1997
Report No. 035-97	Auditor General Advisory: Trends in Department of the Navy Financial Audits	May 12, 1997
Report No. 029-97	FY 1996 Annual Financial Report: Report on Internal Controls and Compliance With Laws and Regulations	April 15, 1997
Report No. 022-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Auditor's Opinion	March 1, 1997

Air Force Audit Agency

Project No. 97068043	Opinion on Fiscal Year 1997 Air Force Working Capital Fund Financial Statements	February 27, 1998
Project No. 97053012	Contingent Liabilities, FY 1996 Air Force Consolidated Financial Statements	April 10, 1997
Project No. 97053011	Eliminating Entries and Nonoperating Changes, FY 1996 Air Force Consolidated Financial Statements	April 15, 1997
Project No. 97053009	Opinion on Fiscal Year 1997 Air Force Consolidated Financial Statements	February 27, 1998

Appendix B. Summary of Prior Coverage and Audit Reports on DoD Financial Statements

Project No. 96053019	Real Property and Nonmilitary Equipment, FY 1996 Air Force Consolidated Financial Statements	February 11, 1997
Project No. 96053015	Military Pay, FY 1996 Air Force Consolidated Financial Statements	April 15, 1997
Project No. 96053005	Operating Materials and Supplies, FY 1996 Air Force Consolidated Financial Statements	January 30, 1997
Project No. 96053004	Civilian Pay, FY 1996 Air Force Consolidated Financial Statements	April 17, 1997
Project No. 96053003	Fund Control Process, FY 1996 Air Force Consolidated Financial Statements	February 7, 1997
Project No. 96053002	Federal Mission Property, Plant, and Equipment FY 1996 Air Force Consolidated Financial Statements	February 3, 1997
Project No. 96053001	Opinion on FY 1996 Air Force Consolidated Financial Statements	March 1, 1997

Appendix C. Total DoD Assets and Revenues by Reporting Entity

Total DoD Consolidated Assets **$1,330.2 billion**
Total DoD Consolidated Revenues **$270.4 billion**

DoD Reporting Entity	Total Assets (billions)	Percentage of Total DoD Assets	Total Revenue (billions)	Percentage of Total DoD Revenues
Army General Fund	$ 215.3	16.2	$ 64.7	23.9
Navy General Fund	457.5	34.4	68.1	25.2
Air Force General Fund	343.8	25.8	64.5	23.8
U.S Army Corps of Engineers (Civil Works)	40 4	3.0	6.1	2.3
Army Working Capital Fund	14.5	1.1	9.7	3.6
Navy Working Capital Fund	23.9	1.8	20.0	7.4
Air Force Working Capital Fund	28.7	2.2	13.0	4.8
Defense Logistics Agency Working Capital Fund	12.0	0.9	12.9	4.8
Defense Finance and Accounting Service Working Capital Fund	0.7	0.1	1.9	0.7
Defense Commissary Agency Working Capital Fund	0.4	0.0	6.1	2.3
Joint Logistics Systems Center Working Capital Fund	1.5	0.1	0.0	0.0
U.S. Transportation Command Working Capital Fund[1]	2.6	0.2	4.4	1.6
Defense Information Systems Agency Working Capital Fund	0.9	0.1	2.4	0.9
Adjustments to Working Capital Fund Components	1.2	0.1	(0.0)	0.0
Defense Security Assistance Agency[2,4]	27.9	2.1	4.6	1.7
DoD Military Retirement Trust Fund	143.3	10.8	38.1	14.1
National Defense Stockpile Transaction Fund	4.1	0.3	0.5	0.2
Other Defense Organizations[3]	46.5	3.5	50.0	18.5
Eliminating Entries	(7.2)	(0.5)	(92.0)	(34.0)
DoD Consolidated Totals[4]	$1,330.2	100.0	$270.4	100.0

[1] The USD(C) did not submit the FY 1997 Financial Statements of the U.S Transportation Command Working Capital Fund for audit.

[2] Dollar amounts were not included in the FY 1997 DoD Consolidated Financial Statements.

[3] No official financial statements were produced, but data are included in the FY 1997 DoD Consolidated Financial Statements.

[4] DoD Consolidated totals do not include dollar amounts for the Defense Security Assistance Agency because that agency was not included in the FY 1997 DoD Consolidated financial statements. However, the data will be included in the FY 1998 DoD Consolidated Financial Statements

Appendix D. Statements of Federal Financial Accounting Standards and Concepts

	Publication	Publication Date	Effective Date
Concept No. 1	Objectives of Federal Financial Reporting	September 2, 1993	
Concept No. 2	Entity and Display	June 6, 1995	
Standard No. 1	Accounting for Selected Assets and Liabilities	March 30, 1993	FY 1994
Standard No. 2	Accounting for Direct Loans and Loan Guarantees	August 23, 1993	FY 1994
Standard No. 3	Accounting for Inventory and Related Property	October 27, 1993	FY 1994
Standard No. 4	Managerial Cost Accounting Standards for the Federal Government	July 31, 1995	FY 1997
Standard No. 5	Accounting for Liabilities of the Federal Government	December 20, 1995	FY 1997
Standard No. 6	Accounting for Property, Plant, and Equipment	November 30, 1995	FY 1998
Standard No. 7	Accounting for Revenue and Other Financing Sources	May 10, 1996	FY 1998
Standard No 8	Supplementary Stewardship Reporting	June 11, 1996	FY 1998
Recommended Standard No. 9	Recommended: Deferral of Required Implementation Date for Statement of Federal Financial Accounting Standards No. 4	October 1997	
Exposure Draft	Management's Discussion and Analysis	February 1997	
Exposure Draft	Governmentwide Supplementary Stewardship Reporting	June 1997	
Exposure Draft	Accounting for Internal Use Software	June 25, 1997	
Invitation for Views	Accounting for the Cost of Capital by Federal Entities	July 1996	
Interpretation 1	Reporting on Indian Trust Funds	March 12, 1997	
Interpretation 2	Accounting for Treasury Judgment Fund Transactions	March 12, 1997	
Interpretation 3	Measurement Date for Pension and Retirement Health Care Liabilities	August 29, 1997	
Report 1	Overview of Federal Financial Accounting Concepts and Standards	December 31, 1996	
Volume 1	FASAB Volume 1, Original Statements	March 1997	

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Principal Deputy Under Secretary of Defense for Acquisition and Technology
    Deputy Under Secretary of Defense (Logistics)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army
Chief, U.S. Army Corps of Engineers

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 Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency
Director, Defense Logistics Agency
Director, Defense Security Assistance Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency
Commander, Joint Logistics Systems Center

Non-Defense Federal Organizations

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

Part III - Management Comments

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE
1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

AUG 19 1998

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements (Project No. 7FI-2031.03)

Our response to the subject audit is attached. The primary point of contact (POC) is Mr. Ron Warner, (703) 607-2857 or DSN 327-2857, and the secondary POC is Mr Mike Bryant, (703) 607-1562 or DSN 327-1562.

Roger W. Scearce
Brigadier General, USA
Deputy Director

Attachment:
As stated

cc:
DFAS-HQ/CEI
DFAS-CL/PI
DFAS-CO/EI
DFAS-DE/POB
DFAS-IN/P
DFAS-KC/PA

DFAS Comments on Audit Report on Major Deficiencies Preventing Favorable Audit Opinions on the FY 1997 DoD Financial Statements (Project No. 7FI-2031.03)

General Comments.

Throughout the report, the auditors refer continually to problems that exist within DoD's accounting systems. They do not distinguish between accounting systems and other DoD management or feeder systems. The latter is a broader, yet more accurate, description of the automated (and some manual) systems that process financial and financial-related data within the DoD.

Since 80 percent of the financial information that resides on the Department's financial statements originates from non-financial feeder systems, a discussion of the problems with these feeder systems is essential to a full presentation of DoD's CFO compliance status. As a result, the senior managers of the DoD are not given essential information needed to begin correcting DoD's CFO compliance problems.

Specific Comments.

Page 9, first paragraph, Fund Balance With Treasury Nonconcur The underlying report did not present evidence that the $4 4 billion in check issue differences were directly related to the Army Fund Balance With Treasury amounts

Page 22, 1st paragraph, Defense Information Systems Agency Working Capital Fund. Nonconcur. We disagree that undistributed is a problem in and of itself that precludes an audit of the Fund Balance With Treasury amount and is a basis for a disclaimer of opinion.

Page 22, third paragraph, Defense Finance and Accounting Service (DFAS) Working Capital Fund. Nonconcur. We disagree that undistributed adversely affects the Fund Balance With Treasury for DFAS. We also disagree that the effect of the undistributed amounts on accounts payable and accounts receivable is a basis for a disclaimer of opinion.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

F. Jay Lane
Salvatore D. Guli
Richard B. Bird
John J. Vietor
Craig W. Michaels
Craig W. Zimmerman
Linda C. Servais-Byers
Susanne B. Allen