

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**MAJOR DEFICIENCIES PREVENTING AUDITORS FROM
RENDERING AUDIT OPINIONS ON DOD GENERAL
FUND FINANCIAL STATEMENTS**

Report No. 95-301

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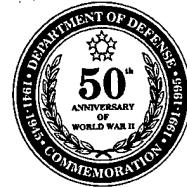
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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget
USD(C)	Under Secretary of Defense (Comptroller)



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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August 29, 1995

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
COMMANDER, U.S. ARMY CORPS OF ENGINEERS
AUDITOR GENERAL, DEPARTMENT OF THE ARMY**

**SUBJECT: Audit Report on Major Deficiencies Preventing Auditors From Rendering
Audit Opinions on DoD General Fund Financial Statements
(Report No. 95-301)**

We are providing this audit report for information and use. It identifies and summarizes the major deficiencies that prevent auditors from rendering audit opinions on the DoD general fund financial statements. It also identifies actions taken or under way to correct these deficiencies. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

The courtesies extended to the audit staff are appreciated. Questions about this audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (317) 542-3859 (DSN 699-3859), or Mr. John J. Vietor, Audit Project Manager, at (317) 542-3855 (DSN 699-3855). The distribution of this report is listed in Appendix L. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 95-301
(Project No. 4FI-2012)

August 29, 1995

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

Executive Summary

Introduction. This report summarizes the major deficiencies impeding the ability of DoD to produce auditable general fund 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 audited financial statements of DoD general funds. We plan to issue a similar report each year.

Audit Objective. The audit objective was to identify and summarize the major deficiencies that prevented auditors from rendering audit opinions, other than disclaimers, on Army and Air Force general fund financial statements, and to identify the actions taken or under way to correct these deficiencies.

Audit Results. We identified four major deficiencies that prevented auditors from rendering audit opinions on Army and Air Force general fund financial statements.

- o Adequate accounting systems were not in place.
- o Assets were not reported adequately or properly valued.
- o Disbursements and collections were not adequately accounted for.
- o Contingent liabilities were not recognized or adequately disclosed.

Numerous corrective actions, some long-term, are planned and ongoing to address these deficiencies. Defense Finance and Accounting Service management has said that these long-term corrective actions, including the development and implementation of new accounting systems, will not be completed until September 1998. Until that date, general fund financial statements will remain unauditable. Under these assumptions, the Inspector General, DoD, will not be able to render audit opinions on Army and Air Force general fund financial statements until March 2000 at the earliest, and rendering audit opinions will occur only if corrective actions meet the Defense Finance and Accounting Service schedule. Although consolidating financial statements for the Navy general fund have not yet been prepared and audited, preliminary indications are that the same problems will preclude rendering an opinion on those statements. We believe that taking longer than September 1998 to implement the corrective actions needed to produce auditable financial statements is unacceptable. In the meantime, until adequate accounting systems are in place, DoD needs to continue to aggressively correct unsound accounting policies and procedures.

This summary report contains no recommendations because the needed recommendations were made in other reports. It is intended to help the Congress and DoD assess progress being made toward the goal of preparing general fund financial statements that can receive an audit opinion other than a disclaimer. We view it as

essential that the Chief Financial Officer and the Inspector General, DoD, accept the challenge of submitting audited financial statements to Office of Management and Budget as soon as possible. The ultimate benefit of DoD submitting auditable financial statements is the potential to properly account for DoD resources at all levels. Accurate and reliable information must be available to DoD financial managers for informed decision making and to properly manage billion-dollar DoD programs. Unmatched disbursements, duplicate and erroneous payments, and Antideficiency Act violations are examples of DoD operations and programs that are adversely impacted by deficiencies in financial management systems and an inadequate internal control structure.

Management Comments. This report contains no recommendations that are subject to resolution in accordance with DoD Directive 7650.3. Accordingly, comments are not required. We issued a draft of this report on June 22, 1995, and received comments from the Under Secretary of Defense (Comptroller), the Air Force Audit Agency, and the U.S. Army Corps of Engineers. None of the respondents disagreed with the facts and conclusions in the report. Comments received were reviewed and appropriately considered in preparing the final report. See Part I for a complete discussion of management's comments and Part III for the complete text of these comments.

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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 Office of Management and Budget (OMB) has designated activities, including the Department of the Army and Department of the Air Force, to prepare financial statements. The OMB did not require audited financial statements for the Department of the Navy or other Defense agencies. The CFO Act requires the Inspector General (IG), or appointed external auditors, to audit the financial statements in accordance with generally accepted Government auditing standards and other standards established by the OMB. The IG, DoD, and the auditors of the Military Departments, under the cognizance of the IG, DoD, conducted these audits. Public Law 103-356, the Government Management Reform Act of 1994, October 13, 1994, requires DoD to issue agency-wide audited financial statements beginning in FY 1996 and annually thereafter. The audited financial statements for FY 1996 are required to be submitted to OMB by March 1, 1997.

Magnitude of Assets. DoD prepared general fund financial statements for FY 1994 for three major activities: the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program. The FY 1994 financial statements of the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program, included assets of \$612.9 billion and revenues of \$126.5 billion. Appendix C summarizes financial data from the FY 1993 and 1994 Statements of Financial Position and Statements of Operations for the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program.

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 organization being audited. The audit includes a review of conformity with generally accepted accounting principles. Auditors use the audit report to render an audit opinion or, if circumstances require, disclaim an opinion. Auditors can render three types of audit opinions.

- o Unqualified opinion: an unqualified opinion states that the financial statements are presented fairly.

- o Qualified opinion: a qualified opinion states that, except for stated qualifications, the financial statements are presented fairly.

- o Adverse opinion: an adverse opinion states that the financial statements are not fairly presented.

When auditors cannot conduct the audit, a disclaimer of opinion is issued. A disclaimer of opinion states that the auditor does not render an audit opinion on the financial statements, and is appropriate when auditors have not performed an audit sufficient in scope to enable them to form an opinion on the financial statements. Restrictions on the scope of an audit, whether imposed by the client or the circumstances, may result from limitations on the timing of work, the inability to obtain sufficient evidence, or the inadequacy of accounting records. When these restrictions are significant, auditors may disclaim an opinion.

Previous Financial Statement Audits of DoD General Funds. Financial statement audits of DoD general funds have been performed since FY 1988. Disclaimers of opinion have been rendered on the Army and Air Force financial statements. Even though opinions have been disclaimed on the overall financial statements, the focus of the previous audits was the Statement of Financial Position.

Army General Fund Financial Statements. The General Accounting Office (GAO) disclaimed opinions on the FY 1991 and 1992 Army general fund financial statements. The Army Audit Agency disclaimed opinions on the FY 1993 and 1994 financial statements.

Air Force General Fund Financial Statements. The GAO disclaimed opinions on the FY 1988 and 1989 Air Force general fund financial statements. The Air Force Audit Agency disclaimed opinions on the FY 1992 through 1994 financial statements.

U.S. Army Corps of Engineers, Civil Works Program. The U.S. Army Corps of Engineers, Civil Works Program's financial statements were audited by the GAO in FYs 1991 and 1992 and by the Army Audit Agency in FY 1993 as part of the Army's general fund financial statements. Opinions were disclaimed in each of these years. Beginning in FY 1994, DoD required separate financial statements and a separate audit opinion for the U.S. Army Corps of Engineers, Civil Works Program. The Army Audit Agency disclaimed an opinion on the FY 1994 financial statements of the U.S. Army Corps of Engineers, Civil Works Program.

Navy General Fund Financial Statements. DoD has not yet prepared Navy general fund financial statements for audit by independent auditors. The GAO is auditing the Navy's FY 1995 general fund financial data. The GAO does not plan to complete an audit of the Navy's FY 1995 general fund financial statements. Although requested to do so by the GAO, the Navy has not been required to prepare general fund financial statements. The IG, DoD, with support from the Naval Audit Service, will conduct the first-year audit of the Navy general fund in FY 1996.

Defense Agencies' General Fund Financial Statements. Defense agencies have not yet prepared financial statements. As a result of the Government Management Reform Act of 1994, Defense agencies will be required to prepare FY 1996 financial statements. However, these statements will not be audited. Rather, the IG, DoD, plans to perform audits of internal controls and compliance with laws and regulations within the Defense agencies.

Audit Results

Additionally, the IG, DoD, will provide audit coverage of the financial information in the "Other Defense" category from the perspective of consolidated DoD-wide financial statements. This audit approach, agreed to by the Chief Financial Officer of the DoD, is based on the materiality of the "Other Defense" category in relation to the DoD-wide financial statements.

See Appendix D for a list of audit reports that have been issued for FY 1993 and 1994 general fund financial statements.

Audit Objectives

The objective of the audit was to identify and summarize the major deficiencies that prevented auditors from rendering audit opinions, other than disclaimers, on Army and Air Force general fund financial statements, and to identify the actions taken or under way to correct these deficiencies. See Appendix A for a discussion of the scope and methodology, and Appendix B for a summary of prior coverage related to the audit objectives.

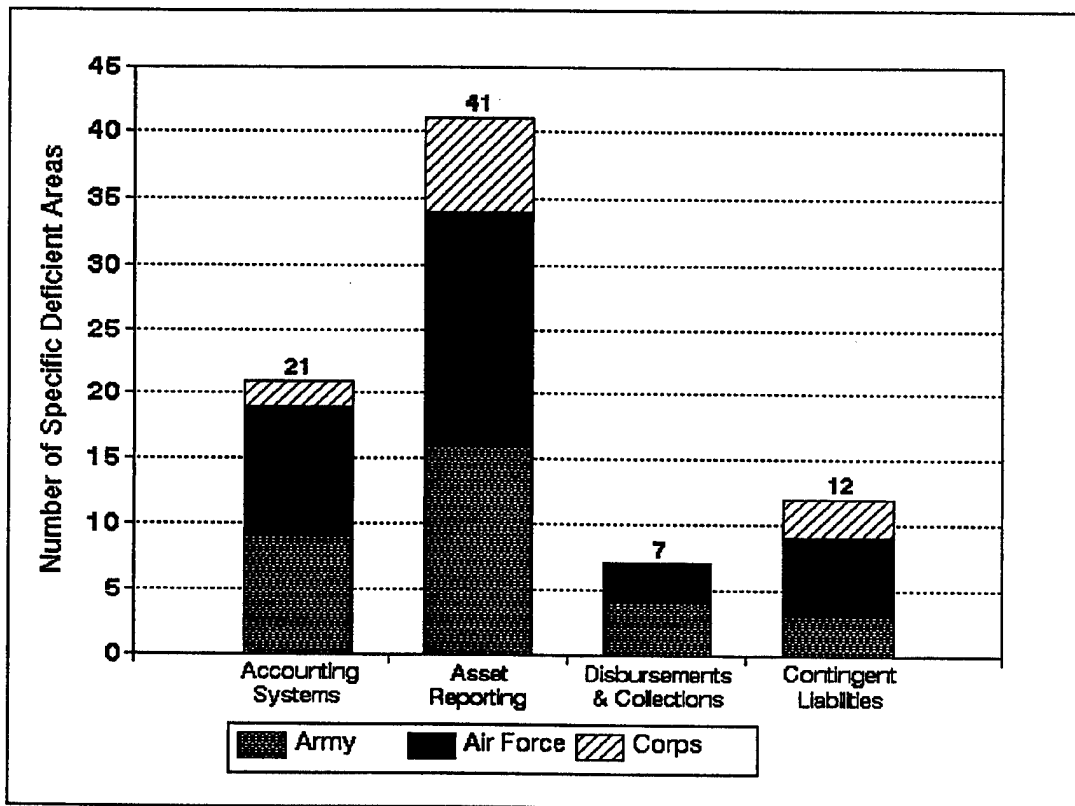
Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

Auditors have been unable to render audit opinions on Army and Air Force general fund financial statements since 1990, when the first disclaimer of opinion was issued on the FY 1988 Air Force consolidated financial statements. We reviewed the reasons that auditors could not render an audit opinion on FY 1993 and 1994 DoD general fund financial statements. We determined that among numerous issues reported by the auditors, the following four major deficiencies (in priority order) prevented the auditors from rendering audit opinions.

- o Adequate accounting systems were not in place.
- o Assets were not reported adequately or valued properly.
- o Disbursements and collections were not adequately accounted for.
- o Contingent liabilities were not recognized or adequately disclosed.

Additional major deficiencies may be reported after completing first-year audits of the Navy general fund financial statements. The four major deficiencies reported to date are summarized in this finding. The four summaries include descriptions of the deficiencies and the corrective actions taken or under way to remove them. The following is a chart showing the specific deficient areas for each of the four major deficiencies for each of the general fund financial statements.

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements



Major Deficiencies and Specific Deficient Areas

A crosswalk of the 4 major deficiencies to 34 audit reports for FYs 1993 and 1994 can be found at Appendix E. Appendix E also summarizes the 81 specific deficient areas included under each of the four major deficiencies. The 81 specific deficient areas are discussed in detail in Appendixes F through I.

Accounting Systems

Description of the Deficiency. Accounting systems supporting DoD general funds did not have integrated, double-entry, transaction-driven general ledgers to compile and report reliable and auditable information. The information was not auditable because the accounting systems did not produce an audit trail of information from occurrence of a transaction through recognition in the accounting records and ultimately to the general fund financial statements. See Appendix F, "Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports," for details of the accounting system deficiencies associated with compiling the general fund financial statements for the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program. The accounting systems' inadequacies caused material uncertainties related to the reasonableness

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

of amounts reported on Army and Air Force general fund financial statements for FYs 1993 and 1994. The Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program, reported about \$612.9 billion of assets and \$126.5 billion of revenues on their respective general fund financial statements. Because of the accounting systems' inadequacies, auditors could not obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the financial statements. For example, the Corps of Engineers Management Information System did not include an integrated, transaction-driven general ledger with supporting subsidiary ledgers. Also, several key line items on the U.S. Army Corps of Engineers, Civil Works Program's financial statements were not produced or supported by its general ledger system or subsidiary accounting systems. Unreliable financial data associated with the U.S. Army Corps of Engineers, Civil Works Program, which had FY 1994 assets of \$48.3 billion, would significantly impact DoD's ability to produce auditable general fund financial statements for the entire Department of Defense. Inadequacies in accounting systems are the major deficiency that prevented auditors from rendering audit opinions on FY 1993 and 1994 general fund financial statements. Until the Defense Finance and Accounting Service (DFAS) implements accounting systems with integrated, double-entry, transaction-driven general ledgers to compile and report information, auditors will be impeded in determining whether valid transactions are properly recorded, processed, and summarized. This presents a significant scope limitation to the auditors and will likely continue to cause auditors to disclaim opinions on DoD general fund financial statements.

Corrective Actions Taken or Under Way. The long-term DFAS solution to producing auditable financial statements is the development of new accounting systems with integrated subsidiary ledgers and general ledgers designed for accrual accounting. To accomplish this, DFAS has developed a two-phased approach. The first phase is the selection, upgrading, and deployment of existing Service-unique accounting systems as interim migratory systems. Selected accounting systems will include integrated, double-entry, transaction-driven general ledgers that can record transactions on an accrual basis, and in which transactions can be traced from the line-item balances on final financial statements to the individual source records. The second phase is the selection and implementation of one or more DoD standardized accounting systems. DFAS has various plans under way to improve accounting systems and resolve deficiencies in compiling DoD general fund financial statements. However, because we did not audit those plans, we are only restating information, such as milestones and estimated costs, established by DFAS management and providing some limited preliminary insight.

Army Accounting Systems Improvement Plan. The DFAS Indianapolis Center had selected four accounting systems as the interim migratory accounting systems for the Army's general fund. The estimated cost to upgrade the four accounting systems was \$25.7 million, which was scheduled for expenditure between FYs 1995 and 1997. However, this estimate does not include overhead, deployment, training, data conversion, interface, and other costs of full implementation. A September 1997 completion date was established. We doubt that the first phase of the Army's plan to improve accounting systems will produce integrated, double-entry, transaction-driven

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general ledgers at a cost of only \$25.7 million. These doubts are underscored by the \$80.2 million cost cited for upgrading the Air Force's interim migratory accounting systems. We are also concerned that DFAS alone will not be able to integrate the general ledger by establishing transaction-level linkage between accounting and fixed asset management systems without participation of other DoD activities.

U.S. Army Corps of Engineers, Civil Works Program, Accounting Systems Improvement Plan. The U.S. Army Corps of Engineers (the Corps) is developing and testing the Corps of Engineers Financial Management System. This system is said to fully integrate Corps business processes and support the management of all types of work and funds. In addition, finance and accounting personnel at Corps Headquarters have stated that key accounts and transaction codes will be included, and the new system will follow generally accepted accounting principles. During a recent survey of the development of the Corps of Engineers Financial Management System at Huntsville, Alabama, auditors could not determine whether the system met all the key accounting requirements for financial management systems. Specifically, because the system was not fully developed, auditors could not determine whether it was capable of producing year-end closing statements that contained complete, accurate, and verifiable financial data. However, the auditors did note that the system was designed to use DoD standard general ledger accounts and DoD general ledger summary accounts, and appeared to have strong internal security controls designed to protect system data and provide separation of duties. If the Corps of Engineers Financial Management System is fully implemented and includes an integrated, double-entry, transaction-driven general ledger that can record transactions on an accrual basis and allow transactions to be traced from the line-item balances on the final financial statements to individual source records, auditors may be able to conduct sufficient audit work to satisfy themselves as to the reasonableness of amounts reported in the financial statements. However, since the Corps of Engineers Financial Management System will not be in place until FY 1998, auditors will not be in a position to render an opinion on the general fund financial statements of the U.S. Army Corps of Engineers, Civil Works Program, until March 1, 1999, at the earliest. Also, because the Corps is encountering delays in developing and testing the new financial system, these milestones will probably be extended.

Navy Accounting Systems Improvement Plan. Since the Navy's general fund financial statements have not been prepared and submitted for audit, we did not review time frames and estimated costs to develop and implement adequate Navy accounting systems. However, in September 1997, the Navy is scheduled to implement the Standard Accounting and Reporting System-Field Level. The Standard Accounting and Reporting System-Field Level should establish a framework for the Navy's general fund system by making current financial systems more functional, while simplifying operations and upgrading the Navy's accounting functions.

Air Force Accounting Systems Improvement Plan. The DFAS Denver Center had selected five accounting systems as the interim migratory accounting systems for the Air Force's general fund. The estimated cost to upgrade the five accounting systems was \$80.2 million, which was scheduled

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

for expenditure between FYs 1995 and 1998. Although a September 1998 completion date was established, the implementation plan for the DFAS Denver Center's interim migratory accounting systems has not been approved by the Air Force and DFAS Headquarters. The auditors' review of management initiatives also indicated that the planned general ledger systems fall short of meeting requirements for a fully integrated, transaction-driven general ledger system. These general ledger systems will not fully integrate financial management systems with nonfinancial systems such as acquisition, logistics, supply, civil engineering, medical, personnel, and training systems that compile data needed by the financial systems.

DFAS has established a deadline of September 1997 to modify the interim migratory accounting systems to meet accounting system standards. If the accounting systems are modified to meet these standards, DoD may be able to produce auditable general fund financial statements. However, since we did not audit the specific plans made by DFAS management to improve accounting systems, we cannot comment on whether the objectives of the plans can be achieved in those time frames. However, the September 1997 deadline is not consistent with other plans published by DoD. For example, the DoD Chief Financial Officers Financial Management 5-Year Plan, dated November 1994, targets October 1998 as the beginning of the first fiscal year under new system architectures that will produce auditable DoD financial statements. The Air Force Accounting System Improvement Plan allots monies to upgrade accounting systems through FY 1998. Therefore, FY 1999 would be the first year that DoD could produce auditable general fund financial statements. As a result, the earliest date that auditors will be able to render an opinion on DoD general fund financial statements is March 1, 2000. However, that date is conditional on the Navy and the Defense agencies producing auditable financial statements in FY 1999. We believe that taking longer than this to develop and implement new accounting systems is unacceptable. DoD simply cannot afford further delays in fielding systems that will produce auditable financial statements and properly account for DoD resources. Many of the causes of inaccurate financial statements stem from unsound accounting practices that can be corrected through improvements in accounting policies and procedures that govern areas such as data validation, classification, input, exception control, and reconciliation; process verification and management; asset valuation; and compilation and reporting of financial information. Appendix D lists audit reports published in the two previous audit cycles that contain hundreds of recommendations to improve accounting policies and procedures.

Asset Reporting

Description of the Deficiency. Material deficiencies existed in the reporting of \$612.9 billion of assets on the FY 1994 Statements of Financial Position. Auditors were unable to apply sufficient auditing procedures to verify and determine whether these assets were fairly presented. Specifically, procedures and controls over amounts reported for the \$432.5 billion Property, Plant, and Equipment line item and for the \$74.7 billion Inventory line item were not

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

adequate to ensure that the reported amounts were not materially misstated. See Appendix G, "Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports," for details of the deficiencies. These asset reporting deficiencies prevented auditors from verifying the accuracy of reported asset account balances. Because of the uncertainties in these significant asset account balances, auditors were not able to render an audit opinion on the overall financial statements.

Corrective Actions Taken or Under Way. Most of the deficiencies in asset reporting result from the inadequate accounting systems used to compile the DoD general fund financial statements. When adequate accounting systems are implemented, DoD will be able to accurately account for its assets. Effective accounting systems can correct many deficiencies in asset reporting. However, procedures, controls, and compliance with accounting standards must also be improved. Otherwise, asset data will remain unreliable. The Army, the Air Force, and the Corps have made interim improvements to procedures and controls over asset reporting.

Army. The Army Audit Agency made recommendations to DFAS and the Army to help the Army report its assets properly. The Army and DFAS responded promptly and positively to these recommendations. The Army has increased controls over the accuracy of reported assets. However, the Army has been slow to correct and reconcile real property records to the general ledger. As a result, the real property data base does not support the values in the financial statements. In addition, corrective action is still under way to improve financial accountability over billions of dollars in Government property furnished to contractors. But the Army and the other Services still cannot effectively account for and report the amount of property furnished to contractors. Financial reporting for these assets would be improved if a transaction-driven general ledger were used for accounting.

Air Force. The Air Force Audit Agency recommended that DFAS and the Air Force improve the accuracy of asset account balances and strengthen interim internal controls and procedures over asset reporting. The Air Force and DFAS management concurred and were implementing corrective actions. The Air Force and DFAS Denver Center have implemented the Joint Plan to Improve Accounting Operations to track the status of management actions. Those actions address audit recommendations to develop training programs, revise policies and procedures, improve the accuracy of accounting for military equipment, and improve the accuracy of inventory values. Although the Air Force and the DFAS Denver Center have improved the accuracy of inventory values, problems continue because of inappropriate valuation procedures, over- and understatements of quantities, omissions of data, and inaccurate data in automated inventory systems. In addition, although the DFAS Denver Center developed and implemented procedures to improve accountability over Air Force equipment, \$13.2 billion of auditor-recommended adjustments were needed in FY 1994 to improve the accuracy of financial statement account balances for Property, Plant, and Equipment and Munitions.

U.S. Army Corps of Engineers. The Army Audit Agency made recommendations to help the Corps report its assets properly. The Corps took

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

actions to correct many of the problems reported. Specifically, the Corps made substantial progress in conducting inventories to support real property values shown in the financial statements. These physical inventories were necessary to ensure accountability for the assets. The Corps made some progress in moving completed projects from the construction-in-progress accounts. However, the Corps still had much work to do to ensure that the accounts are accurate.

In conclusion, the lack of accounting systems with an integrated, double-entry, transaction-driven general ledger has had a significant impact on DoD ability to accurately report its assets on general fund financial statements. Until an adequate accounting system is in place that provides transaction-driven recognition of events, asset reporting for the Army, the Air Force, and the U.S. Army Corps of Engineers will remain unreliable unless policies and procedures for the updating and use of existing systems can be improved. Interim internal controls and procedures are being implemented so that asset balances can be portrayed more accurately, and we believe such interim measures hold significant promise.

Disbursements and Collections

Description of the Deficiency. Auditors were not able to satisfy themselves as to the reasonableness and could not verify the accuracy of various account balances because the amounts were derived from unreliable disbursement and collection data. The following account balances were adversely affected by unreliable data on disbursements and collections: Fund Balances With Treasury, Accounts Receivable, Accounts Payable, Revenues, and Operating Expenses. The unreliable data resulted from accounting system inadequacies and the failure of accounting personnel to comply with regulations that require financial transactions to be accurately recorded, documented, reconciled, and reported. As a result of inaccurate recording and failure to reconcile these transactions, the Army and the Air Force continued to report significant amounts of unmatched disbursements and negative unliquidated obligations. In addition, the incorrect recording and reporting of transactions prevented auditors from establishing an audit trail to trace amounts in the financial statements back to the detailed records. For example, unreliable collection and disbursement data prevented auditors from verifying \$2.1 billion of Accounts Receivable and \$2.8 billion of Accounts Payable on the Air Force FY 1993 General Fund Statement of Financial Position. Auditors could not audit \$57 billion of Operating Expenses on the Air Force FY 1993 General Fund Statement of Operations. See Appendix H, "Disbursement and Collection Accounting Deficiencies Identified in FY 1993 and 1994 Audit Reports," for details of the problems with reporting disbursements and collections.

Corrective Actions Taken or Under Way. Senior managers in DoD and the Military Departments have placed a high priority on correcting problems in the incorrect recording and reporting of disbursement and collection transactions. Many actions have been taken or are under way to remove this deficiency. Several major actions are:

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

Acquisition and Financial Management Panel. DoD established an Acquisition and Financial Management Panel to design a long-term solution to the system-wide problem of unmatched disbursements and the lack of integration between finance and acquisition systems. This panel formed a working group that drafted a report identifying a strategy for implementing system-wide improvements. Among other items, the report focused on standardizing transaction formats for transmitting contract data between systems and improving the process for computing and validating contract payments.

Unmatched Disbursements. The DFAS, the Military Departments, and the Defense Logistics Agency established a project to reduce the amounts of unmatched disbursements. The focus of this project is to clear existing unmatched disbursements and to improve existing processes and systems to address the system-wide causes of unmatched disbursements. As of June 30, 1994, DoD reported that unmatched disbursements had been reduced from \$19.1 billion to \$9.7 billion. However, the GAO recently reported that, although DoD has made progress in reducing unmatched disbursements, the reduction was significantly less than reported by DoD. DoD reported \$9.5 billion of unmatched disbursements in February 1995.

Negative Unliquidated Obligations. On March 31, 1994, the Under Secretary of Defense (Comptroller) issued guidance to cease the disbursement of funds in excess of available balances. The practice of continuing disbursements under such conditions had created negative unliquidated obligations. We concur with this initiative.

Prevalidation. DoD will soon begin to prevalidate disbursements. DoD, by Congressional direction, required disbursing officers to first determine whether funds were available in appropriations accounts, as well as whether unpaid amounts existed against specific obligations, before making disbursements. By July 1, 1995, DoD plans to match disbursements to obligations, prior to payment, for payments in excess of \$5 million. By October 1, 1995, DoD plans to extend this requirement to payments of \$1 million or more. The IG, DoD concurred with this plan, and will review its implementation in FY 1996.

Policy for Suspension of Research. DoD accounting policy and procedures for researching and correcting unmatched disbursement transactions establishes criteria under which research of unmatched disbursements is suspended. By applying these criteria, DoD can avoid spending substantial time and resources researching old unmatched disbursement transactions. While DoD continued to be engaged in a significant research effort, it is doubtful that it will be able to establish a sufficient basis for resolving many of these old transactions. We concur with this initiative.

Matching to Available Appropriations. Established DoD policy requires that a disbursement that cannot be matched to an existing obligation must have an obligation established in an appropriation that is available for the same purpose. We concur with this initiative.

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

DoD has recognized that its unmatched disbursement problem cannot be solved until a single, shared data base, updated and accessed by expert functional systems, is fully developed and implemented. However, until significant amounts of unmatched disbursements are eliminated, and adequate accounting systems are in place to provide audit trails from line items on financial statements back to the documentation supporting the transactions, auditors will be unable to efficiently make substantive tests, if amounts can be tested at all. This presents a significant limitation in scope and will continue to cause auditors to disclaim opinions on general fund financial statements.

Contingent Liabilities

Description of the Deficiency. Auditors were not able to satisfy themselves as to the reasonableness of the amounts of contingent liabilities that should be recognized as liabilities on the FY 1993 and 1994 Statement of Financial Position and disclosed as footnotes to the financial statements. The Under Secretary of Defense (Comptroller) (USD[C]) established policy that conflicted with generally accepted accounting principles and OMB guidance requiring recognition of certain contingent liabilities. The policy directed that both probable and reasonably possible contingent liabilities be disclosed only in the footnotes to the financial statements. The policy did not allow probable contingent liabilities to be recognized and recorded as liabilities on the Statement of Financial Position, as required by generally accepted accounting principles and OMB guidance. As a result, the Army and the Air Force understated liabilities on their FY 1993 Statements of Financial Position by at least \$31.9 billion. The \$31.9 billion represented probable contingent liabilities, mostly for environmental cleanup and restructuring, which could be reasonably estimated. Another \$16.4 billion of potential litigation was not assessed during FY 1993 for probable contingent liabilities because it involved individual claims of less than \$100 million each. In addition, procedures were not in place to identify and accumulate potential probable contingent liabilities for weapons destruction, missile drawdown, and downsizing in the Air Force that could involve billions of dollars. The Air Force did not disclose in the footnotes to the FY 1993 financial statements the full magnitude, \$25.7 billion, of litigation actions of more than \$100 million each. Similar problems with recognizing and disclosing contingent liabilities were reported by auditors in FY 1994. For example, the Army did not recognize \$26.1 billion of contingent liabilities on the FY 1994 Statement of Financial Position, and the Air Force did not disclose in the footnotes to its initial submission of FY 1994 financial statements \$25 billion in litigation involving individual cases of less than \$100 million each. See Appendix I, "Contingent Liability Reporting Deficiencies Reported in FY 1993 and 1994 Audit Reports," for details of the problems with contingent liabilities, and Part III, "Management Comments," for USD(C)'s position on contingent liabilities.

Corrective Actions Taken or Under Way. Actions taken to date have not yet removed this major impediment to issuing an audit opinion. The three actions taken or under way to resolve this deficiency are as follows.

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

Liability Accounting Guidance. Guidance is forthcoming from the Federal Accounting Standards Advisory Board on accounting for liabilities of the Federal Government. This guidance has been issued as an exposure draft, and a final draft should soon be released. The USD(C) will not reconsider his position on recognizing and disclosing contingent liabilities until OMB accepts and distributes this guidance. However, the USD(C) is committed to implementing this guidance after it is promulgated.

Litigation Action Losses. Action was under way to identify the scope of litigation, claims, and assessments for individual actions of less than \$100 million each. The DoD legal community is working on establishing a methodology to identify and assess the potential Army and Air Force losses that could accrue from legal actions of less than \$100 million each. The Army and Air Force had identified 80,000 such actions totaling \$16.4 billion during FY 1993.

Air Force Contingent Liability Reporting. Air Force management concurred with Air Force Audit Agency recommendations to develop a system-wide, structured approach for compiling and reporting contingent liabilities. This approach should replace the existing process, which is cumbersome and unreliable and is an interim measure being taken until the forthcoming Federal Accounting Standards Advisory Board guidance is implemented within DoD. In addition, subsequent to the FY 1994 audit effort, the DFAS Denver Center was responsive in reacting to audit results by amending the FY 1994 financial statements to disclose contingent liabilities in the footnotes to the amended statements.

All probable contingent liabilities need to be recognized and recorded on the Statement of Financial Position as liabilities, and possible liabilities need to be fully disclosed in the footnotes to the financial statements. Until these contingent liabilities are properly recognized and disclosed and supporting data are provided to auditors for review, the auditors will continue to consider this deficiency a significant scope limitation and a reason for disclaiming an audit opinion.

Conclusion

Until DoD implements the corrective actions necessary to overcome these four major deficiencies, auditable general fund financial statements cannot be prepared for submission to independent auditors. The lack of adequate accounting systems is the major reason why DoD cannot produce auditable general fund financial statements. DoD plans to field integrated, double-entry, transaction-driven general ledgers before the beginning of FY 1999. FY 1999 will be the first year that DoD can expect to produce auditable general fund financial statements under these plans. March 1, 2000, will be the earliest that external auditors will be in a position to render an audit opinion on DoD general fund financial statements. However, the March 2000 date is based on unaudited plans established by DFAS management. These plans do not include the Navy

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

and the Defense agencies, which are not required to submit financial statements until FY 1996. We believe that improved policies and procedures can substantially improve the accuracy of DoD financial statements until interim migratory accounting systems are fielded. These systems should not become a panacea for DoD management in regard to fixing accounting deficiencies; and, the fielding of these systems should not overshadow the importance and benefits of near-term improvements. These benefits include the production of financial information that is more accurate and reliable. DoD financial managers need accurate and reliable information to make informed decisions and to properly manage DoD programs. Additionally, DoD needs to focus attention on establishing a sound internal control structure composed of an adequate control environment, reliable accounting systems, and sufficient control procedures. Auditors are needed to verify the adequacy of management's efforts to correct deficiencies and to ensure that DoD financial managers continue to work toward producing accurate and reliable financial information that is the basis for auditable DoD general fund financial statements. Auditors will continue to identify and report deficiencies and provide advice and assistance as work continues on auditing the DoD general fund financial statements. We will annually identify and summarize the deficiencies that cause auditors to disclaim audit opinions on the DoD general funds. We will also summarize and evaluate corrective actions under way to remove those deficiencies. These annual reports will give Congress and DoD managers an assessment of the progress DoD is making in producing auditable general fund financial statements. Future reports will likely contain recommendations in areas where special emphasis is needed to make improvements or accelerate action that is under way.

Recommendations for Corrective Action

Auditors have included over 200 recommendations for corrective action in the 34 audit reports on DoD general fund financial statements for FYs 1993 and 1994. See Appendix D for a list of the 34 audit reports. This report contains no recommendations. It identifies and summarizes the four major deficiencies preventing auditors from rendering audit opinions on DoD general fund financial statements. This report also identifies and discusses corrective actions taken or under way to remove the four deficiencies.

Accounting Systems. DFAS has developed a two-phased approach to develop new accounting systems with integrated subsidiary ledgers and general ledgers for accrual accounting.

Asset Reporting. The Army, the Air Force, and the U.S. Army Corps of Engineers have made interim improvements to procedures and controls over asset reporting. However, DoD will have major difficulties accounting for its assets until adequate accounting systems are implemented.

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

Collections and Disbursements. Senior managers in DoD and the Military Departments have placed a high priority on correcting problems associated with the incorrect recording and reporting of collection and disbursement transactions.

Contingent Liabilities. Because the USD(C) established policy that conflicted with both generally accepted accounting principles and OMB guidance requiring recognition of certain contingent liabilities, actions taken to remove this major impediment to issuing an audit opinion have been largely unsuccessful.

In addition to these ongoing corrective actions, several accounting standards and concepts have been published that will affect the preparation and auditing of general fund financial statements in the future. See the table below for a list of the accounting standards and concepts. For example, in a recent exposure draft on accounting for Property, Plant, and Equipment, the Federal Accounting Standards Advisory Board proposed different accounting treatments for different categories of Property, Plant, and Equipment. Under this proposal, a significant amount of Property, Plant, and Equipment would be removed from the Statement of Financial Position and reported on a stewardship report.

OMB Statements of Federal Financial Accounting Standards and Concepts			
<u>Number</u>	<u>Title</u>	<u>Status</u>	<u>Date</u>
Standard No. 1	Accounting for Selected Assets and Liabilities	Final	March 30, 1993
Standard No. 2	Accounting for Direct Loans and Loan Guarantees	Final	August 23, 1993
Standard No. 3	Accounting for Inventory and Related Property	Final	October 27, 1993
Concept No. 1	Objectives of Federal Financial Reporting	Final	September 2, 1993
Concept No. 2	Entity and Display	Draft	August 1994
TBD	Managerial Cost Accounting Standards for the Federal Government	Draft	October 7, 1994
TBD	Accounting for Liabilities of the Federal Government	Draft	November 7, 1994
TBD	Accounting for Property, Plant, and Equipment	Draft	February 28, 1995
TBD	Supplementary Stewardship Reporting	Draft	July 7, 1995
TBD	Accounting for Revenue and Other Financing Sources	Draft	July 1995

Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements

Management Comments

Under Secretary of Defense (Comptroller) Comments. The USD(C) comments included the Director, Defense Finance and Accounting Service comments. The USD(C) generally concurred with the report. But, as discussed in the report, again stated they disagreed with recording environmental cleanup costs as contingent liabilities.

Air Force Audit Agency Comments. The Air Force Audit Agency generally concurred with the report. However, the Air Force Audit Agency requested that the report be updated. We accordingly cited their final audit reports instead of draft audit reports and more fully disclosed corrective actions by the DFAS Denver Center to amend the footnotes of the final FY 1994 financial statements to show contingent liabilities.

U.S. Army Corps of Engineers Comments. The U.S. Army Corps of Engineers concurred with the report. The U.S. Army Corps of Engineers' comments provided additional insight into the status of ongoing efforts to correct the four major deficiencies.

See Part III for the complete text of management's comments.

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Part II - Additional Information

Appendix A. Scope and Methodology

Audit Work Performed. Because the Navy and Defense agencies had made limited progress toward issuing general fund financial statements, we reviewed only the Army's and the Air Force's audit reports on financial statements for FYs 1993 and 1994. Although we reviewed final FY 1994 audit opinion reports on general fund financial statements of the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program, the supporting functional audit reports that we reviewed were still in draft form. See Appendix D, "Audit Reports Issued for FY 1993 and 1994 General Fund Financial Statements," for a list of the audit reports we reviewed. Audit reports were not issued for the Navy and the Defense agencies because the Navy and Defense agencies are not required to submit financial statements for audit until FY 1996. The audit was further limited to identifying and summarizing the major deficiencies that prevented auditors from rendering audit opinions on the FY 1993 general fund financial statements for the Army and the Air Force, and the FY 1994 general fund financial statements for the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program. We defined "major deficiency" as a reason why auditors could not render an audit opinion, as reported in their FY 1993 and 1994 audit opinion reports. We interviewed personnel who were responsible for rendering audit opinions on the FY 1993 general fund financial statements for the Army and the Air Force, and the FY 1994 general fund financial statements for the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program. We also interviewed DoD officials who are responsible for ensuring that corrective actions are taken or under way to remove the deficiencies preventing auditors from rendering audit opinions.

Audit Period, Standards, and Locations. We performed this program audit during the period November 1994 through May 1995. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit. Appendix K lists the organizations we visited or contacted.

Appendix B. Prior Audits and Other Reviews

Prior Audits. No prior audits identified the major deficiencies that prevent auditors from rendering audit opinions on DoD general fund financial statements, or corrective actions taken or under way to remove these deficiencies.

Other Reviews. The USD(C) reviewed 14 audit reports on DoD FY 1993 financial statements and transmitted the "Report on Audited Financial Statements, FY 1993," to OMB on September 29, 1994. The report summarized the critical information contained in the 14 audit reports, including the impediments to auditable financial statements and identified deficiencies. The impediments included deficiencies in accounting systems, internal controls, and compliance. The report's scope and overall conclusions covered much more than the audits of the Army and Air Force general fund financial statements. The report included deficiencies identified in the audits of the Defense Business Operations Fund and many smaller revolving and trust funds. In many cases, the other funds use the same automated systems as the Army and Air Force general funds to prepare the financial statements required by the CFO Act. The report discussed 36 problems (findings, internal control weaknesses, and compliance issues) identified in the audits of the Army and Air Force FY 1993 general fund financial statements. However, the report was not written from an external auditor's perspective and did not provide specific management responses or assess the corrective actions taken or under way to correct problems.

Impediments to Auditable Financial Statements. The USD(C) concluded that its financial management systems were not designed to generate auditable financial statements. DoD managers had identified numerous problems with financial systems. The significant problems included:

- o Lack of transaction-driven general ledgers. Finance and accounting systems lacked a single standard transaction-driven general ledger, which is essential for reliable financial reports.

- o Nonintegrated data bases. Nonintegrated data bases prevented the easy or reliable integration or interfacing of information from nonfinancial functional areas, such as personnel, acquisition, and logistics, with finance and accounting systems.

- o Inflexible finance and accounting systems. Finance and accounting systems often were not sufficiently flexible to rapidly respond to changing customer bases, new legislation, contingency operations, management initiatives, requirements from other Government agencies, and other changes.

- o Lack of automated indicators. Finance and accounting systems often did not include automated indicators that measured or were linked to costs, performance measurements, or other output measurements.

Specific weaknesses, such as not verifying and reconciling cash; incorrectly valuing and reconciling inventories; inaccurate reporting of property, plant, and equipment; and failure to report financial data in a consistent and timely manner were cited as examples of inadequate internal controls and undocumented audit trails, all of which contributed to unreliable financial data. The USD(C) concluded that these impediments to auditable financial statements were due largely to long-standing systems problems, and that the continuing systems problems will require a number of years to correct.

Identified Deficiencies. The USD(C) also concluded that the 14 FY 1993 audit reports cited 4 primary deficiencies that caused the auditors to not render an audit opinion or to render a qualified opinion. The deficiencies included:

- o 5 accounting system inadequacies,
- o 28 internal control weaknesses,
- o 5 compliance issues, and
- o inadequate management and legal representation letters.

The USD(C) summarized management responses and corrective actions relating to those deficiencies. Some of the deficiencies related to the audits of the Army and Air Force general fund financial statements; some did not. Management responses and corrective actions did not address the four major deficiencies that prevented auditors from rendering audit opinions on the Army and Air Force FY 1993 general fund financial statements. Examples follow.

Management Responses to Accounting System Deficiencies. Management responses and corrective actions for accounting system deficiencies were too general and did not discuss specific plans and completion dates. The discussions were limited to nonspecific strategies and goals for developing migratory systems, improving data standardization, and changing procedures so that disbursements would be matched to obligations prior to payments.

Management Responses to Internal Control Weaknesses. Management responses and corrective actions for the 28 internal control weaknesses were too general. Twelve broad initiatives were identified, such as establishing a Senior Financial Management Oversight Council and improving the Federal Managers' Financial Integrity Act process.

This report summarizes the corrective actions taken or under way to remove the four major deficiencies that prevented auditors from rendering audit opinions on the FY 1993 general fund financial statements for the Army and the Air Force, and the FY 1994 general fund financial statements for the Army, the Air Force, and the U.S. Army Corps of Engineers, Civil Works Program.

Appendix C. General Fund Financial Statement Data for FYs 1993 and 1994

FY 1993 General Fund Financial Statement Data (Millions) Statement of Financial Position (page 1 of 3)*

Assets	Army**	Air Force	Total
Financial Resources			
Fund Balances With Treasury	\$ 35,280	\$ 65,846	\$101,126
Cash	65	149	214
Foreign Currency	31	0	31
Other Monetary Assets	100	0	100
Accounts Receivable Net, Nonfederal	1,672	721	2,393
Intragovernmental Items:			
Accounts Receivable, Federal	1,766	1,431	3,197
Investments, Federal	197	0	197
Other, Federal	1,519	2	1,521
Total Financial Resources	\$ 40,630	\$ 68,149	\$108,779
Nonfinancial Resources			
Resources Transferable to Treasury	\$ 467	\$ 129	\$ 596
Advances and Prepayments, Nonfederal	1,423	240	1,663
Inventory Not Held for Sale	2,816	30,802	33,618
Property, Plant and Equipment, Net	210,933	226,998	437,931
Other	36,166	0	36,166
Total Nonfinancial Resources	\$251,805	\$258,169	\$509,974
Total Assets	\$292,435	\$326,318	\$618,753

*Totals may contain differences due to rounding. **Includes data on the U.S. Army Corps of Engineers, Civil Works Program.

FY 1993 General Fund Financial Statement Data (Millions)
Statement of Financial Position (page 2 of 3)*

Liabilities	Army**	Air Force	Total
Funded Liabilities			
Accounts Payable, Nonfederal	\$ 4,563	\$2,771	\$ 7,334
Accrued Payroll and Benefits	3,342	1,315	4,657
Deferred Revenue, Nonfederal	494	0	494
Other Funded Liabilities, Nonfederal	253	0	253
Intergovernmental Liabilities:			
Accounts Payable, Federal	2,735	974	3,709
Deferred Revenue	1,181	1,229	2,410
Other Funded Liabilities, Federal	318	158	476
Total Funded Liabilities	\$12,886	\$6,447	\$19,333
Unfunded Liabilities			
Accrued Leave	\$ 1,690	\$1,438	\$ 3,128
Lease Liabilities	22	0	22
Other Unfunded Liabilities	914	401	1,315
Total Unfunded Liabilities	\$ 2,626	\$1,839	\$ 4,465
Total Liabilities	\$15,512	\$8,286	\$23,798

*Totals may contain differences due to rounding.

**Includes data on the U.S. Army Corps of Engineers, Civil Works Program.

FY 1993 General Fund Financial Statement Data (Millions)
Statement of Financial Position (page 3 of 3)*

Net Position	Army**	Air Force	Total
Fund Balances			
Revolving Fund Balances	\$ 1,697	\$ 0	\$ 1,697
Trust Fund Balances	1,702	2	1,704
Appropriated Fund Balances	275,625	319,722	595,347
Total Fund Balances	\$279,024	\$319,724	\$598,747
Less Future Funding Requirements	2,098	1,694	3,791
Net Position	\$276,926	\$318,030	\$594,956
Total Liabilities and Net Position	\$292,438	\$326,316	\$618,754

*Totals may contain differences due to rounding.

**Includes data on the U.S. Army Corps of Engineers, Civil Works Program.

Appendix C. General Fund Financial Statement Data for FYs 1993 and 1994

FY 1993 General Fund Financial Statement Data (Millions) Statement of Operations and Changes in Net Position (page 1 of 2)*

Revenues and Financing Sources	Army**	Air Force	Total
Appropriations Expensed			
Revenues from Sale of Goods:	\$60,401	\$77,814	\$138,215
To the Public			
Intragovernmental	517	147	664
Interest, Federal	9,308	3,689	12,997
Other Revenue and Financing Sources	8	0	8
Less: Taxes and Receipts Returned to Treasury	390	77	467
Less: Capital Appropriations Expended +	351	0	351
Capital Reimbursements	0	25,938	25,938
Total Revenues and Financing Sources	\$70,273	\$55,789	\$126,062
Expenses			
Program or Operating Expense			
Cost of Goods or Services Sold:	\$65,330	\$56,975	\$122,305
To the Public	0	3,353	3,353
Intragovernmental	467	0	467
Depreciation	5,868	0	5,868
Bad Debts and Write-offs	180	0	180
Other	21	51	72
Other Expenses	1	1	2
Total Expenses	45	2	47
	\$71,912	\$60,382	\$132,294

*Totals may contain differences due to rounding.

**Includes data on the U.S. Army Corps of Engineers, Civil Works Program.

**FY 1993 General Fund Financial Statement Data (Millions)
Statement of Operations and Changes in Net Position (page 2 of 2)***

	<u>Army**</u>	<u>Air Force</u>	<u>Total</u>
Excess (Shortage) of Revenues			
Financing Sources Over Total Expenses Before Adjustments	\$ (1,640)	\$ (4,593)	\$ (6,233)
Plus (Minus) Adjustments:			
Prior Period Adjustments	<u>60</u>	<u>0</u>	<u>60</u>
Excess (Shortage) of Revenues			
Financing Sources Over Total Expense	(1,580)	(4,593)	(6,173)
Plus: Unfunded Expenses	<u>1,429</u>	<u>233</u>	<u>1,662</u>
Excess (Shortage) of Revenues and Financing			
Sources Over Funded Expenses	\$ (151)	\$ (4,360)	\$ (4,511)
Net Position, Beginning Balances	\$275,033	\$317,681	\$592,714
Excess (Shortage) of Revenues and Financing			
Sources Over Total Expenses	(1,580)	(4,593)	(6,173)
Increase (Decrease) in Invested Capital	<u>0</u>	<u>4,943</u>	<u>4,943</u>
Plus (Minus) Equity Transfer	<u>3,473</u>	<u>0</u>	<u>3,473</u>
Net Position, Ending Balances	\$276,926	\$318,031	\$594,957

*Totals may contain differences due to rounding.

**Includes data on the U.S. Army Corps of Engineers, Civil Works Program.

FY 1994 General Fund Financial Statement Data (Millions)
Statement of Financial Position (page 1 of 4)*

Assets	<u>Army</u>	<u>Air Force</u>	<u>Corps**</u>	<u>Total</u>
Entity Assets:				
Transactions With Federal Entities:				
Fund Balances With Treasury	\$ 29,938	\$ 58,605	\$ 2,315	\$ 90,858
Investments, Net	1	0	219	220
Accounts Receivable, Net	799	1,313	321	2,433
Interest Receivable	0	0	2	2
Advances and Prepayments	641	4	0	645
Other Federal (Intragovernmental)	0	0	(1,984)	(1,984)
Transactions with Nonfederal Entities:				
Accounts Receivable, Net	272	86	1,024	1,382
Advances and Prepayments	867	138	2	1,007
Other Nonfederal	0	0	(159)	(159)
Cash and Other Monetary Assets	193	0	4	197
Inventory, Net	2,010	0	0	2,010
Work-in-Process	0	9,908	0	9,908
Operating Material and Supplies, Net	0	32,333	17	32,350
Stockpile Materials, Net	30,461	0	0	30,461
Property, Plant, and Equipment, Net	160,373	227,596	44,491	432,460
Other Entity Assets	7,196	0	26	7,222
Total Entity Assets	\$232,751	\$329,983	\$48,260	\$610,994

*Totals may contain differences due to rounding.

**Corps of Engineers, Civil Works Program.

FY 1994 General Fund Financial Statement Data (Millions)
Statement of Financial Position (page 2 of 4)*

	<u>Army</u>	<u>Air Force</u>	<u>Corps**</u>	<u>Total</u>
Nonentity Assets:				
Transactions With Federal Entities:				
Fund Balance With Treasury	\$ 924	\$ 54	\$ 52	\$ 1,030
Accounts Receivable, Net	0	0	1	1
Transactions with Nonfederal Entities:				
Accounts Receivable, Net	23	743	1	767
Cash and Other Monetary Assets	0	140	0	140
Other Nonentity Assets	0	4	0	4
Total Nonentity Assets	\$ 947	\$ 941	\$ 55	\$ 1,943
Total Assets	\$233,698	\$330,925	\$48,315	\$612,938

*Totals may contain differences due to rounding.

**Corps of Engineers, Civil Works Program.

Appendix C. General Fund Financial Statement Data for FYs 1993 and 1994

FY 1994 General Fund Financial Statement Data (Millions)
Statement of Financial Position (page 3 of 4)*

Liabilities	Army	Air Force	Corps**	Total
Liabilities Covered by Budgetary Resources:				
Transactions With Federal Entities:				
Accounts Payable	\$2,319	\$1,503	\$ 161	\$ 3,983
Other Federal Liabilities	1,556	1,124	204	2,884
Transactions with Nonfederal Entities:				
Accounts Payable	64	2,774	422	3,260
Accrued Payroll and Benefits:				
Salaries and Wages	1,236	488	0	1,724
Severance Pay and Separation Allowance	191	19	0	210
Other Nonfederal Liabilities	<u>364</u>	<u>4</u>	<u>480</u>	<u>848</u>
Total Liabilities Covered by Budgetary Resources	\$5,730	\$5,912	\$1,267	\$12,909
Liabilities not Covered by Budgetary Resources:				
Transactions With Federal Entities:				
Accounts Payable	\$ 198	\$ 0	\$ 0	\$ 198
Other Federal Liabilities	0	0	7	7
Transactions with Nonfederal Entities:				
Lease Liabilities	0	0	22	22
Other Nonfederal Liabilities	<u>1,808</u>	<u>1,606</u>	<u>0</u>	<u>3,414</u>
Total Liabilities not Covered by Budgetary Resources	\$2,006	\$1,606	\$ 29	\$ 3,641
Total Liabilities	\$7,736	\$7,518	\$1,296	\$16,550

*Totals may contain differences due to rounding.

**Corps of Engineers, Civil Works Program.

Appendix C. General Fund Financial Statement Data for FYs 1993 and 1994

FY 1994 General Fund Financial Statement Data (Millions)
Statement of Financial Position (page 4 of 4)*

Liabilities	Army	Air Force	Corps**	Total
Fund Balances				
Unexpended Appropriations	\$ 28,855	\$ 55,174	\$ 2,903	\$ 86,932
Invested Capital	199,761	269,837	86,614	556,212
Cumulative Results of Operations	(1,052)	0	(34,343)	(35,395)
Other	405	0	(8,156)	(7,751)
Future Funding Requirements	<u>(2,006)</u>	<u>(1,605)</u>	<u>0</u>	<u>(3,611)</u>
Total Net Position	\$225,963	\$323,406	\$47,018	\$596,387
Total Liabilities and Net Position	\$233,699	\$330,925	\$48,314	\$612,938

*Totals may contain differences due to rounding.

**Corps of Engineers, Civil Works Program.

Appendix C. General Fund Financial Statement Data for FYs 1993 and 1994

FY 1994 General Fund Financial Statement Data (Millions)
Statement of Operations and Changes in Net Position (page 1 of 2)*

Revenues and Financing Sources	<u>Army</u>	<u>Air Force</u>	<u>Corps**</u>	<u>Total</u>
Appropriated Capital Used	\$55,610	\$74,505	\$6,245	\$136,360
Revenues From Sale of Goods:				
To the Public	1,112	220	259	1,591
Intragovernmental	5,177	5,019	3,127	13,323
Interest, Federal	0	0	9	9
Other Revenues and Financing Sources	888	2	148	1,038
Less: Taxes and Receipts Transferred to Treasury or Other Agencies	381	0	98	479
Less: Capital Appropriations Expended + Capital Reimbursements	<u>0</u>	<u>25,322</u>	<u>0</u>	<u>25,322</u>
Total Revenue and Financing Sources	\$62,406	\$54,424	\$9,690	\$126,520
Expenses				
Program or Operating Expenses	\$56,136	\$55,126	\$8,929	\$120,191
Cost of Goods or Services Sold:				
To the Public	1,023	0	164	1,187
Intragovernmental	5,266	0	363	5,629
Cost of Reimbursable Programs	0	4,853	0	4,853
Depreciation	0	0	296	296
Bad Debts and Write-offs	55	132	0	187
Interest:				
Other	2	2	0	4
Other Expenses	<u>2,973</u>	<u>25</u>	<u>0</u>	<u>2,998</u>
Total Expenses	\$65,455	\$60,138	\$9,752	\$135,345

*Totals may contain differences due to rounding.

**Corps of Engineers, Civil Works Program.

Appendix C. General Fund Financial Statement Data for FYs 1993 and 1994

FY 1994 General Fund Financial Statement Data (Millions) Statement of Operations and Changes in Net Position (page 2 of 2)*

	<u>Army</u>	<u>Air Force</u>	<u>Corps**</u>	<u>Total</u>
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Adjustments	\$ (3,048)	\$ (5,713)	\$ (63)	\$ (8,824)
Plus (Minus) Extraordinary Items	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Excess (Shortage) of Revenues and Financing Sources Over Total Expense	\$ (3,048)	\$ (5,713)	\$ (63)	\$ (8,824)
Net Position Beginning Balances	231,027	320,466	49,189	600,682
Adjustments	<u>72</u>	<u>0</u>	<u>0</u>	<u>72</u>
Net Position, Beginning Balances Restated	\$231,099	\$320,466	\$49,189	\$600,754
Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(3,048)	(5,713)	(63)	(8,824)
Increase (Decrease) in Invested Capital	0	9,599	0	9,599
Plus (Minus) Non-Operating Changes	<u>(2,089)</u>	<u>(946)</u>	<u>(2,108)</u>	<u>(5,143)</u>
Net Position, Ending Balances	\$225,962	\$323,406	\$47,018	\$596,386

*Totals may contain differences due to rounding.

**Corps of Engineers, Civil Works Program.

Appendix D. Audit Reports Issued for FY 1993 and 1994 General Fund Financial Statements

IG, DoD, Reports

Army FY 1993 General Fund Financial Statements:

Defense Finance and Accounting Service Work on the Army FY 1993 Financial Statements (Report No. 94-168), July 6, 1994.

Air Force FY 1993 General Fund Financial Statements:

Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements (Report No. 95-067), December 30, 1994.

Army Audit Agency Reports

Army FY 1993 General Fund Financial Statements:

Audit of the Army's FY 93 Financial Statements, Audit Opinion (Report No. HQ 94-450), June 30, 1994.

Audit of the Army's FY 93 Financial Statements, DoD Policy Issues (Report No. HQ 94-451), August 31, 1994.

Audit of the Army's FY 93 Financial Statements, Follow-up Issues (Report No. HQ 94-452), August 30, 1994.

Audit of the Army's FY 93 Financial Statements, Retail Military Equipment (Report No. WR 94-473), August 31, 1994.

FY 93 Financial Statements, Civil Works, U.S. Army Corps of Engineers (Report No. SR 94-481), June 30, 1994.

Audit of the Army's FY 93 Financial Statements, Cash Flow Statement (Report No. SR 94-485), August 31, 1994.

Financial Reporting of Conventional Ammunition (Report No. NR 94-446), August 4, 1994.

Audit of the Army's FY 93 Financial Statements, Military and Civilian Payrolls (Report No. SR 94-486), August 30, 1994.

Appendix D. Audit Reports Issued for FY 1993 and 1994 General Fund Financial Statements

Army FY 1994 General Fund Financial Statements:

Audit of the Army's Principal Financial Statements, Fiscal Years 1994 and 1993, Audit Opinion (Report No. HQ 95-451), March 23, 1995.

Audit of General Ledger Accounting, Standard Operation and Maintenance, Army Research and Development System (Draft Report No. SR 95-452), March 29, 1995.

Audit of Financial Operations, U.S. Army Materiel Command (Draft Report No. SR 95-451), February 27, 1995.

Audit of the Army's FY 94 Financial Statements, Military Travel and Pay Advances (Draft Report No. NR 95-7), March 6, 1995.

Audit of the Army's FY 94 Financial Statements, Financial Reporting of Wholesale Assets (Draft Report No. NR 95-428), April 4, 1995.

Corps of Engineers, Civil Works Program, FY 1994 General Fund Financial Statements:

Audit of FY 94 Financial Statements, Civil Works, U.S. Army Corps of Engineers (Report No. SR 95-449), March 13, 1995.

Air Force Audit Agency Reports

Air Force FY 1993 General Fund Financial Statements:

Opinion on FY 1993 Air Force Consolidated Financial Statements (Report No. 94053022), June 30, 1994.

Review of Military Equipment, FY 1993 Air Force Consolidated Financial Statements (Report No. 93053024), July 20, 1994.

Review of Inventories Not Held For Sale, FY 1993 Air Force Consolidated Financial Statements (Report No. 94053031), July 1, 1994.

Review of Equipment and Vehicle Inventory, FY 1993 Air Force Consolidated Financial Statements (Report No. 93053007), July 22, 1994.

Review of Contingent Liabilities, FY 1993 Air Force Consolidated Financial Statements (Report No. 94053024), August 8, 1994.

Review of Real Property, FY 1993 Air Force Consolidated Financial Statements (Report No. 94053026), July 27, 1994.

Review of Accuracy and Validity of Air Force Obligations, FY 1993 Air Force Consolidated Financial Statements (Report No. 93053015), August 26, 1994.

**Appendix D. Audit Reports Issued for FY 1993 and 1994
General Fund Financial Statements**

Review of the Funds Control Process, FY 1993 Air Force Consolidated Financial Statements (Report No. 94053030), August 26, 1994.

Review of Management Initiatives to Improve Financial Reporting, FY 1993 Air Force Consolidated Financial Statements (Report No. 94053021), August 8, 1994.

Review of Overview and Performance Measures, FY 1993 Air Force Consolidated Financial Statements (Report No. 94053029), August 8, 1994.

Review of Civilian Payroll, FY 1993 Air Force Consolidated Financial Statements (Report No. 93053014), June 6, 1994.

Review of Military Personnel Costs, FY 1993 Air Force Consolidated Financial Statements (Report No. 93053013), July 1, 1994.

Air Force FY 1994 General Fund Financial Statements:

Opinion on FY 1994 Air Force Consolidated Financial Statements (Report No. 94053001), March 1, 1995.

Review of Property, Plant, and Equipment, FY 1994 Air Force Consolidated Financial Statements (Draft Report for Project No. 94053032), February 9, 1995.

Review of the Fund Control Process, FY 1994 Air Force Consolidated Financial Statements (Draft Report for Project No. 94053033), February 15, 1995.

Review of Operating Materials and Supplies, FY 1994 Air Force Consolidated Financial Statements (Draft Report for Project No. 94053034), February 15, 1995.

Review of Military and Civilian Pay, FY 1994 Air Force Consolidated Financial Statements (Report No. 94053035), April 24, 1995.

Review of Contingent Liabilities, FY 1994 Air Force Consolidated Financial Statements (Report No. 94053037), May 1, 1995.

Appendix E. Crosswalk of the Four Major Deficiencies to FY 1993 and 1994 Audit Reports

TITLE; (REPORT NUMBER); DATE	MAJOR DEFICIENCIES			
	ACCOUNTING SYSTEMS	ASSET REPORTING	COLLECTIONS & DISBURSEMENTS	CONTINGENT LIABILITIES
IG, DOD AUDIT REPORTS				
ARMY FY 1993 GENERAL FUND FINANCIAL STATEMENTS:				
DFAS WORK ON ARMY FY 1993 FINANCIAL STATEMENTS (94-168), JULY 6, 1994.	X	X		
AIR FORCE FY 1993 GENERAL FUND FINANCIAL STATEMENTS:				
DFAS WORK ON AIR FORCE FY 1993 FINANCIAL STATEMENTS (95-067), DECEMBER 30, 1994.	X	X	X	
ARMY AUDIT AGENCY AUDIT REPORTS				
ARMY FY 1993 GENERAL FUND FINANCIAL STATEMENTS:				
AUDIT OF ARMY'S FY 93 FINANCIAL STATEMENTS, AUDIT OPINION (HQ 94-450), JUNE 30, 1994.	X	X	X	X
AUDIT OF ARMY'S FY 93 FINANCIAL STATEMENTS, DOD POLICY ISSUES (HQ 94-451), AUGUST 31, 1994.		X		X
AUDIT OF ARMY'S FY 93 FINANCIAL STATEMENTS, FOLLOW-UP ISSUES (HQ 94-452), AUGUST 30, 1994.	X	X		
AUDIT OF ARMY'S FY 93 FINANCIAL STATEMENTS, RETAIL MILITARY EQUIPMENT (WR 94-473), AUGUST 31, 1994.	X	X		
FY 93 FINANCIAL STATEMENTS, CIVIL WORKS, ARMY CORPS OF ENGINEERS (SR 94-481), JUNE 30, 1994.	X	X		X
AUDIT OF ARMY'S FY 93 FINANCIAL STATEMENTS, CASH FLOW STATEMENTS (SR 94-485), AUGUST 31, 1994.	X	X	X	
FINANCIAL REPORTING OF CONVENTIONAL AMMUNITION (NR 94-446), AUGUST 4, 1994.		X		
AUDIT OF ARMY'S FY 93 FINANCIAL STATEMENTS, MILITARY & CIVILIAN PAYROLLS (SR 94-486), AUGUST 30, 1994.	X			
ARMY FY 1994 GENERAL FUND FINANCIAL STATEMENTS:				
AUDIT OF ARMY'S FINANCIAL STATEMENTS, FY 94 & 93, AUDIT OPINION (HQ 95-451), MARCH 23, 1995.	X	X	X	X
AUDIT OF GENERAL LEDGER ACCOUNTING, STANDARD OPERATIONS & MAINTENANCE ARMY RESEARCH & DEVELOPMENT SYSTEM (DRAFT REPORT SR 95-452), MARCH 29, 1995.	X	X		
AUDIT OF FINANCIAL OPERATIONS, U.S. ARMY MATERIEL COMMAND (DRAFT REPORT SR 95-451), FEBRUARY 27, 1995.	X			
AUDIT OF ARMY'S FY 94 FINANCIAL STATEMENTS, MILITARY TRAVEL & PAY ADVANCE (DRAFT REPORT NR 95-7), MARCH 6, 1995.		X		
AUDIT OF ARMY'S FY 94 FINANCIAL STATEMENTS, REPORTING OF WHOLESALE ASSETS (DRAFT REPORT NR 95-428), APRIL 4, 1995.	X	X		
CORPS OF ENGINEERS, CIVIL WORKS PROGRAM FY 1994				
GENERAL FUND FINANCIAL STATEMENTS:				
AUDIT OF FY 94 FINANCIAL STATEMENTS, CIVIL WORKS, ARMY CORPS OF ENGINEERS (SR 95-449), MARCH 13, 1995.	X	X		X

**Appendix E. Crosswalk of the Four Major Deficiencies to FYs 1993 and 1994
Audit Reports**

TITLE: (REPORT NUMBER); DATE	MAJOR DEFICIENCIES			
	ACCOUNTING SYSTEMS	ASSET REPORTING	COLLECTIONS & DISBURSEMENTS	CONTINGENT LIABILITIES
AIR FORCE AUDIT AGENCY AUDIT REPORTS				
AIR FORCE FY 1993 GENERAL FUND FINANCIAL STATEMENTS:				
OPINION ON FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053022), JUNE 30, 1994.	X	X	X	X
REVIEW OF MILITARY EQUIPMENT, FY 1993 AIR FORCE FINANCIAL STATEMENTS (93053024), JULY 20, 1994.	X	X		
REVIEW OF INVENTORIES NOT HELD FOR SALE, FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053031), JULY 1, 1994.	X	X		
REVIEW OF EQUIPMENT & VEHICLE INVENTORY, FY 1993 AIR FORCE FINANCIAL STATEMENTS (93053007), JULY 22, 1994.	X	X		
REVIEW OF CONTINGENT LIABILITIES, FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053024), AUGUST 8, 1994.				X
REVIEW OF REAL PROPERTY, FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053026), JULY 27, 1994.	X	X		
REVIEW OF ACCURACY AND VALIDITY OF AIR FORCE OBLIGATIONS, FY 1993 AIR FORCE FINANCIAL STATEMENTS (93053015), AUGUST 26, 1994.	X		X	
REVIEW OF FUNDS CONTROL PROCESS, FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053030), AUGUST 26, 1994.	X	X	X	
REVIEW OF MANAGEMENT INITIATIVES TO IMPROVE FINANCIAL REPORTING, FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053021), AUGUST 8, 1994.	X	X	X	
REVIEW OF OVERVIEW & PERFORMANCE MEASURES, FY 1993 AIR FORCE FINANCIAL STATEMENTS (94053029), AUG 8, 1994.		X		
REVIEW OF CIVILIAN PAYROLL, FY 1993 AIR FORCE FINANCIAL STATEMENTS (93053014), JUNE 6, 1994.				
REVIEW OF MILITARY PERSONNEL COSTS, FY 1993 AIR FORCE FINANCIAL STATEMENTS (93053013), JULY 1, 1994.				
AIR FORCE FY 1994 GENERAL FUND FINANCIAL STATEMENTS:				
OPINION ON FY 1994 AIR FORCE FINANCIAL STATEMENTS (94053001), MARCH 1, 1995.	X	X	X	X
REVIEW OF PROPERTY, PLANT, & EQUIPMENT, FY 1994 AIR FORCE FINANCIAL STATEMENTS (DRAFT 94053032), FEB 9, 1995.	X	X		
REVIEW OF FUND CONTROL PROCESS, FY 1994 AIR FORCE FINANCIAL STATEMENTS (DRAFT 94053033), FEBRUARY 15, 1995.	X	X	X	
REVIEW OF OPERATING MATERIALS & SUPPLIES, FY 1994 AIR FORCE FINANCIAL STATEMENTS (DRAFT 94053034), FEB 15, 1995.	X	X		
REVIEW OF MILITARY & CIVILIAN PAY, FY 1994 AIR FORCE FINANCIAL STATEMENTS (94053035), APRIL 24, 1995.				
REVIEW OF CONTINGENT LIABILITIES, FY 1994 AIR FORCE FINANCIAL STATEMENTS (94053037), MAY 1, 1995.				X

The 81 Specific Deficient Areas Underlying the 4 Major Deficiencies Preventing Auditors from Rendering Audit Opinions on DoD General Fund Financial Statements

Accounting Systems

Army General Fund Financial Statements:

- o using an integrated, double-entry, transaction-driven general ledger system
- o using automated subsidiary ledgers
- o reporting of fixed assets
- o posting equipment purchases
- o recording accounts payable
- o understanding the general ledger concept
- o identifying abnormal balances
- o posting unearned revenue and advance payments
- o extracting data on wholesale equipment and secondary items

Air Force General Fund Financial Statements:

- o using a transaction-driven general ledger
- o dual reporting of inventories
- o interfacing with the inventory accounting system for assets held by others
- o the status system interfacing with the central procurement accounting system
- o including Military Strategic and Tactical Relay satellites
- o including engine module assets
- o valuing property, plant, and equipment
- o valuing operating materials and supplies
- o identifying variances in equipment-on-loan balances

Appendix E. Crosswalk of the Four Major Deficiencies to FYs 1993 and 1994 Audit Reports

- o identifying errors in construction-in-progress balances

U.S. Army Corps of Engineers, Civil Works Program, General Fund Financial Statements:

- o using a transaction-driven general ledger
- o establishing management controls over the accounting system

Asset Reporting

Army General Fund Financial Statements:

- o reporting equipment held by tactical activities
- o reporting equipment held by nontactical activities
- o reporting equipment-in-transit
- o reporting construction-in-progress
- o reporting design and engineering costs
- o validating installation property records
- o reconciling property records
- o estimating Government-furnished property
- o crosswalking Government-furnished property
- o adjusting the general ledger for Government-furnished property
- o expensing Government-furnished materials as consumables
- o recording ammunition and missiles
- o valuing unserviceable inventory awaiting repair
- o supporting loaned equipment
- o valuing material earmarked for disposal
- o accounting for delinquent travel advances

Air Force General Fund Financial Statements:

- o accounting for assets at acquisition cost

**Appendix E. Crosswalk of the Four Major Deficiencies to FYs 1993 and 1994
Audit Reports**

- o manual processing of real property transactions
- o accounting for tenant organizations' real property values
- o reporting of real property by civil engineers
- o reporting Defense Business Operations Fund real property assets
- o reporting construction-in-progress
- o reporting satellites
- o supporting engineering records for real property
- o updating unit prices for equipment
- o recording unit prices for inventory
- o valuing assets no longer in use
- o classifying cryptographic and medical assets
- o valuing excess and surplus property
- o valuing excess and crashed aircraft engines
- o reporting real property construction
- o reporting B-52 aircraft
- o reporting depot munitions
- o reporting vehicles

**U.S. Army Corps of Engineers, Civil Works Program, General Fund
Financial Statements:**

- o accounting for real property
- o supporting asset costs
- o reporting construction-in-progress
- o accounting for equipment
- o recording long-term receivables
- o recording financing interest as long-term receivables
- o reporting accounts receivable

**Appendix E. Crosswalk of the Four Major Deficiencies to FYs 1993 and 1994
Audit Reports**

Disbursements and Collections

Army General Fund Financial Statements:

- o reporting of contract payments
- o posting progress payments to temporary accounts
- o using element-of-resource codes
- o preparing disbursement and collection vouchers

Air Force General Fund Financial Statements:

- o accounting for operating expenses and accounts payable
- o creating negative unliquidated obligations
- o verifying disbursement and collection transactions

Contingent Liabilities

Army General Fund Financial Statements:

- o recognizing probable contingent liabilities as liabilities on the Statement of Financial Position
- o disclosing ongoing legal actions in the footnotes and recognizing them as liabilities
- o disclosing in the footnotes potential liabilities associated with legal actions of less than \$100 million each

Air Force General Fund Financial Statements:

- o recognizing probable contingent liabilities for environmental cleanup as liabilities on the Statement of Financial Position
- o disclosing in the footnotes the magnitude of potential liabilities associated with legal actions greater than \$100 million each
- o disclosing in the footnotes potential liabilities associated with legal actions of less than \$100 million each
- o disclosing in the footnotes potential liabilities for budgetary contingency amounts for outstanding orders

**Appendix E. Crosswalk of the Four Major Deficiencies to FYs 1993 and 1994
Audit Reports**

- o identifying probable or possible contingent liabilities for weapons destruction, missile drawdown, and downsizing within the Air Force

- o classifying contingent liabilities under procurement contracts

Corps of Engineers, Civil Works Program, General Fund Financial Statements:

- o preparing the legal representation letters

- o maintaining supporting documentation

- o classifying contingencies and unadjudicated claims

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

The existing accounting systems could not produce auditable financial statements. Accounting systems deficiencies were identified in the following areas.

Army General Fund Financial Statements

The accounting systems used to prepare the Army's FY 1993 and 1994 general fund financial statements did not have an integrated general ledger or comprehensive subsidiary ledgers, and did not generate auditable financial information. Accounting system deficiencies were found in:

- o using an integrated, double-entry, transaction-driven general ledger system,
- o using automated subsidiary ledgers,
- o reporting fixed assets,
- o posting equipment purchases,
- o recording accounts payable,
- o understanding the general ledger concept,
- o identifying abnormal balances,
- o posting unearned revenue and advance payments, and
- o extracting data on wholesale equipment and secondary items.

These deficient areas are described below.

Using an Integrated, Double-Entry, Transaction-Driven General Ledger System. The DFAS Indianapolis Center was not in compliance with the DoD requirement to use an integrated standard general ledger to produce the Army's financial statements. Both the DFAS Indianapolis Center and external auditors have recognized the need for an integrated, double-entry, transaction-driven general ledger system for preparing the Army's financial statements. In the interim, the DFAS Indianapolis Center needed strict compensating controls to reduce the risks of the inadequate accounting system now used and to increase the accuracy and reliability of the financial statements. The accounting systems also did not generate subsidiary ledgers or transaction files supporting the cash and cash-based general ledger accounts. Such files are necessary to test the

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

reliability of the financial statement data. The FY 1994 audit stated that the use of status and expenditure data to produce the Army's general fund financial statements at the DFAS Indianapolis Center is an interim solution. That method will soon be unacceptable for producing the financial statements.

Using Automated Subsidiary Ledgers. Accounting offices could not provide auditors with a complete set of automated subsidiary records for amounts reported to the DFAS Indianapolis Center. Field accounting activities reported financial data to the DFAS Indianapolis Center for consolidation into the Army's department-level financial statements. The field accounting records constituted the subsidiary ledgers to support the Army totals. However, the accounting offices did not have complete sets of automated subsidiary records consisting of subsidiary ledgers or transaction files. Lacking subsidiary ledgers, auditors could not sample and test transactions supporting the amounts used to prepare the Army's financial statements; consequently, inadequate audit trails existed. For example, the Standard Operations and Maintenance Army Research and Development System did not create account groupings of the detailed transactions to support the general ledger cash and cash-related account balances, which prevented auditors from properly testing these accounts.

Reporting Fixed Assets. Lacking a complete general ledger, the dollar values reported for fixed assets in the Army's financial statements were derived from systems designed to manage or physically account for these items. These management systems did not interface with the accounting systems, and did not always contain complete and accurate data. Audit results showed that the values of selected asset lines on the financial statements were not accurate and that supporting information was not adequate to determine the correct values.

Posting Equipment Purchases. Equipment purchases were not properly posted to the general ledger because the systems did not recognize such transactions. Disbursements for some capital equipment purchases, which should have been reported as assets, were treated as expenses instead. The previously discussed lack of a complete general ledger prevented the auditors from determining the amount of capital purchases improperly expensed and recommending an adjustment.

Recording Accounts Payable. Accounting offices did not record accounts payable when activities received goods and services from contractors. This occurred because some logistics systems (for contract management) were not integrated with the accounting system. With an integrated logistics and accounting system, material receipts posted to the logistics system automatically update the accounting system and calculate the appropriate payables. However, receipts for items purchased on contract were not reported because no accounting entries were made when the accounting office input the receiving reports. As a result, accounts payable to the private sector were understated on the Army's FY 1994 Statement of Financial Position.

Understanding the General Ledger Concept. Accounting offices did not understand their general ledgers because accounting procedures focused on budget execution rather than the general ledger. For example, auditors identified discrepancies between the general ledger and budget execution reports

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

because accounting personnel made changes in the budget execution system without processing corresponding transactions through the general ledger. In addition, accounting personnel had little knowledge of how the general ledgers worked and how day-to-day actions affected the ledgers. The accounting personnel understood only single-entry data, such as commitments, obligations, and disbursement data. They did not know how cash-based transactions affected other accounts because they did not use or review general ledger data.

Identifying Abnormal Balances. Auditors' reviews of general ledger balances showed that many of the accounts had abnormal balances. Accounting personnel were not aware that their stations reported abnormal balances and did not research the causes and make corrections. In FY 1993, accounting offices reported a combined credit balance for accounts receivable (debit balance accounts) of about \$3.1 million. Additionally, accounting offices reported \$405 million of accrued payroll and benefits from prior years. Payroll accruals are established at year's end to account for payroll expenses that have been incurred but not paid. Accounting offices should clear these accruals when they process the payroll in the next period, usually in 1 or 2 weeks instead of 1 year.

Posting Unearned Revenue and Advance Payments. Accounts receivable and unearned revenue were overstated on the Army's FY 1994 Statement of Financial Position because the accounting system could not distinguish between earnings from orders paid in advance and earnings on orders not paid in advance. Instead, the accounting system created a receivable during the billing cycle for orders paid in advance. In addition, accounting offices generally did not record unearned revenue in the general ledger. Auditors identified instances in which accounting offices recorded collections as reimbursements earned instead of unearned revenue. This caused misstatements of the affected revenue accounts.

Extracting Data on Wholesale Equipment and Secondary Items. The system application used to extract data from the Commodity Command Standard System was flawed, and prevented wholesale equipment and secondary items owned by project managers from being reported in the general ledger. As a result, the reported value of Army assets was understated by \$3.8 billion.

Air Force General Fund Financial Statements

Existing accounting systems could not produce auditable financial statements. The Air Force did not have a transaction-driven general ledger. Auditors could not determine the accuracy of account balances because financial accounting systems did not sufficiently accumulate, account for, and report financial information. Accounting system deficiencies were found in:

- o using a transaction-driven general ledger,
- o dual reporting of inventories,

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

- o interfacing with the inventory accounting system for assets held by others,
- o the status system interfacing with the central procurement accounting system,
- o capturing Military Strategic and Tactical Relay satellites,
- o capturing engine module assets,
- o valuing property, plant, and equipment,
- o valuing operating materials and supplies,
- o identifying variances in equipment-on-loan balances, and
- o identifying errors in construction-in-progress balances.

These deficient areas are described below.

Using a Transaction-Driven General Ledger. The Air Force did not use a transaction-driven general ledger to provide a single source for compiling and reporting financial information for use in preparing financial statements. Although the DFAS Denver Center was developing a transaction-based financial management system, it will not be operational for several years. Because a double-entry, transaction-driven general ledger was not used, and the DFAS Denver Center's supplemental journal voucher system did not contain adequate internal controls to ensure the validity of the data used to prepare the financial statements, the DFAS Denver Center could not prepare meaningful financial statements in accordance with the DoD Accounting Manual. Consequently, Air Force and DFAS Denver Center personnel were forced to extract data from multiple automated systems, as well as some manual systems, to prepare the Air Force's annual consolidated financial statements. This contributed to control problems in developing accurate financial statements, and directly affected all aspects of financial management and reporting of information on the Air Force's financial statements.

Dual Reporting of Inventories. Because accounting systems did not interface, auditors identified dual reporting of inventories in FY 1993. This condition occurred because the Air Force and the DFAS Denver Center erroneously included the inventory data in two accounts, both of which were reported on the financial statements. The dual reporting of inventory resulted in a \$4.8 billion overstatement of inventory on the Air Force's general fund financial statements for FY 1993.

Interfacing With the Inventory Accounting System for Assets Held by Others. The Air Force's inventory accounting system and the Army's system did not interface to allow for the reporting of assets held by others. In FY 1993, Air Force personnel did not report at least \$221 million of Air Force

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

ammunition held by the Army. This condition occurred because the Army made coding errors in reporting to the Air Force the volume of Air Force ammunition in the Army's possession.

Status System Interfacing With the Central Procurement Accounting System. Automated systems that controlled data on contracts, obligations, and payments did not properly interface with the Air Force's central procurement accounting system. Unreconciled differences in obligations existed between Air Force logistics centers and the DFAS Columbus Center. This affected the auditors' ability to determine the accuracy of account balances on financial statements.

Capturing Military Strategic and Tactical Relay Satellites. Air Force accounting systems did not include a \$1.45 billion Military Strategic and Tactical Relay Satellite in a general ledger balance forwarded to the DFAS Denver Center. This resulted from a misunderstanding of conditions under which satellites should be reported.

Capturing Engine Module Assets. Air Force accounting systems did not include \$914 million of uninstalled engine modules and \$186 million of contractor logistics support engines in the financial statements. The accounting systems omitted engine modules from financial statement reporting because of untimely suspense dates. This caused \$1.1 billion of engine module assets to be excluded from the consolidated trial balance that was forwarded to the DFAS Denver Center.

Valuing Property, Plant, and Equipment. Auditors could not validate \$227.6 billion of property, plant, and equipment because the accounting systems did not accumulate, account for, and report the acquisition cost of military equipment. Automated systems valued assets at standard cost instead of original acquisition cost. The Air Force did not value military equipment, vehicles, and other equipment in accordance with applicable accounting standards. Systems used to account for military equipment computed the account balance using a table of standard value instead of the original acquisition cost.

Valuing Operating Materials and Supplies. Auditors could not validate \$32.3 billion of operating materials and supplies because the accounting systems did not accumulate, account for, and report the acquisition cost of operating materials and supplies. Automated systems valued assets at standard cost instead of original acquisition cost. The Air Force did not value operating materials and supplies in accordance with applicable accounting standards. Systems used to account for military equipment computed the account balance using a table of standard values instead of the original acquisition cost.

Identifying Variances in Equipment-on-Loan Balances. The DFAS Denver Center was unable to identify large account balance variances. Between FYs 1992 and 1993, the Air Force equipment-on-loan balance increased from \$400 million to \$18 billion. The DFAS Denver Center did not identify this variance, and accounting personnel did not analyze account balances for unusual changes. As a result, the FY 1993 financial statements contained an equipment balance that was overstated by nearly \$18 billion. Although the DFAS Denver

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

Center corrected the equipment balance in the financial statements, the accounting system's internal control structure should have prevented this variance.

Identifying Errors in Construction-in-Progress Balances. Accounting system processes and controls did not identify errors in account balances caused by processing of vouchers. In FY 1993, accounting office personnel overstated the value of construction-in-progress by \$1.2 billion by incorrectly processing two general ledger journal vouchers. Auditors identified the overstatement during a FY 1993 year-end review of general ledger account balances. Accounting personnel did not detect the error because they did not analyze year-end account balances to identify changes. An account analysis would have detected the large increase in the account balance, signaled a need to investigate the increase, and prevented the \$1.2 billion overstatement on the FY 1993 financial statements.

U.S. Army Corps of Engineers, Civil Works Program, General Fund Financial Statements

Flaws in the accounting system used by the U.S. Army Corps of Engineers prevented the auditors from determining the reasonableness of amounts reported on the FY 1993 Statement of Financial Position for the U.S. Army Corps of Engineers, Civil Works Program (the Corps). Auditors could not render an opinion on the reliability of the FY 1993 Statement of Financial Position, which reported \$50.5 billion of assets. Material uncertainties existed regarding the reasonableness of amounts reported for most of the Corps' assets; financial management practices for project costs damaged the fiscal integrity of the cost management system and reduced the usefulness of the financial information; and the financial management system's inadequacies prevented Corps personnel from reporting reliable financial information. In FY 1994, the absence of an integrated accounting system prevented the Corps from ensuring that reliable data were reported in the FY 1994 Statement of Operations. The auditors also reported material uncertainties regarding the reasonableness of the \$48.3 billion in assets reported by the Corps in FY 1994. These uncertainties prevented auditors from determining the reasonableness of revenues and expenses. The accounting system had deficiencies in:

- o using a transaction-driven general ledger, and
- o establishing management controls over the accounting system.

These deficient areas are described below.

Using a Transaction-Driven General Ledger. The Corps of Engineers Management Information System did not incorporate an integrated, transaction-driven general ledger and prevented the Corps from reporting reliable financial information. An integrated system is necessary to apply generally accepted accounting principles to produce complete, accurate, and verifiable financial data. Because the Corps' accounting system was not an integrated system based

Appendix F. Accounting System Deficiencies Identified in FY 1993 and 1994 Audit Reports

on a standard general ledger, several material line items on the Corps' FY 1993 and 1994 financial statements were not produced or supported by a general ledger or subsidiary accounting records. As a result, the Corps had to use alternative sources for many line items on its financial statements. For example, Fund Balances With Treasury, Revenues and Other Financing Sources, and Total Expenses were developed from Treasury and budget reports. In addition, Unexpended Appropriations, Invested Capital, and the Cumulative Results of Operations used calculated figures. Because the Corps did not derive line item amounts from its accounting system, an audit of the entire Statement of Operations, Budget and Execution, Cash Flows, and several accounts in the Statement of Financial Position would have been impractical. In FY 1993, auditors identified several other deficient areas related to the Corps' current financial system.

- o Key accounts and transaction codes were missing from the Management Information System. Therefore, the Corps could not ensure that all transactions were accurately processed and recorded.

- o The Corps had to allocate detailed expense classes on the Cash Flow Statements based on its FY 1993 budget because the Corps of Engineers Management Information System could not produce a breakdown of expenses.

- o Programming the current financial system was complex because the system was not based on a standard general ledger. The system used non-general ledger financial classifications, such as accounting element numbers and electronic adding machine codes. Because the Corps used non-general ledger amounts, revolving fund line items on the Statement of Financial Position were unauditable.

These weaknesses limited the Corps' ability to prepare reliable financial statements. The line items represented significant funds and assets; therefore, auditors disclaimed an opinion on the FY 1993 and 1994 financial statements of the U.S. Army Corps of Engineers, Civil Works Program.

Establishing Management Controls Over the Accounting System. Weak management controls over access to data and separation of duties left the Corps' financial data vulnerable to error and manipulation. Inadequate security and disaster recovery plans could result in permanent losses that could destroy the Corps' financial system. These accounting system control deficiencies are described below.

Data Access. The Corps' accounting system contained weaknesses in control over access because of utilities such as database building. In 1991, the GAO found that although Corps Headquarters issued guidelines to control the use of the database-building procedure, Corps districts still used database building extensively. Although some uses were legitimate, the lack of management controls left the data vulnerable to unauthorized changes.

Separation of Duties. Finance and accounting offices did not effectively separate the duties of entering and processing data. Control personnel performed functions that were the responsibility of accounting

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personnel. Accounting personnel were responsible for entering and correcting data, and control personnel were responsible for correct processing. Auditors found, however, that the control section made pre-edit corrections of time and attendance data and changed the data base.

Systems Security. The Corps Program Management Office identified weaknesses in network security caused by physical links, dial-in access, connection to public networks, inadequate virus prevention, and inadequate protection of confidential data stored in Oracle databases. These vulnerabilities exposed the financial data to manipulation. Virus scanning was added, but few other changes were made.

Disaster Recovery Planning. Both the GAO and the Program Management Office identified disaster recovery and backup as a weakness. As a result, the Program Management Office completed a Continuity of Operations Plan for hardware and the network in fall 1993. However, the plan did not outline procedures for recovering applications and had never been fully tested.

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Asset reporting deficiencies were identified in the following areas.

Army General Fund Financial Statements

Procedures and controls were not adequate to ensure that the Army's assets were fairly stated on the Army's FY 1993 and 1994 Statements of Financial Position. Auditors identified asset reporting deficiencies in:

- o reporting equipment held by tactical activities,
- o reporting equipment held by nontactical activities,
- o reporting equipment-in-transit,
- o reporting construction-in-progress,
- o reporting design and engineering costs,
- o validating installation property records,
- o reconciling property records,
- o estimating Government-furnished property,
- o crosswalking Government-furnished property,
- o adjusting the general ledger for Government-furnished property,
- o expensing Government-furnished materials as consumables,
- o recording ammunition and missiles,
- o valuing unserviceable inventory awaiting repair,
- o supporting loaned equipment,
- o valuing material earmarked for disposal, and
- o accounting for delinquent travel advances.

Detailed descriptions of these deficient areas follow.

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Reporting Equipment Held by Tactical Activities. The Continuing Balance System - Expanded did not capture items with certain control codes and nonstandard stock numbers. Therefore, those items were not considered for financial reporting purposes. This occurred because the Continuing Balance System - Expanded was designed for visibility over tactical equipment, not for financial reporting purposes.

Reporting Equipment Held by Nontactical Activities. The Army's system of financial reporting for equipment owned by nontactical activities did not produce reliable results, and resulted in an understatement of the property, plant, and equipment line on the Statement of Financial Position. In FY 1993, the auditors found significant control problems with the Army's procedures for reporting equipment held by nontactical activities:

- o All property books were not identified and reported for inclusion in the financial statements. Accounting offices did not request input from 7 of the 13 activities that were audited.

- o Accounting offices did not always use appropriate cutoff dates for reporting purposes. Only one of the four offices reviewed used a cutoff date of September 30, 1993. Others used dates ranging back to the end of FY 1992.

- o Property book officers did not always use current equipment prices when computing their year-end totals.

These asset reporting problems resulted in a \$715 million understatement (the difference between the \$2.2 billion recorded in the property books that were audited and the \$1.5 billion reported in the FY 1993 financial statements) of property, plant, and equipment.

Reporting Equipment-in-Transit. Army records for equipment-in-transit were inaccurate and incomplete. As a result, the Army did not have adequate visibility over equipment-in-transit. The equipment accounts in the Army's financial statements could be misstated. Specifically, in FY 1993, the following occurred.

Invalid Transactions. The auditors found that about \$517 million (92 percent) of the \$564 million of sampled in-transit transactions was not valid, primarily because the receiving activities did not process the necessary receipt documents. Army officials were aware of problems in this area and were making efforts to correct system shortfalls. These initiatives should help reduce some of the inaccuracies, but the receiving activities continue to have problems. Until this problem is resolved, equipment-in-transit records in the Continuing Balance System - Expanded, which is the subsidiary record for equipment on hand at various tactical units, will be erroneous, and the data will not be useful.

Unreported Transactions. The auditors also found that equipment-in-transit to nontactical activities and National Guard units was not reported to the general ledger. As of September 30, 1993, the Continuing Balance System - Expanded showed about \$3.1 billion in equipment-in-transit to these activities. However, because the in-transit data in the Continuing Balance System -

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Expanded appear to be inaccurate, the auditors could not estimate the amount that should be added to the financial statements for the nontactical activities and National Guard units.

Reporting Construction-in-Progress. The Army's military construction-in-progress account, as reported by the Corps of Engineers, contained significant amounts of completed project costs. As a result, projects could be counted twice on the financial statements: as construction-in-progress and as facilities-in-use.

Reporting Design and Engineering Costs. The Corps of Engineers made little progress in ensuring that design and engineering costs were included in the cost of military construction projects transferred to DoD customers. These costs are a component of asset value, and the failure to include them caused installations to understate their real property values. Also, because the Corps retained costs in its military construction-in-progress account, that account was overstated on the Army's financial statements.

Validating Installation Property Records. Most major commands have not conducted on-site reviews to validate installations' real property records. Until those reviews are completed, the Army will not have reasonable assurance of the accuracy of the reported \$33 billion in real property.

Reconciling Property Records. The data query used to reconcile the Army's real property records with the general ledger did not provide the supporting data needed to verify the accuracy of the real property account balance. Consequently, there was no assurance that all appropriate costs were captured for financial reporting purposes.

Estimating Government-Furnished Property. The Army was unable to accurately segregate contractors' information by fund and to the proper general ledger accounts needed to ensure appropriate financial reporting. In FY 1993, contractors reported about \$20.3 billion for Government-furnished property. The appropriate fund could be determined for the \$3.7 billion in real property because it was reported through the Army's real property reporting system. However, the Army could not determine how to properly report the remaining \$16.6 billion of Government-furnished property on its general fund and Defense Business Operations Fund financial statements because contractors' reports did not distinguish between property owned by the general fund and the Defense Business Operations Fund. As a result, the Army used estimates to report Government-furnished property on the financial statements of the general fund and the Defense Business Operations Fund.

Crosswalking Government-Furnished Property. The categories that contractors used to report Government-furnished property could not be crosswalked to the Army's general ledger accounts and to an appropriate line item on the financial statements. As a result, much of the total was classified as other entity assets.

Adjusting the General Ledger for Government-Furnished Property. Differences between the contractors' accountable records and the amounts

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

recorded in the general ledger necessitated a \$5.6 billion adjustment to the general ledger to bring them into agreement. This adjustment was necessary because the Army's financial and contract management systems could not produce reliable financial data; the contractors had the most accurate data because they maintained the accountable logistical records.

Expensing Government-Furnished Materials as Consumables. Based on DoD instruction, the Army did not take action on the recommendation to request an accounting policy change allowing consumable Government-furnished materials to be expensed. If DoD agrees to expense Government-furnished material, the need to account for material furnished to contractors as work-in-process or construction-in-progress will cease to exist. Instead, expense accounts and reporting procedures will be needed for adequate financial reporting.

Recording Ammunition and Missiles. A significant portion of the Army's war reserve ammunition and missiles were not recorded as assets on the Army's FY 1993 Statement of Financial Position. War reserve munitions are maintained in case of future conflicts. They are not programmed for use during a specific accounting period. Accounting standards prescribe that items held for future use over the long term, such as war reserves, should be treated as assets and included in the Statement of Financial Position. Based on USD(C) guidance, FY 1993 year-end balances on the Statement of Financial Position reflected only those munitions maintained at wholesale supply activities and reported through the Commodity Command Standard System. The Statement of Financial Position did not include war reserves maintained at other activities and reported only through the Worldwide Ammunition Reporting System. This caused incomplete reporting and inconsistent treatment of war reserves in the financial statements. As a result, the Army's FY 1993 Statement of Financial Position was understated and should have reflected \$6.4 billion of additional war reserves currently reported only through the Worldwide Ammunition Reporting System. This issue was resolved in FY 1994.

Valuing Unserviceable Inventory Awaiting Repair. Equipment managers at the national inventory control points reported unserviceable inventory at full standard price, a total of \$14.7 billion. The reported values, however, should have been reduced by the costs of repairing the items. However, because estimates of repair costs were not available, the value of the unserviceable inventory was overstated by an undeterminable amount.

Supporting Loaned Equipment. Loan managers did not maintain the necessary files and records needed to support the reported \$2.3 billion of equipment on loan to other activities. The related financial and logistical data in the Commodity Command Standard System could not be reconciled. Further, loan managers' files did not match the financial or logistical system balances in the Commodity Command Standard System, and did not accurately reflect the equipment actually on loan. Because of these inconsistencies, auditors could not verify the amounts reported in the financial statements.

Valuing Material Earmarked for Disposal. Material earmarked for disposal should have been valued at net realizable cash value, but the Commodity

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Command Standard System was programmed to record inventory at the full standard price. Therefore, the value of ammunition scheduled for demilitarization was overstated by about \$2.2 billion, and the value of other unrepairable assets was overstated by about \$500 million.

Accounting for Delinquent Travel Advances. Accounting offices did not transfer delinquent travel advances from the travel advance account to the refunds receivable account. This caused an error on the FY 1993 financial statements because these two accounts are included in different line items on the financial statements. This error resulted in overstatements of advances and prepayments and understatements of accounts receivable on the financial statements.

Air Force General Fund Financial Statements

Material deficiencies existed in the amounts reported for assets. Equipment, inventories, and real property were not reported accurately, and acquisition costs were not used for most assets. Auditors identified asset reporting deficiencies in:

- o accounting for assets at acquisition cost,
- o manual processing of real property transactions,
- o accounting for tenant organizations' real property values,
- o reporting of real property by civil engineers,
- o reporting the Defense Business Operations Fund's real property assets,
- o reporting construction-in-progress,
- o reporting satellites,
- o supporting engineering records for real property,
- o updating unit prices for equipment,
- o recording unit prices for inventory,
- o valuing assets no longer in use,
- o classifying cryptographic and medical assets,
- o valuing excess and surplus property,
- o valuing excess and crashed aircraft engines,

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

- o reporting real property construction,
- o reporting B-52 aircraft,
- o reporting depot munitions, and
- o reporting vehicles.

The details of these deficient areas are discussed below.

Accounting for Assets at Acquisition Cost. Air Force personnel and item managers provided the DFAS Denver Center with inaccurate equipment values for the Air Force's financial statements. The Air Force valued equipment at standard cost rather than original acquisition cost. The Air Force's standard cost is based on the latest purchase price of items acquired, and all like items are revalued based on each new purchase of the item. This method of asset valuation does not comply with existing accounting standards. If the Air Force cannot comply with the accounting standards, auditors will be unable to render unqualified audit opinions. This deficiency is also an accounting systems deficiency. As previously discussed, Air Force does not have a financial accounting system that accumulates, accounts for, and reports equipment at the original acquisition cost.

Manual Processing of Real Property Transactions. Defense Accounting Offices made errors while manually processing real property transactions. Specifically, 29 of 60 Defense Accounting Offices reported inaccurate or incomplete data in FY 1993, resulting in total discrepancies of \$522 million. Eighteen of 20 Air Force accounting offices made similar errors, resulting in discrepancies of \$818 million. The errors were not detected because accounting personnel did not reconcile discrepancies between accounting data and engineering data. Because of these errors, the Defense Accounting Offices materially misstated real property values. Engineering offices provided accounting offices with real property vouchers to advise the accountants of changes in real property status that should be entered in the accounting records. This manual process allowed recording errors.

Accounting for Tenant Organizations' Real Property Values. When reporting real property values to the DFAS Denver Center, accounting offices omitted real property values for tenant organizations. This occurred because accounting personnel did not know which organizations had accounting responsibility for tenant organizations. The accounting offices did not detect the omissions because they did not properly reconcile their real property accounts to engineers' records. Because tenants' real property data were omitted, accounting personnel understated real property values by \$480 million on the Air Force's FY 1993 Statement of Financial Position.

Reporting of Real Property by Civil Engineers. Civil engineers at three base-level offices also omitted real property data when reporting to the accounting offices. This condition occurred in FY 1993 because the engineers did not update their data base before submitting data to the accountants. If the engineers had reconciled their inventory reports to the Air Force's property

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

inventory records, they would have detected the omitted data and made corrections. The engineers' omissions caused the FY 1993 real property values to be understated by \$455 million.

Reporting Defense Business Operations Fund Real Property Assets. The Air Force's general ledger contained real property that should have been recorded and reported by the Defense Business Operations Fund rather than the Air Force general fund. This occurred because the Air Force Real Estate Agency had not published criteria and instructions to help base-level accounting personnel identify real property and construction-in-progress recorded and reported by other DoD agencies. As a result, \$222.4 million of real property assets were reported on an incorrect DoD agency's financial statements.

Reporting Construction-in-Progress. In FY 1993, Air Force personnel stationed in Korea reported \$1.2 billion of construction-in-progress, rather than the correct total of \$10 million. This occurred as the result of accounting errors at base level. The errors were not detected because abnormal changes in account balances were not adequately analyzed. As a result, the construction-in-progress account in the FY 1993 Air Force consolidated financial statements was materially overstated.

Reporting Satellites. Personnel at the Air Force's Space Command satellite operations branch overstated procurement and launch costs for satellites of the Defense Meteorological Satellite Program and Global Positioning System. As a result, the property, plant, and equipment line on the Air Force's FY 1994 financial statements was overstated by \$259.9 million.

Supporting Engineering Records for Real Property. Engineering records that supported real property costs in installation-level accounts were not complete. In FY 1993, 16 of 35 bases did not have complete records in support of recorded real property costs, although Air Force regulations required retention of those records. Civil engineering personnel could not explain why the records were not retained and could not reconstruct supporting documents. The lack of support for reported real property costs prevented auditors from validating those reported values. This condition was also reported in the audit of the FY 1992 Air Force consolidated financial statements.

Updating Unit Prices for Equipment. In FY 1993, personnel at six accounting offices provided the DFAS Denver Center with understated values for some items of equipment having a unit cost of \$1 million or greater. This occurred because base supply personnel and item managers did not update prices in the accounting system and on the master price list. Before October 1992, the accounting system could accept unit prices only up to \$999,999.99; items costing \$1 million or more were input with a unit price of \$999,999.99. In October 1992, Air Force personnel modified the system to accept prices up to \$99,999,999.99, and required identification and change of price for all items in the system and on the master price listing with a unit price of greater than \$999,999.99. Base supply personnel and item managers did not complete this identification and revision. As a result, the FY 1993 account balance for equipment was understated by at least \$83 million.

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Recording Unit Prices for Inventory. Because of inaccurate unit prices, the Air Force overstated assets in the operating materials and supplies account by at least \$80.3 million. Most of the errors identified were not material; however, auditors identified one asset listed in the Financial Inventory Accounting and Billing System at a unit price of \$99,999,999.99 that created an overstatement of \$79.4 million. As a result, the value of operating materials and supplies reported in the financial statements may be materially misstated.

Valuing Assets no Longer in Use. In FY 1993, auditors found that the Air Force financial statements did not properly value assets that were no longer in use. Reporting assets that are no longer in use at their full operational value decreases the usefulness of the financial statements to financial managers and misrepresents the value of reported assets. The DFAS Denver Center reported 2,287 aircraft valued at \$8 billion and 168 missiles valued at \$300 million at their full operational value, although they were categorized as "not in use" by the Air Force as of September 30, 1993. The "not in use" category includes retired aircraft and missiles awaiting disposition or having no operational or storage value. Also included in the "not in use" category are aircraft on loan to contractors or other Government agencies. Air Force accounting offices had not identified and informed the DFAS Denver Center of aircraft and missiles not currently in use. As a result, the DFAS Denver Center did not properly value military equipment no longer in use or unavailable.

Classifying Cryptographic and Medical Assets. Personnel at Defense Accounting Offices misclassified cryptographic equipment and medical equipment as assets rather than expenses on the FY 1993 Air Force financial statements. This condition occurred because personnel did not comply with directions from the USD(C) requiring that only items costing \$15,000 or more be entered in equipment asset accounts. The Acting USD(C) increased the threshold from \$5,000 to \$15,000 in September 1992, and Defense Accounting Office personnel were not aware of the change. As a result, the Air Force's FY 1993 financial statements overstated equipment assets by \$693 million.

Valuing Excess and Surplus Property. The Air Force overvalued 176 B-52 aircraft scheduled for destruction by almost \$1.25 billion. Directives require that unserviceable and excess assets be revalued based on the salvage value of equipment. However, one Air Force activity valued excess and surplus property at the acquisition cost less the standard cost of missing or removed parts. When aircraft were depreciated to no value, arbitrary values were assigned. As a result, scrap excess and surplus aircraft were sometimes assigned the same value as operational aircraft, and salvageable property was sometimes reduced to no value and had arbitrary values assigned to it.

Valuing Excess and Crashed Aircraft Engines. The DFAS Denver Center reported 2,372 excess and crashed aircraft engines at their full operational value on the FY 1994 financial statements. This occurred because the DFAS Denver Center was not notified that the trial balance for uninstalled engines contained

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

excess and crashed engines. Because these engines were reported at full value rather than salvage value, the property, plant, and equipment line item was overstated by \$773 million on the Statement of Financial Position.

Reporting Real Property Construction. The Air Force financial statements contained construction-in-progress amounts for projects that the Air Force had already capitalized as completed real property construction. Auditors identified projects at six locations where the U.S. Army Corps of Engineers continued to report construction-in-progress amounts for completed projects, although the Air Force had taken possession of these projects and capitalized them in base-level real property inventory accounts. As a result, \$260.5 million of Air Force real property was recorded and reported twice on the FY 1994 financial statements.

Reporting B-52 Aircraft. The Air Force transferred 176 B-52 aircraft from active status to the excess and surplus property account, but did not delete them from the active aircraft account. As a result, the aircraft inventory values, totaling \$1.8 billion, were included in both accounts and double-counted on the financial statements.

Reporting Depot Munitions. The DFAS Denver Center double-reported \$513 million of Air Force depot munitions held by the Army because the amount was included in both the Ammunition Held by Other Government Agencies account and the Materiel On Hand - Supply Officer account. Including both amounts in the financial statements would have resulted in an overstatement; however, the auditors advised the DFAS Denver Center personnel of the duplication, and the amount was removed from the Ammunition Held by Other Government Agencies account.

Reporting Vehicles. An Air Force installation double-reported 386 vehicles in the general ledger because the base vehicle control officer incorrectly processed duplicate transactions for vehicle updates. This duplication caused an \$8.6 million overstatement in the financial statements.

U.S. Army Corps of Engineers, Civil Works Program, General Fund Financial Statements

Procedures and controls were not adequate to ensure that the Corps' assets were not materially misstated on the FY 1993 and 1994 Statements of Financial Position. Specifically, auditors identified asset reporting deficiencies in:

- o accounting for real property,
- o supporting asset costs,
- o reporting construction-in-progress,
- o accounting for equipment,

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- o recording long-term receivables,
- o recording financing interest as long-term receivables, and
- o reporting accounts receivable.

These deficient areas are described in detail below.

Accounting for Real Property. Real property values of about \$32.6 billion reported in the FY 1993 financial statements were not adequately supported by information in the subsidiary records. This occurred because the Corps did not enter all reports of real property modifications in subsidiary ledgers, did not complete physical inventories, did not establish guidance for reconciling real property to financial records, and included unsupported costs in the financial statements. As a result, the year-end values of real property differed by \$10.5 billion between the general ledger and subsidiary ledgers. The value of real property reported on the financial statements was \$32.6 billion, and the real estate records, or subsidiary ledgers, showed a value of \$22.1 billion. Auditors also compared the general and subsidiary ledgers individually and found an absolute difference of \$14.6 billion. The Corps made substantial progress during FY 1994 in performing inventories required to support the \$30.7 billion of real property assets in the FY 1994 financial statements. However, the Corps must complete the inventories of all its structures and facilities and must reconcile property records with accounting records to ensure that the financial statements accurately represent its real property assets.

Supporting Asset Costs. The Corps did not maintain sufficient documentation to support asset values that were used to calculate FY 1994 charges to customers for depreciation and plant increment. For example, auditors found that the 4 districts reviewed could not support recorded values for 31 (63 percent) of 49 sample items. Where documentation was available, it did not match the asset values recorded in the accounting system. This occurred because the Corps did not require finance and accounting personnel or asset managers to maintain or consolidate asset valuation records over the period of each asset's life. As a result, there was no assurance that the Corps properly computed depreciation and plant increment charges.

Reporting Construction-in-Progress. Completed construction projects were included in the Corps' construction-in-progress account for both the U.S. Army Corps of Engineers, Civil Works Program, and military construction projects. In FY 1993, the auditors estimated that about \$6 billion of the \$23.3 billion total was for completed projects. The U.S. Army Corps of Engineers, Civil Works Program's construction-in-progress account totaled about \$14 billion. At least \$1.8 billion of that amount represented projects that had been completed and should have been transferred from the construction-in-progress account before the end of FY 1993. In FY 1994, auditors found that construction-in-progress accounts still contained completed project costs and other costs that belonged elsewhere.

Accounting for Equipment. In FY 1993, the Corps could not support the \$1.3 billion of equipment shown in the general ledger with accurate information

Appendix G. Asset Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

on the quantity, type, and value in the property records. In addition, none of the Corps' districts that were audited had reconciled financial records to property records. The auditors compared equipment values in the general ledger with the property records and identified an absolute difference of about \$147 million between the two sets of records.

Recording Long-Term Receivables. The Corps did not record all long-term receivables that were due from the public. Some Corps districts did not record all long-term receivables in the general ledger account and on the "Report on Accounts and Loans Receivable Due from the Public - Schedule 9." In some districts, the Corps did not record any long-term receivables. As a result, in FY 1993, the auditors identified about \$370.1 million of long-term receivables that were not recorded in the general ledger account and on the Schedule 9. In addition, long-term receivables may be understated by \$370.1 million as assets on the FY 1993 Statement of Financial Position.

Recording Financing Interest as Long-Term Receivables. The Corps recorded long-term receivables at incorrect amounts because financing interest was included in the long-term receivable account. The Corps earned financing interest each year when project investment costs were billed. At that time, the districts should have recorded the interest. In FY 1993, one district overstated its long-term receivable account by \$8.9 million in financing interest.

Reporting Accounts Receivable. The Corps did not properly present accounts receivable in its FY 1993 financial statements. This occurred because of the following reporting deficiencies.

Reporting Accounts Receivable in an Incorrect Category. The Corps reported receivables in an incorrect category. All receivables were reported in the Financial Resources assets section of the financial statements. The Corps should have reported funds that were not authorized to offset Corps expenditures in the Nonfinancial Resources category under Resources Transferable to Treasury. This includes assets that the Corps is required by law to transfer to the Treasury. For example, the Corps collects amounts under the Water Supply Act of 1958 and deposits them directly to the general fund of the Treasury.

Writing Off Uncollectible Accounts. Corps districts wrote off uncollectible accounts incorrectly. As of September 30, 1993, the accounting system did not have an allowance for doubtful accounts or a bad debt expense account. All 11 districts reviewed wrote off uncollectible receivables by reversing the original entry. This caused problems with matching revenues and expenses. As a result of these deficiencies, the Corps' accounts receivable could have been misstated on the FY 1993 Statement of Financial Position.

Appendix H. Disbursement and Collection Accounting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Current procedures for reporting disbursements and collections did not provide reliable data for financial statement reporting. Deficiencies were identified in the following areas.

Army General Fund Financial Statements

Army accounting offices did not always record, process, and report accurate data on disbursement and collection transactions. Auditors identified accounting deficiencies with disbursements and collections in:

- o reporting contract payments,
- o posting progress payments to temporary accounts,
- o using element-of-resource codes, and
- o preparing disbursement and collection vouchers.

These deficient areas are described in detail below.

Reporting Contract Payments. Auditors concluded that accounting personnel arbitrarily posted progress payments to any available unliquidated contract obligation. Accounting personnel posted accounting transactions to obligations different from those recorded in the subvouchers prepared by the DFAS Columbus Center. For example, the Army Communications - Electronics Command received deliverables for two lines on a contract. Auditors compared the obligations that both the DFAS Columbus Center and the accounting office posted the disbursements against and found that neither office posted the disbursements against the correct obligations. Accounting personnel said they attempted to post disbursements to the correct obligations. However, if an obligation was already liquidated, they posted disbursements to any available unliquidated obligation that would not create a negative unliquidated obligation. Auditors also identified transactions that were recorded in incorrect contracts.

Accounting personnel also stated that much of the disbursement information they received from the DFAS Columbus Center was not accurate, and that the DFAS Columbus Center's vouchers did not include sufficient information to readily determine the proper distribution of progress payments. In addition, accounting personnel believed they were under pressure to post disbursements quickly and to avoid creating negative unliquidated obligations. Some progress was noted during the FY 1994 audit, but the problem has not been solved.

Appendix H. Disbursement and Collection Accounting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Posting Progress Payments to Temporary Accounts. Accounting personnel supporting the Army Aviation and Troop Command posted progress payments to temporary accounts instead of attempting to match them to actual obligations. The accounting office established temporary procurement request order numbers that did not have any funds obligated against them. Contract progress payments were then posted to these temporary accounts, thus creating negative unliquidated obligations. These negative unliquidated obligations were not tracked and reported by the accounting office because the obligations were below the installation level for procurement request order numbers. When the command received a deliverable on a contract, the accounting office would recoup the progress payments from the temporary account and post the partial or final disbursement to the accounting classification for the deliverable. During FY 1993, the accounting office posted 528 transactions for about \$53 million against these temporary accounts. The accounting office established these procedures to alleviate its problems with accurately recording and recouping progress payments on contracts. These procedures helped to alleviate the problems with posting progress payments, but continued to:

- o make the accounting office vulnerable to violations of the Antideficiency Act,
- o distort the Army's status of funds data reported to the U.S. Treasury,
- o invalidate measures of undistributed disbursements and negative unliquidated obligations, and
- o allow duplicate contract payments to go undetected.

The only difference between these procedures and those used by the other accounting offices was that progress payments were arbitrarily distributed against and recouped from temporary accounts at the budget line item level instead of being distributed against and recouped from specific obligations on the contract.

Using Element-of-Resource Codes. Budget personnel did not assign correct element-of-resource codes when obligating funds. The code identified expenditure categories and governed posting to the general ledger accounts. Accurate element-of-resource information is important because the DFAS Indianapolis Center uses the codes to classify disbursements for reporting on the Statement of Cash Flows and to classify expenses in the footnotes. If the Army continues to incorrectly assign element-of-resource codes, the potential exists for misstatements in the Army's general fund financial statements.

Preparing Disbursement and Collection Vouchers. Accounting office procedures for preparing disbursement and collection vouchers did not result in an adequate audit trail. Review of disbursement and collection vouchers at accounting offices identified the following problems:

Appendix H. Disbursement and Collection Accounting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Maintaining Supporting Documentation. Accounting personnel did not obtain supporting documentation from program managers before billing customers because they believed that program managers were responsible for ensuring that billed amounts were correct and supported.

Producing an Audit Trail. The Standard Operation and Maintenance Army Research and Development System did not produce an audit trail for amounts on customer bills. Auditors could not readily determine the reasons for the charges because the system did not produce an audit trail detailing these charges.

Maintaining a Filing System. Accounting offices did not maintain an adequate filing system. Auditors and accounting office personnel spent large amounts of time in locating the hard-copy vouchers for disbursement transactions. For example, at one accounting office, accounting personnel could not locate vouchers because personnel put the vouchers on microfiche and disposed of voucher packages to create free space. However, the microfiches were coded incorrectly and could not be located. Until accounting offices prepare complete vouchers and establish a filing system that allows them to access the vouchers in a timely manner, their records will not be auditable.

Air Force General Fund Financial Statements

Disbursement and collection account balances were questionable. Auditors could not verify the accuracy of account balances because the DFAS Denver Center derived the amounts from unreliable fund control data. Auditors identified deficiencies in the following collection and disbursement areas:

- o accounting for operating expenses and accounts payable,
- o creating negative unliquidated obligations, and
- o verifying disbursement and collection transactions.

These deficient areas are discussed below.

Accounting for Operating Expenses and Accounts Payable. In FY 1993, fund control data were not a reliable source for operating expenses and accounts payable balances. Operating expenses totaling \$484.2 million and accounts payable balances totaling about \$2.6 million were invalid or were not supported by documentation. Accounting personnel did not comply with Air Force regulations and procedures for documenting, validating, reconciling, and reporting transactions that affect obligations. As a result of unreliable fund data, auditors could not verify \$57 billion of operating expenses, \$2.1 billion of accounts receivable, and \$2.8 billion of accounts payable on the Air Force's FY 1993 general fund financial statements.

Appendix H. Disbursement and Collection Accounting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Creating Negative Unliquidated Obligations. FY 1993 obligations included almost \$5.8 billion of negative unliquidated obligations, representing significant errors in Air Force obligation data. Auditors found that more than 6,000 of the nearly 27,000 records examined in FY 1993 represented negative unliquidated obligations. Negative unliquidated obligations occurred because of overpayments to contractors, errors in posting disbursement, or other accounting errors. The lack of controls affected the auditors' ability to determine whether the Air Force's financial statements were presented fairly.

Verifying Disbursement and Collection Transactions. The DFAS Denver Center's disbursement and collection amounts for FY 1993 varied significantly from subsidiary records. Auditors were unable to verify the transactions affecting line items on the FY 1993 financial statements. The DFAS Denver Center had 12,051 transactions, totaling \$3.3 billion, that had not been reconciled to subsidiary records. At 11 locations, accounting personnel had not reconciled differences between the DFAS Denver Center's control records and their own subsidiary records. Reconciliations were not possible at nine of those locations because accounting personnel had not maintained supporting documentation. The unreliable controls over Air Force funds prevented auditors from verifying the disbursement and collection data that the DFAS Denver Center used to compile the balances for Fund Balances With Treasury of \$65 billion and Accounts Receivable of \$2.1 billion on the Air Force's general fund financial statements for FY 1993.

Appendix I. Contingent Liability Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

Procedures used by the Army and the Air Force for reporting contingent liabilities did not comply with generally accepted accounting standards.

Army General Fund Financial Statements

The Army understated its contingent liabilities. Deficiencies in recognizing and disclosing contingent liabilities were identified in:

- o recognizing probable contingent liabilities as liabilities on the Statement of Financial Position,

- o disclosing ongoing legal actions in the footnotes and recognizing them as liabilities, and

- o disclosing in the footnotes potential liabilities associated with legal actions of less than \$100 million each.

These deficient areas are described below.

Recognizing Probable Contingent Liabilities as Liabilities on the Statement of Financial Position. The Army did not recognize \$26.1 billion of contingent liabilities on the FY 1994 Statement of Financial Position. The latest guidance issued by the OMB requires that Statement of Financial Accounting Standards Number 5, "Accounting for Contingencies," be followed for presentation of contingent liabilities. Statement 5 requires probable contingencies (those likely to occur) to be recorded in the Statement of Financial Position. Based on auditors' analyses of the existing accounting standards, the estimated probable amounts for contingent liabilities should have been recorded in the financial statements. The Army estimated its probable contingent liabilities at about \$26.1 billion, but did not record them as liabilities on the FY 1994 Statement of Financial Position, as required. The liabilities were not recorded because the USD(C) continued its policy of footnote disclosure only. As a result, the probable contingent liabilities were not recorded on the FY 1994 Statement of Financial Position, thereby understating total liabilities in FY 1994 by about \$26.1 billion.

Disclosing Ongoing Legal Actions in the Footnotes and Recognizing them as Liabilities. The Army did not disclose in the footnotes nor recognize on the FY 1994 Statement of Financial Position potential liabilities related to outstanding litigation, claims, and assessments. Guidance from the DoD General Counsel prevented the Army from disclosing a significant portion of the

Appendix I. Contingent Liability Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

claims filed against it, and also prevented any estimate of the potential liability for probable judgments against the Army. In addition, the auditors were unable to determine the monetary effects of litigation, claims, and assessments against the Army. This was a significant scope limitation that prevented the auditors from quantifying the amount of contingent liabilities that should have been disclosed in the footnotes or recognized as liabilities on the Statement of Financial Position.

Disclosing in the Footnotes Potential Liabilities Associated With Legal Actions of Less Than \$100 Million Each. The legal representation letter, which was received from the Army's Office of the General Counsel, did not address litigation, claims, and assessments for items that were below the \$100 million reporting threshold for individual cases, but exceeded \$300 million in aggregate. The Army General Counsel's legal representation letter conformed to the guidance from the DoD General Counsel. In the footnotes to the Army's general fund financial statements for FY 1992, the Army reported involvement in approximately 10,000 legal actions with a potential for more than \$12 billion in losses. No such disclosure was included in the FY 1993 and 1994 financial statement footnotes. The auditors recognized that the Army probably would not lose all of the pending cases, and that the Army's liability in each case was limited to certain dollar amounts, with the remainder to be paid out of the Judgment Fund maintained by the Department of Justice. However, the legal representation letter did not comment on the potential Army losses, and the FY 1994 financial statements did not accrue a liability for litigation loss. As a result, liabilities disclosed on footnotes and the liability for litigation loss may be significantly understated.

Air Force General Fund Financial Statements

Contingent liabilities were underestimated. Deficiencies were identified in:

- o recognizing on the Statement of Financial Position probable contingent liabilities for environmental cleanup,
- o disclosing in the footnotes the magnitude of potential liabilities for legal actions greater than \$100 million each,
- o disclosing in the footnotes potential liabilities for legal actions of less than \$100 million each,
- o disclosing in the footnotes potential liabilities for budgetary contingency amounts for outstanding orders,
- o identifying probable contingent liabilities for weapons destruction, missile drawdown, and downsizing in the Air Force, and
- o classifying contingent liabilities under procurement contracts.

Appendix I. Contingent Liability Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

These deficient areas are discussed below.

Recognizing on the Statement of Financial Position Probable Contingent Liabilities for Environmental Cleanup. In FY 1993, the DFAS Denver Center did not recognize \$6.2 billion of environmental cleanup costs as a liability on the financial statements. The projected costs of the Air Force's environmental cleanup responsibilities were \$6.2 billion. The DFAS Denver Center disclosed this amount in the footnotes to the financial statements rather than recognizing the liability on the FY 1993 Statement of Financial Position. DoD accounting policy requires that when contingencies are probable and estimable, they should be recognized as liabilities in the Statement of Financial Position. Disclosing probable material liabilities only as footnotes to the financial statements may cause users of the statements to believe that a significant liability exists and will have to be funded.

Disclosing in the Footnotes the Magnitude of Potential Liabilities for Legal Actions Greater Than \$100 Million Each. The DFAS Denver Center did not adequately disclose in the footnotes to the initial financial statement submission the magnitude of potential liabilities associated with ongoing legal actions greater than \$100 million each. The Air Force was required to report all legal actions exceeding \$100 million. However, because the Air Force General Counsel did not provide the FY 1994 data before the DFAS Denver Center prepared the financial statements, the data were omitted. In January 1995, the Air Force General Counsel identified and reported five lawsuits against the Air Force, involving about \$2.6 billion in claims, as of September 30, 1994. The DFAS Denver Center subsequently amended the FY 1994 financial statements and disclosed this \$2.6 billion in the footnotes.

Disclosing in the Footnotes Potential Liabilities for Legal Actions of Less Than \$100 Million Each. The Air Force did not initially disclose in the footnotes to the financial statements potential liabilities of \$25 billion for legal actions of less than \$100 million each. This occurred because the Air Force Legal Services Agency did not provide the DFAS Denver Center with FY 1994 data on the 3,744 litigation claims, for less than \$100 million each, in time for the data to be included in the initial submission of the FY 1994 financial statements. However, the DFAS Denver Center subsequently amended the FY 1994 financial statements and disclosed this \$25 billion in the footnotes. In FY 1993, the Air Force did not disclose in the footnotes \$4.4 billion, consisting of about 70,000 cases under \$100 million each. The cases were not disclosed because the claims would probably be paid from Treasury's Claims, Judgments and Relief Acts Fund, not Air Force Funds. However, because these claims were related to Air Force activities, they should have been disclosed in the footnotes to the FY 1993 financial statements.

Disclosing in the Footnotes Potential Liabilities for Budgetary Contingency Amounts for Outstanding Orders. The DFAS Denver Center did not initially disclose budgetary contingency amounts totaling at least \$44.7 billion for undelivered orders outstanding or unfilled orders outstanding. The Air Force provided the FY 1994 information on budgetary contingencies to the DFAS Denver Center. However, because of a miscommunication between personnel who prepared the financial statements and those who extracted the data, this

Appendix I. Contingent Liability Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

\$44.7 billion was not disclosed in the footnotes to the initial submission of the FY 1994 financial statements. The DFAS Denver Center subsequently amended the FY 1994 financial statements and disclosed this \$44.7 billion in the footnotes.

Identifying Probable Contingent Liabilities for Weapons Destruction, Missile Drawdown, and Downsizing in the Air Force. The Air Force did not submit, and the DFAS Denver Center did not report, several categories of probable or possible contingencies. For example, the Air Force may have existing contingent liabilities associated with international treaties or agreements, weapons destruction, and missile drawdown. Other liabilities may exist because the downsizing of the military and civilian work forces, unemployment compensation, and severance pay. The Air Force and the DFAS Denver Center did not disclose these potential liabilities in the footnotes to the financial statements or recognize them as liabilities on the FY 1993 Statement of Financial Position because neither DFAS nor the Air Force had adequate guidance and procedures for identifying all possible and probable contingent liabilities.

Classifying Contingent Liabilities under Procurement Contracts. The Air Force did not separately identify, classify, and report \$709.5 million in contingent liabilities under procurement contracts. This condition occurred because the general ledger had no account for accumulating this data, and the Air Force did not develop alternative procedures for segregating the required data. Contingent liabilities under contract should be separately identified, classified, and reported as proprietary contingencies. Instead, contingent liabilities under contract were combined with other commitments and reported as budgetary contingencies. As a result, these contingent liabilities were not properly classified on the FY 1994 financial statements.

U.S. Army Corps of Engineers, Civil Works Program, General Fund Financial Statements

The Corps did not furnish sufficient information for the auditors to adequately evaluate contingent liabilities. During FY 1993, deficiencies in recognizing and disclosing contingent liabilities were identified in:

- o preparing the legal representation letter,
- o maintaining supporting documentation, and
- o classifying contingencies and unadjudicated claims.

These deficient areas are discussed below.

Preparing the Legal Representation Letter. Army regulations required legal counsel to decide whether contingent liabilities exist, are probable, possible, or remote, and to report the amount to be recorded for the contingency. The legal

Appendix I. Contingent Liability Reporting Deficiencies Identified in FY 1993 and 1994 Audit Reports

representation letter gives auditors assurance that all legal claims and assessments are disclosed. Corps counsel provided us with a legal representation letter. However, the letter did not address the auditors' inquiry about claims greater than \$300 million, did not include all liabilities identified as probable, and did not follow DoD requirements for form and content concerning nonaccounting principles.

Maintaining Supporting Documentation. Auditors could not determine the accuracy of the records because districts did not maintain sufficient supporting documentation to reconcile reported and unreported discrepancies. One district did not maintain supporting documents for its unadjudicated claims contingencies. Another district did not report any unadjudicated claims, although the Army Claims Service showed that the district had active, unadjudicated claims. Several discrepancies existed in values and numbers reported to Corps Headquarters' resource management, and legal counsel for the same contractor claim. As of September 30, 1993, 1 district reported 7 contractor claims valued at \$4,189,251 to resource management, and 13 contractor claims valued at \$1,719,243, through the legal counsel's Case Management Information System II. However, auditors could not determine which information was accurate because of the lack of supporting documentation. Therefore, the accuracy of both reporting processes must be viewed as unreliable. Auditors found similar differences at five of six other districts.

Classifying Contingencies and Unadjudicated Claims. Auditors reviewed estimated contingent liabilities and found instances when they were not properly classified or fully shown. The Corps did not separately identify liabilities under the Federal Tort Claims Act for less than \$2,500 or single non-tort contingent liabilities over \$100 million. The Corps is required to report contingent liabilities in accordance with the Federal Tort Claims Act. This act limits the Army's liability to \$2,500 for each claim. Because settlements and awards over \$2,500 are paid from the Treasury's Claims, Judgments and Relief Acts Fund, the Corps funds are not affected. Auditors' review of 13 of the 43 divisions and districts showed a \$49.2 million net overstatement of contingent liabilities for torts. Districts did not distinguish between these claims. For example, 1 district reported 23 tort claims, valued at \$12,798,074, as contingent liabilities. However, the Corps was responsible for only 11 of these claims, valued at \$13,513. DoD guidance established the thresholds for reporting litigations, claims, and assessments at \$100 million for separate claims and \$300 million for aggregate claims. The Corps did not separately identify or report single contingent liabilities over \$100 million. For example, one district with \$162.8 million in adjudicated claims had a claim for \$110 million that it did not report separately, and two other districts did not report some claims over \$100 million.

In FY 1994, the Corps did not furnish sufficient information for the auditors to evaluate the adequacy of financial statement adjustments and disclosures related to contingent liabilities.

Appendix J. Potential Benefits Resulting From Audit

This report contains no recommendations. It is for information purposes only. The report focuses Congressional and DoD management attention on the progress DoD is making in preparing general fund financial statements that can receive an audit opinion other than a disclaimer.

Appendix K. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Department of the Army

U.S. Army Audit Agency, Alexandria, VA

Department of the Navy

Naval Audit Service, Arlington, VA

Department of the Air Force

Air Force Audit Agency, March Air Force Base, CA

Other Defense Organizations

Defense Finance and Accounting Service, Arlington, VA

Defense Finance and Accounting Service Denver Center, Denver, CO

Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN

Non-Defense Federal Organizations

General Accounting Office, Washington, DC

Appendix L. Report Distribution

Office of the Secretary of Defense

Secretary of Defense
Deputy Secretary of Defense
Under Secretary of Defense (Acquisition and Technology)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
 Deputy Chief Financial Officer
 Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Health Affairs)
Assistant to the Secretary of Defense (Public Affairs)
Deputy Under Secretary of Defense (Logistics)
General Counsel of the Department of Defense

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, 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, Advanced Research Projects Agency
Director, Ballistic Missile Defense Organization
Director, Central Imagery Office
Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Cleveland Center
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Denver Center

Other Defense Organizations (Cont'd)

Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Information Systems Agency
Director, Defense Intelligence Agency
Director, Defense Investigative Service
Director, Defense Logistics Agency
Director, Defense Mapping Agency
Director, Defense Nuclear Agency
Director, National Security Agency
Inspector General, National Security Agency
Director, On-Site Inspection Agency
Director, Joint Staff
Director, American Forces Information Service
Director, Office of the Civilian Health and Medical Program of the Uniformed Services
Director, Defense Prisoner of War/Missing in Action Office
Director, Defense Technology Security Administration
Director, Department of Defense, Dependent Schools
Director, Section 6 Schools
Director, Office of Economic Adjustment
Director, Washington Headquarters Services
President, Defense Acquisition University
President, Defense Systems Management College
President, Uniformed University of the Health Sciences

Non-Defense Federal Organizations

Office of Management and Budget
National Security and International Affairs Division, Technical Information Center,
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 National Security
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight

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Part III - Management Comments

Under Secretary of Defense (Comptroller) Comments



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



JUL 21 1995

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Audit Report on Major Deficiencies Preventing Auditors From Rendering Audit
Opinions on DoD General Fund Financial Statements (Project No. 4FL-2012)

The Department generally agrees with the report findings that the Department (a) does not have an integrated, double entry, transaction driven general ledger system, (b) does not have adequate interfaces with non-financial systems, and (c) does not adequately record and reconcile "Fund Balance With Treasury" general ledger account to amounts reported by the Treasury.

The Department does not agree, however, with the finding that environmental cleanup costs, as defined and estimated by the auditors, should be considered a contingent liability. The Federal Accounting Standards Advisory Board (FASAB) is expected to recommend standards for defining and including amounts for contingent liabilities later this year. The Department will follow the FASAB recommendation, as implemented by the Office of Management and Budget in its form and content guidance.

My point of contact on this guidance is Mr. Oscar G. Covell. He may be reached at (703) 697-6149.

Alvin Tucker
Deputy Chief Financial Officer

cc: Director, DFAS

Air Force Audit Agency Comments



DEPARTMENT OF THE AIR FORCE
AIR FORCE AUDIT AGENCY

28 JUL 1995

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
ATTENTION: MR. RUSSELL A. RAU

FROM: AFAA/FS
5023 4th Street
March AFB CA 92518-1852

SUBJECT: DoDIG Draft Audit Report on Major Deficiencies Preventing
Auditors from Rendering Audit Opinions on DoD General Fund
Financial Statements (Project 4FI-2012)

1. We appreciate the opportunity to comment on the subject draft report. We noted in our review that two sections of the report contain outdated information. Specifically, Appendix D references two Air Force Audit Agency (AFAA) draft reports but the final versions of those reports were published prior to completion of your audit. Additionally, we believe the Air Force reporting of contingent liabilities discussed in Appendix I of your draft should more fully disclose the status of management actions taken.

a. We recommend you update the list of audit reports in Appendix D (page 36) to reference the following published AFAA reports rather than the draft reports shown in your report:

(1) Review of Military and Civilian Pay, FY 1994 Air Force Consolidated Financial Statements (Report No. 94053035), 24 April 1995.

(2) Review of Contingent Liabilities, FY 1994 Air Force Consolidated Financial Statements (Report No. 94053037), 1 May 1995.

b. The FY 1994 Air Force contingent liabilities data discussed on pages 72 and 73 of Appendix I of the report refers to contingencies the Defense Finance and Accounting Service (DFAS) omitted in their initial FY 1994 Air Force consolidated financial statements issued in November 1994. The omissions you discuss (\$2.6 billion in the second paragraph of page 72, \$25 billion in the third paragraph of page 72, and \$44.7 billion in the first paragraph of page 73) were accurate as of November 1994. However, based on our audit results and other

Air Force Audit Agency Comments

information, DFAS amended the Air Force financial statements to include the previously omitted contingencies. The official FY 1994 Air Force financial statements, published 1 March 1995, include the contingent liabilities we discussed in our draft report. We recommend you include management's corrective actions in your audit report to more fully disclose the issue and management's prompt and responsive actions.

2. If you have any questions about our comments, please contact Mr. Kelton Seelig at DSN 947-7031.



JAMES R. SPEER
Assistant Auditor General
(Financial and Support Audits)

U.S. Army Corps of Engineers Comments

CEAO (36) 1st End Patters/202-761-4461

02 AUG 1995

SUBJECT: Major Deficiencies Preventing Auditors from Rendering
Audit Opinions on DOD General Fund Financial Statements, Project
No. 4FI-2012

Commander, U.S. Army Corps of Engineers, ATTN: CEAO, Washington,
D.C. 20314-1000

FOR The Auditor General, ATTN: SAAG-PRF-E, Pentagon.

HQUSACE Command comments on subject audit are attached and
forwarded.

FOR THE COMMANDER:



ROBERT H. GRIFFIN
Colonel, Corps of Engineers
Chief of Staff

AUG 3 1995

**Major Deficiencies Preventing Auditors from
Rendering Audit Opinions on DOD General
Fund Financial Statements, Project No. 4FI-2012**

A. DEFICIENCY 1: Adequate accounting systems were not in place.

The DODIG assertion is correct in that the Corps of Engineers does not currently have an integrated accounting system that satisfies the requirements of the CFO Act. The Corps of Engineers Financial Management System (CEFMS) is now undergoing BETA Testing, and when implemented, will provide an integrated accounting system in full compliance with the CFO Act. We know of no other DOD Activity that is this close to CFO Act compliance. Full deployment is expected to be in the middle of FY 98.

B. DEFICIENCY 2: Assets were not reported adequately or properly valued.

An inventory of real property was completed in March 95 with reconciliation due to be completed by 30 Sep 95. We know of no other DOD Activity that has taken similar real property corrective action. Also, HQUSACE has issued policy making project managers responsible for the completion of the financial closeout for all projects, thereby ensuring specific accountability for transferring completed projects from the CIP. Since March 1994, considerable Command emphasis and oversight has been placed on CIP to eliminate completed projects from the CIP and transfer costs to a DOD installation or the civil works plant in service account.

C. DEFICIENCY 3: Disbursements and collections were not adequately accounted for. USACE was not identified as being deficient in this area.

D. DEFICIENCY 4: Contingent liabilities were not recognized or adequately disclosed. This is an issue between Department of Defense Inspector General, Army General Counsel and Defense Finance and Accounting Service. This command is in compliance with Department of Defense Policy.

AUG 3 1998

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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