Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE STOCK FUND FINANCIAL STATEMENTS (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIAL MANAGEMENT SYSTEM) FOR FY 1991

Report Number 92-129 August 26, 1992

Department of Defense

The following abbreviations and acronyms are used in this report.

DFAS ..... Defense Finance and Accounting Service
DFSC ..... Defense Fuel Supply Center
DLA ..... Defense Logistics Agency
DSF ..... Defense Stock Fund
FMFIA ..... Federal Managers Financial Integrity Act
OMB ..... Office of Management and Budget
SAMMS ..... Standard Automated Materiel Management System

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

August 26, 1992

MEMORANDUM FOR COMPTROLLER AND CHIEF FINANCIAL OFFICER, DOD
DIRECTOR, DEFENSE LOGISTICS AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on the Defense Stock Fund Financial Statements (Materiel Managed Under the Standard Automated Material Management System) for FY 1991 (Report No. 92-129)

We are providing this final report for your information and use, and for use by Congress. The audit was required by the Chief Financial Officers Act of 1990. The Act requires the Inspector General to render an opinion on the fairness of the financial statements of revolving funds such as the Defense Stock Fund, in accordance with DoD accounting policies and procedures and generally accepted accounting principles, and to report on the adequacy of internal controls and compliance with laws and regulations.

A draft report dated April 30, 1992, was provided to the Defense Logistics Agency and the Defense Finance and Accounting Service to give management an opportunity to correct conditions noted and mitigate the potential effect on the FY 1991 financial statements. Comments to the draft report were received on July 8, 1992 and revised financial statements were received on August 20, 1992. Comments to the draft report and actions taken to adjust the financial statements and provide appropriate disclosures and supplementary information were generally responsive and were considered in preparing the final report. However, comments to some recommendations involving Defense Fuel Supply Center financial data that are not material to our opinion on the Standard Automated Material Management System inventory only were partially responsive and additional action is required.

There were internal control weaknesses in ensuring that general ledger account balances were reconciled to subsidiary records; that subsidiary records were periodically verified to supporting documentation; and that unusual account balances such as negative inventories were reviewed. In addition, managers of the Defense Stock Fund were not in compliance with requirements of the Federal Managers Financial Integrity Act.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Director, Defense Logistics Agency and the Director, Defense Finance and Accounting Service must provide comments on the unresolved recommendations and internal control weaknesses discussed in Part VI of this report. As required by DoD Directive 7650.3, the comments should indicate either concurrence or nonconcurrence with each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, state your specific reasons for each nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. We request final comments on the unresolved recommendations and internal control weaknesses by October 26, 1992.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Charles Hoeger or Mr. Terrance Wing at (215) 737-3881 (DSN 444-3881). The distribution of this report is listed in Part VII, Appendix C.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosure

Office of the Inspector General

AUDIT REPORT NO. 92-129 **August 26, 1992**
(Project No. 1LD-5008)

FINAL REPORT ON THE DEFENSE STOCK FUND FINANCIAL STATEMENTS (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIAL MANAGEMENT SYSTEM) FOR FY 1991

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires an annual audit of the financial statements of the Defense Stock Fund. The Defense Stock Fund is a revolving fund established for procuring, storing and selling consumable type supply items to DoD Components and other Government agencies. For FY 1991, the Defense Stock Fund reported, after audit adjustments, revenues of $17.80 billion and a net loss of $2.05 billion. Financial inventory accounts managed under the Standard Automated Material Management System represented $7.74 billion (75 percent) of the $10.34 billion inventory and 51 percent of the assets ($15.24 billion) reported on the Defense Stock Fund FY 1991 Financial Statements.

Objectives. The initial objectives of the audit were to determine whether the FY 1991 Defense Stock Fund financial statements present fairly the financial position and results of operations of the fund. Based on the results of our survey, we concluded that we could not provide an opinion on the Defense Stock Fund financial statements taken as a whole and we revised our objectives to address inventory accounts for materiel managed under the Standard Automated Material Management System. Because the Chief Financial Officers Act requires annual audits, we also did work in the fund's fuels and subsistence commodities and in Standard Automated Material Management System financial accounts other than inventory.

Audit Results. The auditors identified needed accounting adjustments to the original FY 1991 Defense Stock Fund financial statements dated March 2, 1992. Adjustments to Standard Automated Material Management System inventory financial data increased the total inventory by $18 million. Adjustments to fuels, subsistence and Standard Automated Material Management System financial accounts other than inventory increased total assets by $49.9 million; increased total liabilities by $374 million; decreased total equity by $306 million; reclassified $1.67 billion of expenses as an extraordinary item; and increased the net loss for the year by $395 million. The financial statements did not contain footnote disclosures related to inventory restrictions and unsupported account balances and that the statements required additional supplemental information to enhance the usefulness of the statements. In addition, problems were noted with the Standard Automated Material Management System physical inventory process and with Defense Fuel Supply Center accounting procedures.

Auditor's Opinion. Except for the effects of uncertainties associated with the reported $355 million of inventory other than stock on hand (primarily materiel at contractors, under repair or assembly, and intransit from procurement) and an incomplete management representation letter, the $7.74 billion of Standard Automated Material Management System inventory included in the Defense Stock Fund FY 1991 financial statements and the accompanying Notes to the Principal Statements related to the inventory fairly presents, in all material respects, the Standard Automated Material Management System inventory. General ledger inventory account balances for other than stock on hand were not valued at cost, included inventories that were priced at a negative value, and were not supported by related balances or documentation in subsidiary records (Footnotes 11 and 13 to the Principal Statements).

Internal Controls. Part II contains our report on internal controls. For the Standard Automated Material Management System inventory, other than stock on hand, there were no controls in place to provide for the periodic verification of subsidiary records to supporting documentation and for the review of unusual subsidiary records such as negative inventories or overage transactions. We noted that internal management control reviews related to the Standard Automated Material Management System inventory, other than stock on hand, to implement the Federal Managers Financial Integrity Act did not determine if controls existed or were in place to ensure that financial account balances were accurate.

Compliance with Laws and Regulations. Part III contains our report on compliance with laws and regulations. We noted in Part II, "Report on Internal Controls," that requirements of the Federal Managers Financial Integrity Act were not effectively implemented. Because noncompliance with laws and regulations may also represent internal control weaknesses, we provide details of this issue in Part II.

Benefits of the Audit. The audit significantly improved the accuracy of the FY 1991 financial statements; consequently, managers will have more accurate data to use in their decisionmaking processes.

Recommendations. No recommendations are made to revise the financial statements because management incorporated our recommended accounting adjustments, footnote disclosures and supplementary information in revised Defense Stock Fund financial statements received on August 20, 1992.

Recommendations are made to improve Defense Fuel Supply Center accounting procedures. We recommend that the Defense Fuel Supply Center reconcile financial inventory data with stock records and that Defense Fuel Supply Center establish cut-off procedures to ensure that transactions are recorded in the proper accounting period (PART VI).

Management Comments. Management generally concurred with our recommended changes to the March 2, 1992, financial statements. In addition, management comments to the draft report and actions taken or planned to improve internal control deficiencies and operational issues were considered generally responsive. The conditions identified during the audit and managements' actions taken or planned are summarized in Part VII, Appendix A. We will forward these recommendations to the Assistant Inspector General for Analysis and Followup for followup action.

Management disagreed with our qualified opinion on the Standard Automated Material Management System inventory. Management stated that even if the $355 million of Standard Automated Material Management System inventory other than stock on hand were over or understated by some unknown value, the difference would not materially misstate the total inventory value. Management also nonconcurred with recommendations to improve Defense Fuel Supply Center accounting procedures. We request final comments on the unresolved recommendations and internal control weaknesses by October 26, 1992.

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This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703)-614-6303.

PART I -

INDEPENDENT AUDITOR'S OPINION ON THE FINANCIAL STATEMENT INVENTORY ACCOUNT (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIAL MANAGEMENT SYSTEM) FOR FY 1991

PART I -
INDEPENDENT AUDITOR'S OPINION ON THE FINANCIAL STATEMENT INVENTORY ACCOUNT (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIAL MANAGEMENT SYSTEM) FOR FY 1991

We have audited the Defense Stock Fund (DSF) Financial Statement Inventory Account, inventory managed under the Standard Automated Material Management System (SAMMS), and related Notes to the Financial Statements for the Inventory Account as of and for the year ended September 30, 1991. This account is the responsibility of the Defense Logistics Agency (DLA) and the Defense Finance and Accounting Service (DFAS).

Scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and Office of Management and Budget (OMB) Bulletin 91-14, "Audit Requirements for Federal Financial Statements," September 10, 1991. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Financial Statement Inventory Account, inventory managed under SAMMS and related Notes to the Financial Statement for the Inventory Account, are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures related to the Financial Statement Inventory Account, inventory managed under SAMMS, including the Notes thereto. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Financial Statement Inventory Account, inventory managed under SAMMS. We believe that our audit provides a reasonable basis for our opinion. This financial statement audit was made from January 1991 through July 1992.

Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal Agencies are to be promulgated by the Comptroller General and the Director, OMB, based on advice from the Board. In the interim, Federal agencies are to follow the applicable accounting standards contained in agency accounting policy, procedures manuals, and/or related guidance. The summary of significant accounting policies included in the notes to the Principal Statements describes the accounting standards prescribed by the DoD Accounting Manual and used to prepare the financial statements.

Limitations of scope. We requested that the Director, DLA, provide a management representation letter for the period of the audit. A management representation letter confirms in writing to the auditor that the management of the fund acknowledges responsibility for the fair presentation of the financial statements and the availability of all financial records and data; provides information that may have a material effect on the financial statements; and reduces the possibility for misunderstanding about the subject of the representations. The management letter was received from the DLA Comptroller but did not address material events that may have occurred after the year audited or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements.

Inventory other than stock on hand (primarily with contractors, under repair or assembly, and intransit from procurement), managed under SAMMS and included in the FY 1991 DSF Financial Statement Inventory Account, was valued at $355 million. General ledger account balances to support the inventory other than stock on hand were not valued at cost, included inventories that were priced at a negative value, and were not supported by related balances or documentation in subsidiary records. We determined that it was not practical for us to

perform, nor did we perform, sufficient alternative audit procedures to satisfy ourselves as to the proper value of these assets. Footnotes 11 and 13 to the financial statements describe some of the problems with this inventory.

Opinion. In our opinion, except for the effects of any adjustments that might have been determined to be necessary had we received a complete management representation letter and been able to perform the necessary auditing procedures to substantiate the inventory other than stock on hand account balances, the Financial Statement Inventory Account, inventory managed under the SAMMS only and the related Notes to the Financial Statement for the Inventory Account present fairly in all material aspects, the Financial Statement Inventory Account for materiel managed under the DLA's SAMMS for the DSF as of September 30, 1991, in accordance with DoD accounting policies and procedures and generally accepted accounting principles.

Other financial information. Our audit was conducted for the purpose of forming an opinion on the SAMMS inventory described above. We have reviewed the financial information relating to the SAMMS inventory presented in the management's overview of the DSF. The information presented in the Overview is presented for the purpose of additional analysis. Such information has not been audited by us and, accordingly, we do not express our opinion on this information. This information is addressed, however, in our Report on Compliance with Laws and Regulations," Part III, in accordance with section 6.a.(3), (4), and (5) of OMB Bulletin 91-14.

Robert J. Lieberman
Assistant Inspector General
for Auditing

PART II -

REPORT ON INTERNAL CONTROLS

(MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIEL MANAGEMENT SYSTEM)

PART II - REPORT ON INTERNAL CONTROLS (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIAL MANAGEMENT SYSTEM)

Introduction. We have audited the DSF Financial Statement Inventory Account, inventory managed under SAMMS, for the year ended September 30, 1991, and have issued our report on August 26, 1992.

Objectives and scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin 91-14. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements. We applied those standards to the Financial Statement Inventory Account, inventory managed under SAMMS.

In planning and performing our audit of the DSF Financial Statement Inventory Account for the year ended September 30, 1991, we considered the related internal control structure. The purposes of this consideration were to determine our auditing procedures for the purpose of expressing our opinion on the DSF Financial Statement Inventory Account, inventory managed under SAMMS, and to determine whether the internal control structure met the objectives identified in the preceding paragraph. This included obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to the inventory cycle, classes of transactions, or account balances; and for those significant control policies and procedures that have been properly designed and placed in operation, performing sufficient tests to provide reasonable assurance that the controls are effective and working as designed.

Management of the DSF is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures applicable to DSF operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over assets.

Internal control categories. For the purpose of this report, we classified the significant SAMMS inventory internal control policies and procedures in the following categories:

- o General ledger: policies and procedures associated with reconciling general ledger account balances with subsidiary ledgers and supporting records.

- o Inventories: policies and procedures associated with receiving, storing, issuing, reporting and valuing inventories.

- o Transaction processing: processing and flow of financial data into the financial accounts.

- o Financial reporting: policies and procedures used to prepare financial statements.

Reportable conditions. We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the Comptroller General and OMB Bulletin 91-14. Reportable conditions are matters that come to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to ensure that obligations and costs are in compliance with applicable laws; that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and that revenues and expenditures applicable to DSF operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over the assets.

Inventory other than stock on hand. Internal controls did not ensure that a reported $355 million of SAMMS inventory, for assets other than stock on hand, included in the DSF Financial Statement Inventory account was reasonably stated. General ledger financial account balances for these inventories were not valued at cost, included inventories that were priced at a negative value, were not supported by related balances in subsidiary records, and details to support the subsidiary account balances were invalid. DSF management footnoted the DSF Financial Statements to disclose the conditions noted and agreed to take corrective action and provided an estimated completion date of December 31, 1992.

Federal Managers Financial Integrity Act. Internal management control reviews to implement the FMFIA did not determine whether adequate control measures existed and were implemented to ensure that inventory general ledger account balances, for other than stock on hand, agreed with subsidiary ledger account balances and that subsidiary ledger accounts were properly supported. DSF management agreed to take corrective action and provided an estimated completion date of December 31, 1992.

We believe the conditions reported in the preceding paragraphs are material weaknesses as defined in DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Implementation of the actions discussed in Appendix A and the recommendations in Part VI of this report would correct the identified conditions.

Our consideration of the internal control structure for the SAMMS inventory would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

PART III -

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIEL MANAGEMENT SYSTEM)

PART III -
REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS (MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIAL MANAGEMENT SYSTEM)

Introduction. We have audited the DSF Financial Statement Inventory Account, inventory managed under SAMMS, for the year ended September 30, 1991, and have issued our report on August 26, 1992.

Objectives and scope. We conducted our audit in accordance with generally accepted Government standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin 91-14. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements. We applied these standards to the Financial Statement Inventory Account, inventory managed under SAMMS only.

Compliance with laws and regulations applicable to the DSF is the responsibility of management. As part of obtaining reasonable assurance about whether the DSF Financial Statement Inventory account, inventory managed under SAMMS, is free of material misstatement, we tested compliance with laws and regulations that may directly affect the financial statement inventory account balance, inventory managed under SAMMS. We also tested certain other laws and regulations designated by OMB and DoD. The laws and regulations tested were:

- Federal Managers' Financial Integrity Act of 1982
- Chief Financial Officers Act of 1990
- OMB Bulletin 91-15, "Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity"
- DoD Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity
- Policy and Procedures Manual for Guidance of Federal Agencies (Title 2)
- DoD Manual 7220.9-M, DoD Accounting Manual

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA), and compared the agency's most recent FMFIA reports with our evaluation of the internal control system. We also reviewed and tested the entity's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the overview of the fund. However, our objective was not to provide an opinion on overall compliance with such provisions.

Results of review. The results of our tests indicate that with respect to the items tested, except for noncompliance with the FMFIA, as described in Part II of this report, "Report on Internal Controls," management complied in all material respects with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that management had not complied in all material respects with the provisions identified above.

PART IV -

SCHEDULE OF INVENTORY ACCOUNTS

(MATERIEL MANAGED UNDER THE STANDARD AUTOMATED MATERIEL MANAGEMENT SYSTEM)

FY 1991 Inventory Accounts for the
Standard Automated Materiel Management System Supply Centers
of the Defense Stock Fund
(Thousands)

	General Ledger Account	Total SAMMS	SAMMS Supply Centers					
			DCSC	DESC	DGSC	DISC	DPSC Medical	DPSC Clothing
131	Contractors and Test Facilities	$112,838	$1,796	$5,362	$6,019	$232	$9,217	$90,212
132	In Process of Assembly/Disassembly	86,843	2,625	13	3,598	2	63,952	16,653
135	Temporarily In Use	1,046	177	0	821	0	0	48
140	Intransit From Procurement	117,087	16,627	9,313	14,724	16,660	19,398	40,365
141	Intransit Between Storage Locations	35,138	1,162	4,563	1,540	1,669	3,936	22,268
142	Intransit From Customers	1,879	92	238	594	535	407	13
	Subtotal	354,831	22,479	19,489	27,296	19,098	96,910	169,559
130	Stock On Hand	9,107,451	1,774,109	1,990,990	1,541,644	1,403,821	532,176	1,864,711
	Total Inventory	9,462,282	1,796,588	2,010,479	1,568,940	1,422,919	629,086	2,034,270
	Less: Inventory Adjustment 1/	1,721,789	328,214	384,093	330,500	488,355	46,921	143,705
	Financial Inventory	$7,740,493	$1,468,374	$1,626,386	$1,238,440	$934,564	$582,165	$1,890,565

DLA reported total inventories of $10.34 billion on the FY 1991 financial statements. As shown above, SAMMS supply centers account for $7.74 billion. The balance represents non-SAMMS supply centers -- $1.98 billion for fuels, $572 million for subsistence, $27 million for the National Security Agency, and $16 million for base operating supplies.

SAMMS Supply Centers:

DCSC - Defense Construction Supply Center
DESC - Defense Electronics Supply Center
DGSC - Defense General Supply Center
DISC - Defense Industrial Supply Center
DPSC-Medical - Defense Personnel Support Center, Directorate of Medical Materiel
DPSC-Clothing - Defense Personnel Support Center, Directorate of Clothing and Textile Materiel

1/ Adjustment to re-value stock on hand identified as potential excess and materiel requiring repair.

PART V -

DEFENSE STOCK FUND - FINANCIAL STATEMENTS FOR FY 1991

Note: Blank pages in the Defense Stock Fund financial statements were omitted from this report.

DEFENSE LOGISTICS AGENCY

DEFENSE STOCK FUND

FISCAL YEAR 1991

FINANCIAL STATEMENTS

DEFENSE LOGISTICS AGENCY
DEFENSE STOCK FUND

OVERVIEW TO THE FINANCIAL STATEMENTS OF THE DEFENSE STOCK FUND FOR FISCAL YEAR 1991

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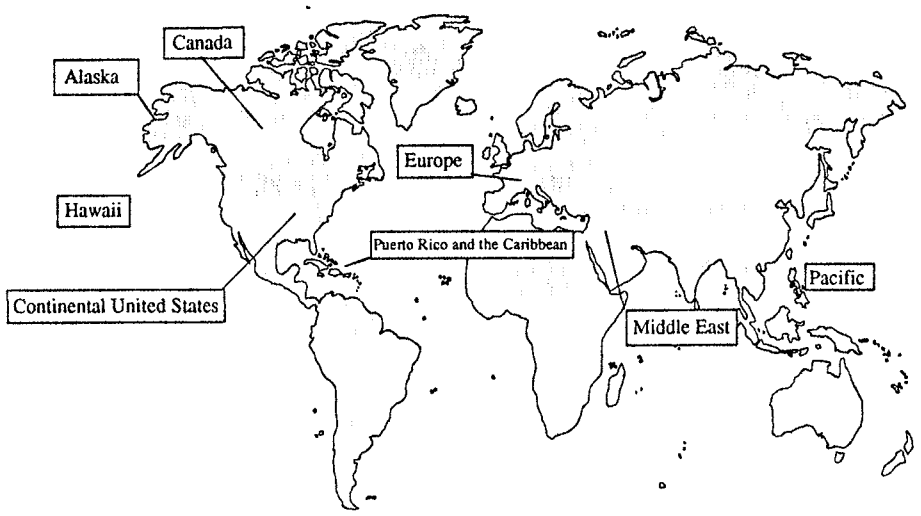
DEFENSE LOGISTICS AGENCY
OVERVIEW of the DEFENSE STOCK FUND

DLA MISSION

The mission of DLA, as a combat support agency, is to provide effective and efficient worldwide logistics support to the Military Departments and the Unified and Specified Commands. DLA provides support under conditions of peace and war to the Military Departments, as well as to other DoD components, Federal agencies, and foreign governments. The agency provides effective logistic support in the areas of contracting, materiel management, distribution, contract administration and technical support. Our goal is to provide that support at the lowest possible cost. DLA manages over three million consumable items. These items include food, fuels, clothing, medical, general, electronics, industrial and construction supplies.

We carry out our worldwide logistics mission from facilities located throughout the continental United States, Alaska, Hawaii, Puerto Rico and Canada. Our overseas facilities operate from locations throughout Europe, the Pacific, the Middle East and the Caribbean.

DLA ACTIVITIES WORLDWIDE



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The Defense Construction Supply Center, located in Columbus, Ohio, manages 594,000 national stock numbers that include construction materiel, construction equipment and components, lumber and automotive parts.

The Defense Personnel Support Center located in Philadelphia, Pennsylvania, manages 98,000 national stock numbers that include three of our most important commodities: food, clothing and textile items and medical supplies.

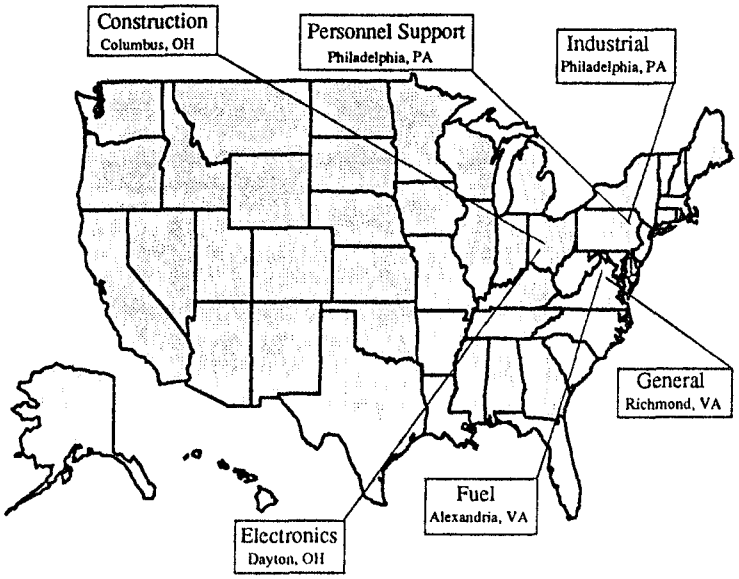
The Defense Industrial Supply Center, also located in Philadelphia, Pennsylvania, manages 945,000 national stock numbers that include industrial hardware items such as bearings, wire and a variety of hardware supplies.

The Defense Electronics Supply Center, located in Dayton Ohio, manages 973,000 national stock numbers that include communication equipment and integrated circuits.

The Defense Fuel Supply Center, located in Alexandria, Virginia, manages petroleum products, natural gas and coal.

The Defense General Supply Center, located in Richmond, Virginia, manages 421,000 national stock numbers that include photographic equipment and supplies, packaged petroleum products and food service equipment.

DLA SUPPLY CENTERS



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A. SUPPLY OPERATIONS MISSION

DLA provides logistics services directly associated with furnishing materiel commodities and items of supply that have been determined to be appropriate for integrated management by a single agency on behalf of all DoD components, or that have been otherwise specifically assigned. DLA also administers assigned Department-wide logistics management systems, programs, and activities, including the provision of technical assistance, support services, and information.

Supply Operations manages, procures, stores and issues over 3 million consumable items. This is accomplished through a network of six inventory control points, six distribution regions and depots. DLA is assuming management responsibility for an additional 900,000 consumable items currently managed by the military services. The DoD is also in the process of transferring all supply depots to DLA.

B. EMERGENCY SUPPLY OPERATIONS CENTER (ESOC)

The HQ DLA ESOC acts as DLA's single focal point to execute supply support in national emergencies, and for disaster relief and humanitarian assistance operations, both foreign and domestic. Under the guidance of the Executive Director, Directorate of Supply Operations (DLA-O), the HQ DLA ESOC exercises its authority and fulfills its responsibilities through the coordinated efforts of headquarters and field Supply Operations, Contracting, Technical and Logistics Services, and the ESOCs.

Most recent examples of ESOC support of disaster relief and humanitarian assistance include:

Hurricane Hugo	Sep 1989
San Francisco Earthquake	Oct 1989
El Salvador Civil War	Dec 1989
Operation Just Cause Humanitarian Relief	Dec 1989
Operation Provide Comfort*	Apr-May 1991

* Operation Provide Comfort was the largest humanitarian relief effort undertaken in history. DLA provided 25 million meals, 3.8 million clothing items, and 3,500 tents in support of this relief effort for Kurdish refugees in Northern Iraq.

C. DLA SUPPORT TO DESERT STORM

The Iraqi invasion of Kuwait caused DLA to activate its crisis action command and control system, Basic Emergency Plan, to provide full-time support to the operation. During the operation, DLA filled 2.3 million requisitions worth almost $3.5 billion. This support was provided in the following areas:

1. Supplies and Materiel: the Inventory Control Points expedited procurements of: subsistence, clothing, petroleum products, weapon systems components, construction material, medicine, medical supplies and equipment; the Distribution Regions/Depots expedited shipments of materiel to requisitioners.

2. Services: the Defense Industrial Plant Equipment Center (DIPEC) activated shipboard repair teams, the Defense Reutilization Marketing Center (DRMS) established a Saudi office, the Defense Technical Information Center (DTIC) assisted with research and information, the Defense Automation Resources Information Center (DARIC) provided automation equipment, the Defense National Stockpile Center (DNSC) supported the effort through its William Langer Jewel Bearing Plant, and established and managed a Department of Defense donation program.

D. SECURITY ASSISTANCE

DLA provides supply management, distribution and transportation, contract management, quality assurance and excess/surplus property disposition support to the Security Assistance program. DLA activities involved include Inventory Control Points, Distribution Regions/Depots, Defense Contract Management Command (DCMC) and the Defense Reutilization and Marketing Service (DRMS).

E. FINANCIAL PERFORMANCE

Effective 1 October 1990 (FY 91), operating costs incurred to support the management, acquisition and distribution of stock fund material were financed by the Defense Stock Fund. In addition to the cost of materiel, the costs of inventory control point operations, distribution depot operations, and support costs were included in the stock fund. In FY 91, the Agency was managed under a total cost per output (referred to as unit cost). Under the unit cost concept all the costs incurred within a defined activity unit are related to the output of the activity. The Defense Stock Fund recovered the additional operating costs through increased surcharges in the standard price charged to customers for items requisitioned. Reimbursements from the customers provide the working capital for the fund.

In FY 91, the Agency's unit cost goals were $0.93 per dollar of nonfuel gross stock fund sale and $39.00 per barrel of fuel. DLA achieved its overall unit cost goals. With the implementation of unit cost, the unit cost goal is one of the key indicators to measure financial performance.

FY 91 UNIT COST GOALS

Supply Managemet	Goal	Actual
Nonfuels Costs per dollar of sale	$0.93	$0.86
Fuel Costs per barrel	$39.00	$38.68
Distribution Depots		
Cost per line item received and issued	$24.53	$23.61

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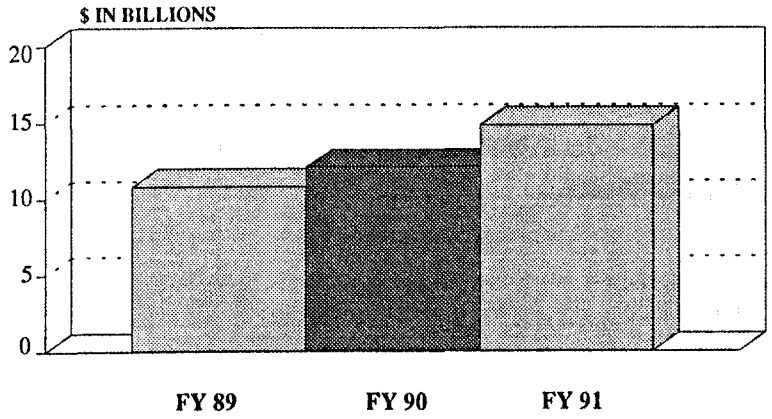
Total inventory showed a real decrease of $200 million in constant 1991 dollars. Material returns and capitalizations totaled $1.2 billion. Operations for FY 91 showed a net loss caused primarily by the writedown of stock fund inventories classified as potential excess, the writedown of inventory for cost of repair and changes in prices particularly in the fuel commodity. The deployment of U.S. forces in response to the Iraqi invasion of Kuwait had a significant impact on the FY 91 DLA stock fund activity. Operations Desert Shield and Desert Storm increased FY 91 obligations (3.1 billion), demands ($3.3 billion) and gross sales ($3.3 billion). Credits and allowances of $237 million were more than double the usual Defense Stock Fund experience and the ending cash balance was over $3 billion.

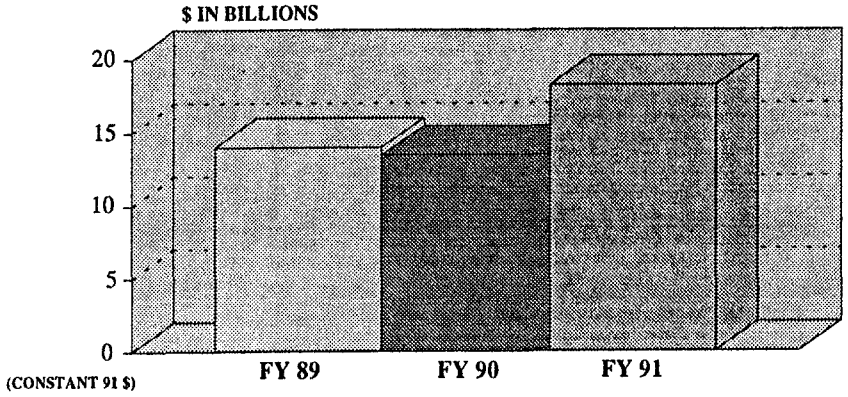
	($ in billions)		
	FY 89	FY 90	FY 91
Obligations	$10.8	$12.1	$14.8
Gross Sales	$11.2	$11.1	$18.2
Orders/Demands	$11.4	$11.1	$18.1

F. PROGRAM PERFORMANCE AND WORKLOAD INDICATORS

TOTAL OBLIGATIONS
FY 1989 - FY 1991

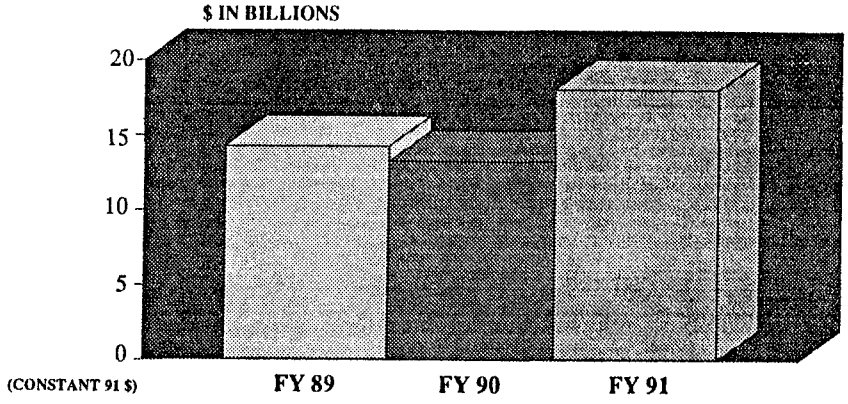


TOTAL GROSS SALES
FY 89 - FY 91

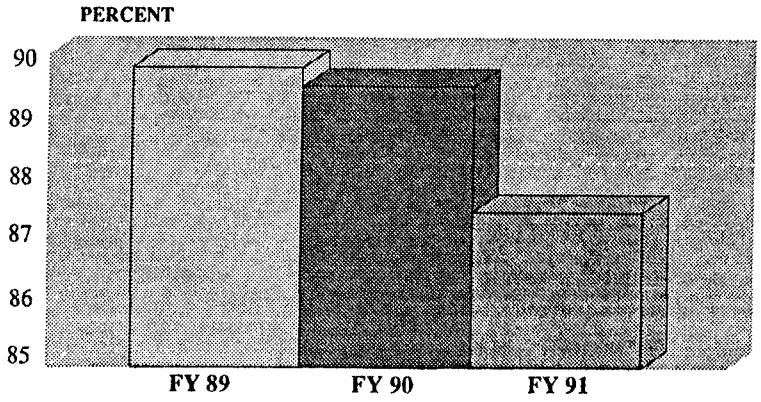


11

TOTAL DEMANDS
FY 89 - FY 91



DLA STOCK AVAILABILITY*
FY 89 - FY 91



* This chart shows DLA's performance in support of the services. It reflects percentage of time demands were filled on first pass. In FY 89 stock availability was 89.8%. However, due to funding constraints, Operation Desert Storm, and consumable items transferring from the services, FY 91 ended at 87.5%.

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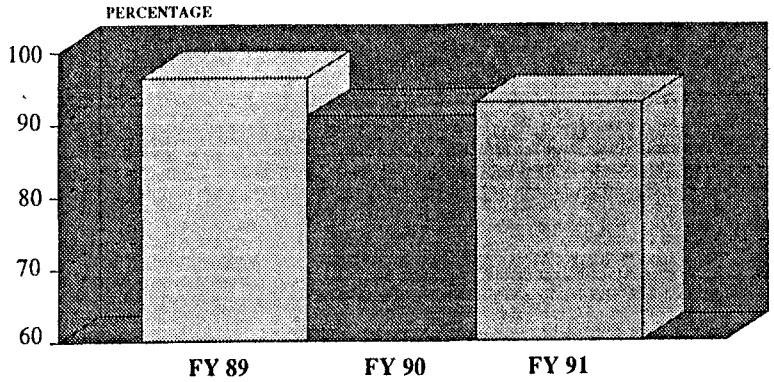
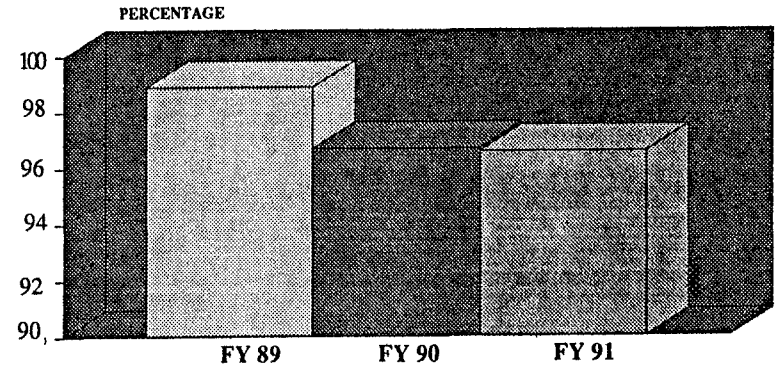
DEPOT PROCESSING/SHIPPING EFFECTIVENESS*
FY 89 - FY 91



* Shipping effectiveness measures total pipeline from time the materiel release order (MRO) is received at the depot until the materiel is delivered to the customer. Reflects performance based on percentage of time customers receives the materiel ordered within the 21-day uniform materiel movement and issue priority systems (UMMIPS) standard for depot processing and transportation time for IPG III routine requisitions.

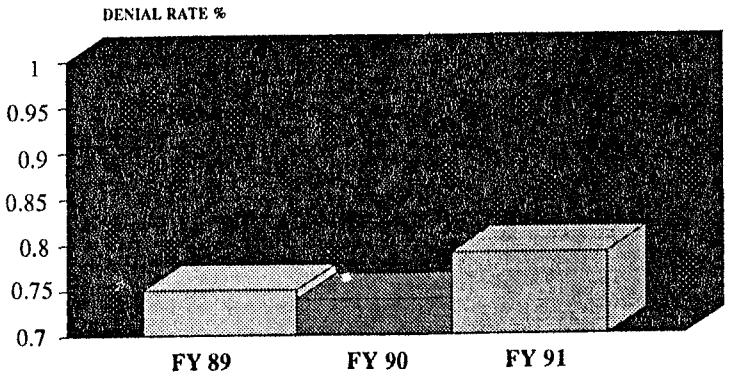
Performance on upward trend in FY 91 after decline in FY 90. Slight decline in performance in FY 90 and FY 91 due to Desert Shield/Storm impact. There was a significant increase in tonnage handled at the depots.

ON-TIME RECEIPT PROCESSING**
FY 89 - FY 91



** On-time receipt processing reflects the percentage of time that new procurement and customer return receipts are recorded and stowed in location within established time standards (6 calendar days for new procurement and 10 days for customer returns). There is a slight decrease in performance in FY's 90 and 91 as the volume of customer returns increased but performance was still above the DoD goal of 90%.

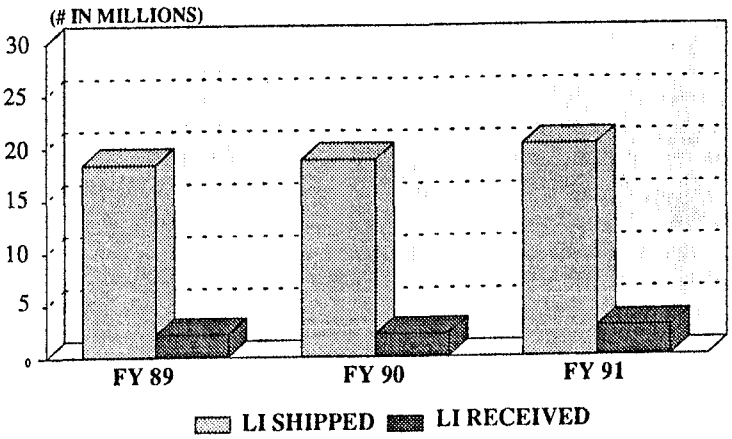
MATERIEL DENIALS*
FY 89 - FY 91



* The materiel denial rate measures that percentage of time depots are unable to satisfy a demand because the required materiel, available on the stock record, is either not on hand or cannot be located.

Performance over the last three years has been at or below the DLA goal of less than 0.8 percent (DoD goal is 1.0 percent).

DEPOT
LINE ITEMS SHIPPED & RECEIVED



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G. FINANCIAL MANAGEMENT ISSUES IN THE 90'S

1. BASE REALIGNMENTS AND CLOSURES

Of the 126 closure and/or realignment actions recommended by the 1988 and 1991 Defense Realignments and Base Closure Commissions, DLA is a tenant activity at 28 sites. The effected activities include Defense Reutilization and Marketing Offices, Defense National Stockpile depots, DLA Distribution sites, a well as the DLA Headquarters. The closure/ realignment actions should not impact DLA financial resources since the Services, owners of the real estate, will bear the base closure and realignment costs of all tenants, and reap the savings resulting from the actions. The extent to which DLA personnel will be affected is dependent on site closure or realignment, and the relocation site.

2. DEFENSE BUSINESS OPERATIONS FUND (DBOF)

Beginning in FY 92 the Defense Stock Fund and the Defense Industrial Fund will be consolidated with other stock funds and industrial funds to form the DBOF. The DBOF will then be divided into various "Business Areas" according to the mission of an activity. The DLA business areas affected will be supply management, distribution depots, reutilization and marketing, industrial plant equipment maintenance, and clothing and textile factory. This covers about 33,000 of DLA's almost 55,000 employees. For most of the activities it will not be a significant change, since in FY 91 the supply management an distribution depots are funded through the Defense Stock Fund.

DEFENSE STOCK FUND

PRINCIPAL STATEMENTS

FISCAL YEAR 1991

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SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Identification:
Department/Agency: **Defense Logistics Agency**
Bureau/Organizational Unit: **Defense Stock Fund**
OMB Identification Code: **Principal Statements**
Basis Used:

ASSETS		Total
1. Fund Balance with Treasury and Cash		
a. Fund Balance	3,019,852,092	
b. Cash		
c. Foreign Currency, Net		
d. Subtotal		3,019,852,092
2. Accounts Receivable		
a. Federal Agencies		
1. Current	1,269,520,425	
2. Noncurrent		
b. Public		
1. Current	180,373,518	
2. Noncurrent	237,277	
c. Less: Allowances		
d. Subtotal		1,450,131,220
3. Advances and Prepayments		
a. Federal Agencies	437,527,594	
b. Public		
c. Subtotal		437,527,594
4. Inventories		
a. Operating consumables	10,336,194,821	
b. Product or Service Components		
c. Stockpiled materials		
d. Other		
e. Subtotal		10,336,194,821
5. Investments, Net		
a. Federal Securities		
b. Non-Federal Securities		
c. Other-Public Securities		
d. Subtotal		
6. Loans Receivables		
a. Federal Agencies		
1. Current		
2. Noncurrent		
b. Public		
1. Current		
2. Noncurrent		
c. Less: Allowances		
d. Subtotal		

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SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Bureau/Organizational Unit:

ASSETS Continued		**Total**
7. Property, Plant, and Equipment, Net		
a. Structures, Facilities, and Leasehold Improvements		
b. Military Equipment		
c. ADP Software		
d. Equipment		
e. Assets Under Capital Lease		
f. Other		
g. Construction-in-Progress		
h. Land		
i. Allowances		
j. Subtotal		
8. Other Assets		
a. Acquired Collateral		
b. Deferred Exp from Cap Lease		
c.		
d. Other		
e. Subtotal		
9. TOTAL ASSETS		15,243,705,727
LIABILITIES		
10. Accounts Payable		
a. Federal Agencies	855,245,128	
b. Public	980,318,113	
c. Subtotal		1,835,563,241
11. Interest Payable		
a. Federal Agencies		
b. Public		
c. Subtotal		
12. Accrued Payroll and Benefits		
13. Accrued Unfunded Annual Leave		
14. Unearned Revenue (Advances)		
a. Federal Agencies	318,054,764	
b. Public		
c. Subtotal		318,054,764
15. Deposit Funds		
16. Debt Issued Under Borrowing		
a. Gross Federal Debt		
b. Intragovernmental Debt		
c. Other Debt		
d. Subtotal		
17. Actuarial Liabilities		
a. Pension Plans		
b. Insurance and Annuity Programs		
c. Subtotal		

SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Liabilities Continued		Total
18. Other Liabilities		
a.		
b.	2,300,088	
c.		
d.		
e.		
f. Subtotal		2,300,088
19. TOTAL LIABILITIES		2,155,918,093
EQUITY		
Appropriated Fund Equity		
20. Unexpended Financed Budget Authority		
a. Unexpended Appropriations		
b. Less: Unfilled Customer Orders		
c. Subtotal		
21. Invested Capital		
Revolving Fund Equity		
22. Revolving Fund Balance(s)		
a. Appropriated Capital	6,605,564,868	
b. Cumulative Results	6,482,222,766	
c. Donations		
d. Subtotal		13,087,787,634
Trust Fund Equity		
23. Trust Fund Balances		
24. TOTAL EQUITY		13,087,787,634
25. TOTAL LIABILITIES AND EQUITY		15,243,705,727

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center Operations Directorate Washington, DC 20376-5001**	
4 Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1090**

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SF 221

REPORT ON OPERATIONS
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Stock Fund**
OMB Identification Code: **Principal Statements**

REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used		
2. Revenue		
a. Federal Sources	17,798,519,915	
b. Public Sources		
c. Subtotal		17,798,519,915
3. Government receipts		
4. Other		
a.		
b.		
c. Gains		
d. Other	142,104,515	
e. Subtotal		142,104,515
5. Less: Receipts Returned to Treasury		
6. Total Financing Sources		17,940,624,430
OPERATING EXPENSES		
7. Cost of Goods Sold		16,405,851,311
8. Operating/Program Expenses, Funded		817,918,808
9. Interest Expense, Funded		
a. Federal Financing Bank/ Treasury Borrowings		
b. Federal Securities		
c. Other		
d. Subtotal		
10. Other Funded Expenses		
a. Loss on Disposition of Assets		
b. Inventory Losses		
c. Investment Losses		
d. Other Losses	1,094,583,648	
e. Subtotal		1,094,583,648

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SF 221

REPORT ON OPERATIONS
for the year ended September 30, 1991

Bureau/Organizational Unit:

NET RESULTS		Total
11. Unfunded Expenses		
12. Total Operating Expenses		18,318,353,767
13. Net Results Before Adjustments		-377,729,337
14. Less: Capital Expenditures		
15. Less Extraordinary Items		1,671,159,000
16. Net Results		-2,048,888,337

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center Operations Directorate Washington, DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1090**

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SF 222

REPORT ON CASH FLOW
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Stock Fund**
OMB Identification Code: **Principal Statements**
Basis Used:

Description		Total
1. Fund balance with Treasury and cash, beginning of period (PY SF 220)		872,571,081
2. Sources of funds:		
a. Increase in debt		
b. Appropriations		
c. Revenue	17,940,624,430	
d. Sale of assets		
e. Increase in payables	549,438,238	
f. Decrease in receivables and advances	-734,619,797	
g. Other		
h. Total		17,755,442,871
3. Application of funds:		
a. Operating expenses (SF 221)	18,318,353,767	
b. Less: Expenses not requiring outlays (SF 221)		
c. Increase in investments		
d. Increase in inventory	-4,292,650,907	
e. Purchase of property, plant and equipment		
f. Other	1,582,459,000	
g. Total		15,608,161,860
4. Fund balance with Treasury and cash, end of period (SF 220)		3,019,852,092

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center** **Washington, DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

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SF 223

REPORT ON RECONCILIATION
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Stock Fund**
OMB Identification Code: **Principal Statements**
Basis Used:

Description	Total
1. Total operating expenses (SF 221)	18,318,353,767
2. Adjustments:	
Add:	
a. Capital expenditures	
b. (Increase) decrease in inventories	-4,292,650,907
Deduct:	
a. Increase (decrease) in accounts payable	-185,181,559
b. Accrued expenses not requiring outlays	1,582,459,000
3. Total gross disbursements	15,793,343,419
4. Less: Offsetting collections credited	-17,940,624,430
5. Net disbursements	-2,147,281,011

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center Washington, DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

DEFENSE STOCK FUND

CONSOLIDATING STATEMENTS

FISCAL YEAR 1991

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Note: The Consolidating Statements are omitted from this report because they duplicate the Principal Statements.

DEFENSE STOCK FUND
SUPPORTING SF 220's
FISCAL YEAR 1991

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Note: The Supporting SF 220's are omitted from this report because they duplicate the Principal Statements.

DEFENSE STOCK FUND

NOTES TO THE

PRINCIPAL STATEMENTS

FISCAL YEAR 1991

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DEFENSE STOCK FUND
NOTES TO THE PRINCIPAL STATEMENTS
September 30, 1991

Note 1: General and Accounting Policies

The Defense Stock Fund is one of four revolving fund established in the Department of Defense. The purpose of the stock fund is to procure and maintain an inventory of consumable items used throughout the department. The items are then distributed by sale to other components of the Department of Defense and other government agencies. Sales proceeds are retained in the fund and are available to replenish the inventory.

The Defense Logistics Agency is the assigned manager of the Defense Stock Fund, and determines operating, budgeting, and accounting practices of the fund based on Departmental policies. For management purposes the fund is divided into 10 commodity and operating divisions. These are:

Clothing and textiles
Medical supplies and material
Subsistence
Construction supplies
Electronics supplies
General supplies
Industrial supplies
Bulk fuel products
Base operating support
National Security Agency

Each division is established as an accounting entity, maintaining a complete accounting system based on the original standard general ledger for stock funds of the Department of Defense. The reports presented are consolidated reports of all the above divisions.

Note 2: Fund Balance with Treasury and Cash

All cash resources available to the fund are included in the Treasury balance. No cash resources of the fund are maintained outside the Treasury account for the fund.

Note 3: Accounts Receivable

Receivables from federal agencies are for the sale of supply items in the ordinary course of business of the fund, and substantially all are collected within 30 days from time of sale. The amount of $180,373,518 is due for sales to federal government contractors and non-federal government entities. These are collectible 30 days from the time of billing. Non current receivables of $237,276 are claims against contractors for undelivered or non-quality material for

which recovery of monies paid has been undertaken Some of these accounts are known to be in bankruptcy, and as determinations of uncollectible are made they will be written off No allowance for uncollectible accounts is provided, as amounts written off in any one accounting period are not material in relation to the assets and operating results of the fund.

Note 4: Advances and Prepayments

The amount of $437,527,595 represents progress and advance payments made to finance the early phases of contract performance on production contracts. These amounts are collectible against payments for deliveries made on the contracts.

Note 5: Inventories

Inventories of $10,336,194,821 represent the value of stocked material at acquisition cost or net realizable value. In the stock fund accounting records inventory is carried at its priced value for resale which includes acquisition cost plus amounts added to cover the cost of inventory management and shipment to customers. The original acquisition cost of most items in inventory is not available, and the repricing to acquisition cost or realizable value has been done using adjustment factors that are considered realistic. An amount of $1.64 billion is classified as potential excess inventory and $237 million as unserviceable material. Using DoD guidance, the writedown for the potential excess inventory was $1.6 billion and the estimated cost of repair of the unserviceable material was $118 million.

Note 6 : Accounts Payable

The amount of $855,245,128 payable to other federal agencies principally consists of payments due other Department of Defense funds for costs of operations of inventory control points and storage depots paid out of these other funds that are applicable to the stock fund. Amounts payable to the public are payments due contractors for delivery of material procured in the ordinary business of the fund.

Note 7: Unearned Revenue

Unearned revenue represents amounts received from the Military Services International Logistics Centers and the Defense Security Assistance Agency as the Defense Stock Fund portion of advances or deposits made by foreign countries in support of Department of Defense stock fund inventory levels. There also is an amount received from the military services for deployable medical systems for which the actual sale has not yet been completed.

Note 8: Other Liabilities

The amount of $2,300,089 represents an allowance established to cover possible future payment of accounts payable that have been written off. Accounts payable are written off when in-

voices have not been submitted by contractors. They are considered other liabilities for the period specified in the Uniform Commercial Code of most States.

Note 9: Equity

Cumulative results are reduced form the prior year balance by the net operating loss shown in the statement of operations.

Note 10: Operations

Operations for the year resulted in a net operating loss of $2.048 billion to the fund. This was accounted for in most part by the write down of stock fund inventory classified as potential excess, the writedown of inventory for cost of repair, and a $2.059 billion price change decrease ($1.316 billion was due to fuel price decreases). The amount of the write down was $1,671,159,000 and is included as an extraordinary item in the operating statement. Operating labor and non-labor costs of Supply Centers and Storage Depots involved in management and storage of the fund's inventory are included in the FY 91 costs for the first time. Without the inclusion of the inventory writedown and the decrease in price changes there would have been a net operating gain of $1.681 billion. This is primarily due to the receipt of $907.8 million of material returns without credit.

Note 11: Inventory

An Iamount of $9.1 billion (acquisition price) was reported as inventory stock on hand. There was another $355 million (standard price) of inventories classified as other than stock on hand that are not accurate as presented. The general ledger accounts used to support the trial balance did not agree with the supporting records and related documents. Of this total, there is $200 million of inventory classified as government furnished material for which an improved DoD system is needed. There is also $65.1 million of inventories intransit from procurement classified as overage of which some portion may need more aggressive management attention.

Note 12: Inventory Restrictions

There are several restrictions on the use of inventory. DLA has about $246 million (standard price) of material in a not-ready-for-issue status that requires a review for possible reclassification and contractor ligation resolutions. Prepositioned War Reserve materials for FY 1991 were $2.1 billion (standard price). The inventory breakouts were fuels $1.9 billion and subsistence $.2 billion. There is $105.8 million (standard price) of Cooperative Logistics Supply Support Arrangement inventory that is commingled with DLA's inventory. The inventory investments are $50 million (SDAF) and $55.8 million (Military Services). There is another $171 million reported (standard price) as an uncorrected material weakness relating to nonconforming supplies.

Note 13: Unusual Account Balances

There are some unusual account balances totaling a negative $136.5 million in sesveral inventory accounts. The conditions causing some of the negative balances are either systemic, procedural or human error. There also was an estimated $85.8 million of subsistence inventory intransit from procurement and with contractors and test facilities that was not supported by detailed records and a reliable estimate of the correct value could not be substantiated.

Note 14: Statistical Projections

Based on statistical projections, the DoDIG estimated that DLA inventory (acquisition price) was overstated by a net of $22.6 million because of (1) items not recorded in inventory and (2) overvaluation of inventory due to pricing of logistics transfers, clothing and textile bag items and items that had little or no turnover.

Note 15: Contingencies

There are no known contingencies that would affect the financial position of the fund.

Note 16: Subsequent Event

Effective October 1, 1991, all assets, liabilities, and capital of the fund was transferred to the Defense Business Operations Fund - Defense Agency Supply Management Business Area.

PART VI -

DEFENSE FUEL SUPPLY CENTER ACCOUNTING PROCEDURES

PART VI -
DEFENSE FUEL SUPPLY CENTER ACCOUNTING PROCEDURES

In the draft report, we identified several issues related to Defense Fuel Supply Center (DFSC) accounting procedures that while not material to our opinion on the SAMMS inventory, require management attention. Management nonconcurred with our recommendations to correct the conditions. We believe the recommendations are valid and we request management to reconsider its comments.

Reconciliation Process. DFSC did not reconcile the balance in general ledger inventory accounts with stock item records. The purpose of this reconciliation is to determine if balances in the accounting system are in substantial agreement with accountable inventory records. DLAM 7000.1, "Accounting and Finance Manual," states that these reconciliations should be performed periodically but not less frequently than semiannually, as of the close of business on March 31 and September 30 of each year.

We attempted to reconcile the September 30,1991, DFSC general ledger inventory account balances with stock item records and found the following discrepancies.

o Accounting records showed that bulk fuel stock on hand was valued at $2.261 billion. Based on stock item records, we estimated that the inventory value was $2.397 billion (difference of $136 million). Further, our analysis of data in support of the financial inventory value showed that some storage activities had negative inventories valued at $14.4 million. We were unable to identify the reasons for the $136 million difference.

o Supporting data in accounting records showed that there were 91.1 million gallons of fuel in transit from procurement and 65.6 million gallons in transit between storage points and customers. DFSC stock item records did not provide sufficient details to evaluate the reasonableness of the quantities in the financial records. The stock item records showed total quantity in transit (by item) for quantities in transit from procurement and in transit between storage points, but did not identify quantities in transit between storage points and customers.

Cutoff Procedures. Unlike DSF divisions that operate under SAMMS, the DFSC did not have a process that provided for recording current fiscal year transactions, that are processed or completed in the first month of the next fiscal year, in the current fiscal year financial statements. Without this type of yearend process there is no assurance that transactions are recorded in the proper accounting period. In addition, DFSC financial data is not consistent with DSF divisions operating under SAMMS that have yearend cutoff procedures.

Recommendations.

We recommend that the Director, Defense Logistics Agency and the Director, Defense Finance and Accounting Service require the Defense Fuel Supply Center to:

a. Reconcile general ledger inventory accounting records with stock item records.

b. Establish cutoff procedures to record current fiscal year transactions, that are processed or completed in the next fiscal year, in the current year financial statements.

Management Comments. Management nonconcurred with the recommendations. Management agreed that financial inventory records should be reconciled with supply records in accordance with DoD policy. However, management stated that data input into the Defense Fuels Automated Management System is transaction driven. There should only be one set of records, as there is a single point shared by both supply and financial segments of the integrated system. Consequently, there is no need for reconciliation. Management believed the issue alluded to in this recommendation is that of accounting cutoff dates versus supply cutoff dates for data compilation. Supply records are compiled as of the last day of the month. Accounting records are compiled as of the 25th day of the month. Management did not believe that this difference in arraying data materially affected the representation of transactions.

Regarding the recommendation to establish cutoff procedures, management stated that based on the information provided by the auditors, they do not agree that here is a problem with the Defense Fuels Automated Management System yearend cutoff procedures. However, management was concerned that the recording of transactions is timely and in the proper fiscal year. Management expects that this is an area that will be looked into in the FY 1992 audit of the financial statements.

Audit Response. We consider management's comments to be only partially responsive. Regarding the reconciliation of financial records with supply records, DFSC personnel informed us that at the end of FY 1991, both financial and supply data were compiled as of the same date. Therefore, different cutoff dates were not a reason for the $136 million difference. Management comments correctly stated that financial records and supply records should agree; but in practice this does not always occur. For example, DFSC personnel used data we provided in our reconciliation of September 30, 1991, financial and supply records to identify a system problem that resulted in an imbalance between financial and supply records.

Concerning DFSC yearend cutoff procedures, we informed management that DFSC does not have yearend cutoff procedures and that DFSC yearend procedures are not consistent with activities that operate under SAMMS. Transactions are recorded in the DFSC accounting system as of the date the transactions are processed, regardless of the date that the transactions occurred. For example, we provided data to DFSC personnel showing that prior years' sales (FY 1990 and prior) of $59.7 million were recorded in October 1990 (FY 1991) financial accounts. General Accounting Office, "Policy and Procedures Manual for Guidance of Federal Agencies (Title 2)," states that comparability and consistency are major qualitative factors that enable accounting information to be useful. Comparability relates to the similarity of information produced by an entity from period to period and consistency pertains primarily to information produced by one accounting entity using the same methods over different periods. In addition, the integrity of account balances is increased when all the fiscal year's transactions are recorded in the appropriate period.

We request that management reconsider its comments in response to the final report and provide comments by October 26, 1992.

PART VII -

ADDITIONAL INFORMATION

APPENDIX A - Audit Results and Corrective Actions

APPENDIX B - Activities Visited or Contacted

APPENDIX C - Report Distribution

APPENDIX A. AUDIT RESULTS AND CORRECTIVE ACTIONS

As a result of our draft report and discussions with management, management adjusted the March 2, 1992, DSF financial statements and except for the issues discussed in Part VI of this report, agreed to take action to correct internal control weaknesses. The following is a summary of the financial statement adjustments, additional disclosures and supplementary information, and planned actions to correct internal control weaknesses.

Accounting Adjustments. Management made the following accounting adjustments to the March 2, 1992, financial statements.

o DoD guidance states that when an item is unserviceable, but still repairable and applicable to DoD's needs, an appropriate allowance for the cost of repair will be considered in determining the inventory's valuation. The guidance further provides that if an item of inventory is either not repairable or no longer applicable to DoD's needs, the item will be valued at its net realizable cash value. The calculation to revalue the SAMMS unserviceable and potential excess inventory was incorrect and understated the inventory account. As a result, management increased the value of SAMMS inventory by $18 million. Additionally, the writedown of potential excess and unserviceable stock fund inventory was incorrectly recorded as a FY 1991 expense. DoD guidance directed that the writedown be recorded as an extraordinary item. As a result, management reclassified $1.67 billion of FY 1991 expenses as an extraordinary item.

o DoD directed that, for FY 1991 financial statement presentation purposes, stock fund inventories should be valued at the latest acquisition cost rather than the standard price. The computations to reduce fuels and subsistence inventory incorrectly applied conversion factors to remove the surcharge from the standard price valuation, which understated the inventory accounts. As a result, management increased the value of fuels and subsistence inventory by $49.9 million.

o Defense Management Report Decision No. 901, "Reducing Supply System Costs," transferred the funding for operations and maintenance costs of DLA supply centers, depots, and other major support activities to the DSF. An estimated $286 million of operations and maintenance costs that were incurred by the DSF were not recorded as expenses or accounts payable in the financial statements. Management analyzed our audit results and identified an additional $88 million of major support activity costs that were also unrecorded. As a result, management increased FY 1991 expenses and accounts payable by $374 million.

o The DFSC decreased FY 1991 first destination transportation expenses of $539.8 million by $88.7 million, to correct erroneous or duplicate accruals made in prior years. General Accounting Office's, "Policy and Procedures Manual for Guidance of Federal Agencies (Title 2)," requires that expenses related to the correction of an error in the financial statements of a prior period shall be reported as adjustments to previously reported results, when the results are material. To adjust the financial statements, management decreased the opening equity balance by $88.7 million, and recorded the $88.7 million as a prior period adjustment.

o Based on the above accounting adjustments, management decreased the year end equity balance by $306 million and increased the net results (loss) for the year by $395 million.

Footnote Disclosures. Management revised the notes to financial statements to provide the following information.

o Note 10 was expanded to provide additional information on fund's net operating loss and on the writedown of inventory classified as potential excess.

o Note 11 was added to disclose that $355 million (standard price) of SAMMS inventory other than stock on hand was inaccurately presented. The general ledger accounts used to support the trial balance did not agree with the supporting records and related documents.

o Note 12 was added to disclose restrictions on inventory related to material that was not in a ready-for-issue condition ($246 million), prepositioned war reserve material ($2.1 billion), inventory investments received from foreign military sales customers ($105.8 million), and inventory that was unissuable because of major nonconformances with specifications cited in DoD drawings and military specifications ($171 million).

o Note 13 was added to disclose that the inventory account balance in the financial statements included negative inventory valued at $136.5 million and an estimated $85.8 million of subsistence inventory, intransit from procurement and with contractors and test facilities, that was not supported by detailed records and a reliable estimate of the correct value could not be substantiated.

o Note 14 was added to disclose that the auditors estimated that the SAMMS stock on hand inventory was overstated by a net of $22.6 million.

Supplemental Information. Management revised the overview portion of the financial statements to provide a discussion and analysis of the financial condition of the DSF (section E). Management also provided additional program and workload indicators such as stock availability, materiel denials, total demands, total obligations, and depot processing and shipping effectiveness (section F).

Internal Control Weaknesses. The following is a summary of the conditions, recommendations, management comments, and planned corrective actions related to the internal control weaknesses identified in the draft report.

Physical inventory process. We selected a stratified random sample of 640 items, observed the physical count and reconciliation process at 13 storage depots, and determined if the inventory results were posted to the accountable records. We found that 496 (78 percent) of the item inventory results were posted to the accountable records (35 with counts different than those we observed), 101 were received by the supply centers but were rejected by the supply system and not re-input, and 43 were not received or processed. For the 35 items that were posted with counts different than those we observed, the net variance per count was $506,000. The net difference posted to the supply records was $96,000. Most of this difference was attributed to one depot, Defense Distribution Depot, Memphis, Tennessee, where we observed that reported counts were manipulated to avoid discrepancy values requiring causative research. No research was performed by supply center personnel for the 101 results of inventory transactions that were rejected from the supply centers' files, and none were corrected and later recorded. For the 101 transactions, 27 items had losses of $95,000, 17 items had gains of $40,000, and the remaining 57 had no difference. We projected that the SAMMS on hand inventory was understated by $55 million.

We recommended that the Director, DLA, establish controls to ensure that physical inventory transactions are posted to the accountable records and that rejected transactions are re-input promptly. Management concurred and stated that it believes internal controls exist, but are not being followed and that this issue will be included in the FY 1992 FMFIA reporting requirements. Management also briefed the DLA Director of Supply Operations on the conditions noted and requested the internal review office to review the Memphis depot procedures. The estimated completion date for corrective action is December 31, 1992.

Inventory valuation. DoD directed that, for FY 1991 financial statement presentation purposes, stock fund inventories be reported at the latest acquisition cost rather than standard price. Based on our audit tests, we projected that SAMMS on hand inventory was overstated by $32.4 million because of inventory valuation. Some categories of items that were not priced at the latest acquisition value were clothing and textile bag items (initial issue), items last repriced in FY 1986 and FY 1987, and logistic transfer items.

We recommended that the Director, DLA, establish procedures to ensure that inventory stock on hand is valued at latest acquisition cost for financial statement presentation. Special emphasis should be placed on logistics transfer items because of the ongoing transfer of consumable items managed by the Military Services to DLA. Management concurred and stated that actions will be taken to value the inventory at acquisition cost. The estimated completion date for corrective action is September 30, 1992.

Inventory in transit. We found that in computing the inventory gain or loss due to standard price changes, for materiel in transit between customers and storage points, the DFSC was using reports that had different intransit quantities than those used to compute the value of the materiel intransit.

We recommended that the Director, DLA, require DFSC to use the same quantities to compute the inventory gain or loss due to standard price changes that are used to compute the value of the materiel intransit. Management concurred and stated that it believes there was a systemic problem with the computer program. The estimated completion date for corrective action is September 30, 1992.

SAMMS inventory other than stock on hand. Internal controls did not ensure that the reported $355 million of SAMMS inventory other than stock on hand was reasonably stated. General ledger account balances for these inventories were not valued at cost, included inventories that were valued at a negative value, were not supported by related balances in subsidiary records, and details to support the subsidiary account balances were invalid.

We recommended that the Director, DLA, establish procedures and controls to correct the problems identified with the inventory other than stock on hand. The procedures should provide for the periodic verification of subsidiary records with supporting documentation and the review of unusual subsidiary records such as negative inventories and overage transactions. Management concurred with the recommendation and stated that a memorandum will be issued to stress the need to comply with existing procedures and set up a team to correct current imbalances, such as negative inventories. Letters will be sent to respective offices to ensure that periodically the general ledger control and subsidiary records are reconciled to supporting documentation. The estimated completion date for corrective action is December 31, 1992.

Federal Managers Financial Integrity Act. Internal management control reviews to implement the FMFIA did not determine whether adequate control measures existed and were implemented to ensure that inventory general ledger account balances agreed with subsidiary ledger account balances and that subsidiary ledger accounts were properly supported.

We recommended that the Director, DLA, and the Director, DFAS, ensure that internal management control reviews determine that general ledger account balances are reconciled to subsidiary records and that subsidiary records are periodically verified to supporting documentation. In addition, the reviews must be properly documented to provide a permanent record of the methods used, the key factors considered, and the conclusions reached. Management concurred and stated that DLA and DFAS will include this area in the FY 1992 FMFIA review requirements. The estimated completion date for corrective action is December 31, 1992.

APPENDIX B: ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Comptroller of the Department of Defense, Washington, DC
Office of the Assistant Secretary of Defense (Production and Logistics), Washington, DC

Department of the Air Force

McGuire Air Force Base, Wrightstown, NJ

Defense Activities

Headquarters, Defense Logistics Agency, Cameron Station, VA
- Defense Construction Supply Center, Columbus, OH
- Defense Electronics Supply Center, Dayton, OH
- Defense Fuel Supply Center, Cameron Station, VA
- Defense General Supply Center, Richmond, VA
- Defense Industrial Supply Center, Philadelphia, PA
- Defense Personnel Supply Center, Philadelphia, PA
- Defense Distribution Region Central, Memphis, TN
  - Defense Distribution Depot Albany, GA
  - Defense Distribution Depot Memphis, TN
  - Defense Distribution Depot Red River, TX
  - Defense Distribution Depot San Antonio, TX
  - Defense Distribution Depot Warner Robins, GA
- Defense Distribution Region East, New Cumberland, PA
  - Defense Distribution Depot Charleston, SC
  - Defense Distribution Depot Columbus, OH
  - Defense Distribution Depot Richmond, VA
  - Defense Distribution Depot Tobyhanna, PA
- Defense Distribution Region West, Stockton, CA
  - Defense Distribution Depot Oakland, CA
  - Defense Distribution Depot Ogden, UT
    - Ogden Facility
  - Defense Distribution Depot San Diego, CA
  - Defense Distribution Depot San Joaquin, CA
    - Tracy Facility
- Defense Contract Management District Mid-Atlantic, Philadelphia, PA
- Defense Fuel Supply Point
  - Andrews Air Force Base, Washington, DC
  - Jacksonville, NJ
  - Pinney Point, MD
  - Staten Island, NY
- Defense Systems Automation Center, Columbus, OH

Headquarters, Defense Finance and Accounting Service, Washington, DC
Defense Finance and Accounting Service, Richmond Detachment, Richmond, VA
Defense Finance and Accounting Service, Columbus Center, Columbus, OH
- Richmond Center, Richmond, VA
- Philadelphia Center, Philadelphia, PA
- Defense Fuel Supply Center, Cameron Station, VA

Non-DoD Activities

U.S. General Accounting Office, Washington, DC

APPENDIX C: REPORT DISTRIBUTION

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics)
Assistant Secretary of Defense (Public Affairs)
Comptroller and Chief Financial Officer of the Department of Defense
Deputy Chief Financial Officer of the Department of Defense

Department of the Army

Inspector General, Department of the Army
Auditor General, U.S. Army Audit Agency

Department of the Navy

Director, Naval Audit Service

Department of the Air Force

Auditor General, U.S. Air Force Audit Agency

Defense Agencies

Director, Defense Logistics Agency
Director, Defense Finance and Accounting Service
Director, Defense Contract Audit Agency
Director, Defense Logistics Studies Information Exchange
Director, National Security Agency/Chief, Central Security Service
Inspector General, Defense Intelligence Agency

Non-DoD Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
NSIAD Technical Information Center
NSIAD Director, Logistics Issues

Chairman and Ranking Minority Members of the following Congressional Committees and Subcommittees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

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Janice Conte	Auditor
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Lisa Durso	Auditor
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