

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**SPECIAL DEFENSE ACQUISITION FUND FINANCIAL
STATEMENTS FOR FY 1992**

Report No. 93-121

June 21, 1993

Department of Defense

Acronyms

DFAS	Defense Finance and Accounting Service
DSAA	Defense Security Assistance Agency
OMB	Office of Management and Budget
SDAF	Special Defense Acquisition Fund



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

June 21, 1993

MEMORANDUM FOR SECRETARY OF DEFENSE
COMPTROLLER AND CHIEF FINANCIAL OFFICER OF
THE DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Special Defense Acquisition Fund Financial
Statements for FY 1992 (Report No. 93-121)

We are providing this audit report for your information and use, and for use by Congress. Financial statement audits such as this one are required by the Chief Financial Officers Act of 1990 (the Act). Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Financial Statements," January 8, 1993, which implements the Act, requires the Inspectors General to report on the adequacy of internal controls and compliance with laws and regulations.

Although we evaluated internal controls and compliance with laws and regulations, we are unable to express an opinion on the financial statements. We are disclaiming an opinion on the financial statements because of a scope limitation for which we were unable to apply certain auditing procedures that we deemed necessary. Specifically, we could not ascertain the value of inventory, which represented \$179.4 million. Also, because we were unable to obtain sufficient data on transactions, and because the Fund's accounting records were inadequate, the scope of our audit was restricted.

Internal control weaknesses were noted in the general ledger system, general and application controls for computers, inventory policies and procedures, classification of assets, and disclosure of transactions and accounts. Also, the method of recognizing revenues and expenses was not in compliance with the "DoD Accounting Manual" and generally accepted accounting principles. The usefulness of the financial statements will be in question until the Fund's accounting system is more reliable, and more effective internal controls are developed and implemented. Details of the weaknesses are discussed in Parts II and III of this report.

This report contains no recommendations that are subject to resolution in accordance with DoD Directive 7650.3; therefore, comments to the final report are not required.

The courtesies extended to the audit staff during the audit are appreciated. If you have any questions about this audit, please contact Mr. Alvin L. Madison, Program Director, at (703) 614-1681 (DSN 224-1681), or Mr. Robert W. Otten, Project Manager, at (703) 693-0651 (DSN 224-0651). The distribution of this report is listed in Part IV, Appendix C.

A handwritten signature in cursive script, reading "Robert J. Lieberman".

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 93-121
(Project No. 2FA-2013)

June 21, 1993

**AUDIT REPORT ON THE SPECIAL DEFENSE ACQUISITION
FUND FINANCIAL STATEMENTS FOR FY 1992**

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires an annual audit of the Special Defense Acquisition Fund (the Fund). The Fund, established in 1981 by the Arms Export Control Act, procures Defense articles and services in anticipation of selling or transferring them to foreign customers. The Fund manager is the Defense Security Assistance Agency (DSAA); therefore, DSAA is responsible for the financial statements. The Fund is operated as a revolving fund and was capitalized with revenues from U.S. Government sales and contractors' export sales. The initial FY 1982 capitalization of the Fund was incrementally increased until FY 1987, and has reached the congressionally mandated limit of \$1.07 billion. In FY 1992, the Fund reported revenues of \$142.0 million, and showed a net profit of \$1.86 million after writing off \$8.1 million in unsalable inventory.

Objectives. Our audit objective was to determine whether the Fund financial statements for FY 1992 were presented fairly in accordance with generally accepted accounting principles for Federal entities. We evaluated and tested the internal controls established for the Fund, and we assessed compliance with laws and regulations that could have a material effect on the financial statements. We also determined the reliability and usefulness of financial information reported to the Office of Management and Budget, the U.S. Treasury, DoD, and the Fund's management.

Independent Auditor's Opinion. We are issuing a Disclaimer of Opinion on the financial statements. The Fund did not have a general ledger system that was in compliance with laws and regulations, and certain account balances were combined and not separately presented in the financial statements. Therefore, we were unable to apply auditing procedures to determine the accurate valuation of inventory balances and other account balances. We were also unable to obtain sufficient, competent evidence and make appropriate tests of the accounting records. This limited the scope of our audit; therefore, we are not expressing an opinion on the financial statements of the Fund.

Internal Controls. We identified material internal control weaknesses that required management's attention. The Fund financial statements were not prepared using the accrual method of accounting, and did not comply with accounting principles in the "DoD Accounting Manual." In addition, the accounting system and procedures did not adequately ensure that all transactions were recorded, recognized during the proper accounting period, properly classified, and disclosed in the financial statements of the

Fund. A general ledger system was not implemented until August 1992; general and application controls had not been developed for computers; and policies and procedures for managing inventory and accounts receivable had not been developed. We noted that Fund managers had not conducted internal control reviews, as required by the Federal Managers' Financial Integrity Act, to ensure that account balances were accurate. Part II contains our report on internal control weaknesses.

Compliance with Laws and Regulations. The Fund manager had not complied with laws and regulations that have a direct and material effect on the financial statements. Our tests disclosed noncompliances with the "DoD Accounting Manual." We could not determine whether the Fund's equity was in compliance with its capitalization of \$1.07 billion, as authorized by the Arms Export Control Act. Part III contains our report on compliance with laws and regulations.

Usefulness of the Financial Statements. The reliability and usefulness of the Fund financial statements are questionable. Although we could not ascertain the overall accuracy of the statements, we found numerous control problems that affect the reported account balances, and we believe that the statements do not fairly present an accurate picture of the Fund financial position. Therefore, the usefulness of the financial statements is in doubt. Correcting these deficiencies will significantly improve the accuracy of financial information and financial statements. Managers will also have more accurate data to use in making decisions.

Other Matters Related to the Audit. Managers at the DSAA informed us that beginning in FY 1994, the President will not request obligation authority for the Fund. As a result, the Fund will be disestablished during the next 4 years.

Management Comments. Parts II and III of the report were issued in draft to management on May 17, 1993, and we requested management's comments. We received comments from the Comptroller of the Department of Defense and the Comptroller, Defense Security Assistance Agency. See Part IV for the complete text of management's comments.

The Comptroller of the Department of Defense agreed with the contents of Parts II and III except for the accuracy of the end-of-year inventory value of \$179.4 million. He also stated that using a different method of recognizing revenues and expenses would not be useful, since the Fund is being disestablished.

The Comptroller, Defense Security Assistance Agency, agreed to establish end-of-year cut-off dates for recording transactions and to develop procedures for inventory reporting. However, he did not agree that DSAA should change its method of recognizing revenues and expenses and should establish accounts receivable for assets that the Military Departments divert for their use from the Fund inventory. He also did not agree with our comments on DSAA's end-of-year inventory, and with our suggestion that DSAA establish accounts receivable for any deferred customer payment schedules.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, (703) 614-6303 (DSN 224-6303).

**Part I - Independent Auditor's Opinion
on the Financial Statements**

Introduction

The Chief Financial Officers Act of 1990 requires Federal agencies to prepare financial statements for revolving funds that perform substantial commercial functions, and to have the statements audited. The financial statements include the Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. Also included are the Footnotes, Overview, and Supplemental information.

The Special Defense Acquisition Fund (the Fund), a revolving fund, was authorized in 1981 by Chapter 5 of the Arms Export Control Act. It finances the acquisition of Defense articles with long procurement lead times, in anticipation of selling these articles to eligible foreign nations. The Fund is replenished from the proceeds of sales, and the Arms Export Control Act limits its capitalization to \$1.07 billion. The Defense Security Assistance Agency (DSAA) is responsible for financial management and policy, preparing the Fund's budget, and prioritizing procurements from the Fund. Military Departments make procurements and maintain physical custody over Fund assets that contractors deliver to DoD. The Defense Accounting and Finance Service (DFAS)-Denver Center performs central accounting services for the Fund.

Scope

We attempted to audit the Fund's Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses as of and for the year ended September 30, 1992. The financial statements are the responsibility of DSAA and DFAS. Our responsibility is to express an opinion on those statements based on our audit. An audit includes examining, on a test basis, evidence that supports the amounts and disclosures in those statements, including the notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statements. We believe that our audit provides a reasonable basis for our opinion. This financial statement audit was made between September 1992 and March 1993. We reviewed policies, procedures, and internal controls for Fund assets, liabilities, revenues, and expenses, and we performed tests of Fund transactions to the extent we deemed necessary except where records were inadequate. Part IV, Appendix B, lists the organizations we visited or contacted during the audit.

The Fund's general ledger accounting system was not implemented until August 1992 and does not meet the requirements in the "DoD Accounting Manual" for a general ledger system. The Fund's managers do not use a double-entry system, and their system cannot be used to compute account balances, such as inventory, revenues, and cost of sales. We found that the accounting system that supported the Fund was inadequate, and we found other

internal controls weaknesses (see Part II, Internal Controls). Therefore, we could not apply auditing procedures to quantify the full impact of the deficiencies on reported inventory balances and other account balances.

Auditing Standards

We made our audit in accordance with generally accepted 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 No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

Accounting Principles

Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal entities are to be promulgated by the Joint Financial Improvement Program, based on advice from the Board. In the interim, Federal agencies are to use a comprehensive basis of accounting as defined in OMB Bulletin No. 93-06. The summary of significant policies for the Fund, included in the Notes to the Financial Statements, describes the principles and methods of application that management has concluded are the most appropriate for presenting the Fund's significant assets, liabilities, net position, results of operations, cash flows, and reconciliation to budget.

Disclaimer of Opinion

Since the financial statements were not supported by a general ledger system and an internal control structure that complied with laws and regulations, we could not apply auditing procedures to determine the accurate valuation of inventory balances and other account balances. Also, we could not obtain sufficient data on the account balances to apply appropriate tests in auditing the accounting records. This limited the scope of our audit; therefore, we are not able to express and we do not express an opinion on the Fund financial statements.

Additional Information

Our audit was conducted for the purpose of forming an opinion on the financial statements described above. The information in the Overview and Supplemental sections of the financial statements is presented for additional analysis. We have not audited this information; therefore, we do not express an opinion on it.

Part II - Internal Controls

Introduction

We have audited the internal control structure of the financial statements of the Special Defense Acquisition Fund (the Fund) of the Defense Security Assistance Agency (DSAA) for the year ended September 30, 1992.

DSAA, the Military Departments, and the Defense Finance and Accounting Service (DFAS) are responsible for establishing and maintaining internal controls. To fulfill this responsibility, those organizations are required to assess the costs and benefits of internal control policies and procedures. The objectives of an internal control structure are:

- o to provide management with reasonable but not absolute assurance that transactions are properly recorded to permit preparation of reliable financial statements;
- o to safeguard funds, property, and other assets against unauthorized use or disposition;
- o to ensure that transactions, including those related to obligations, income, and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and other laws and regulations that OMB, the Fund's manager, or the IG, DoD, have identified as being significant and for which compliance can be objectively measured and evaluated;
- o to ensure that data used to support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Objectives and Scope

The objective of our audit was to determine whether material internal control weaknesses existed.

In planning and performing our audit of the Fund's financial statements for the year ended September 30, 1992, we considered its internal control structure. The purposes of this consideration were to determine the auditing procedures that we would use to express our opinion on the financial statements, and to determine whether the internal control structure was established according to DoD policies and procedures. We obtained an understanding of the internal control risks relevant to all significant cycles, classes of transactions, or account balances; and for those significant policies and procedures that have been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed.

For this report, we classified the significant internal control policies and procedures in the following categories.

- o Collections and disbursements: policies, procedures, and internal controls for collections, obligations, and disbursements of funds by DFAS.

- o Inventory: policies, procedures, and internal controls for performing physical inventory counts, properly classifying serviceable and unserviceable inventory, reconciling results to inventory records, and storing and safeguarding inventory.

- o Revenues and cost of sales: policies, procedures, and internal controls relating to the closure of cases, the reporting of revenue, the cost of sales, and profit.

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

We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, and Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

Prior Audit Coverage

In Report No. 92-080, "Audit of the Special Defense Acquisition Fund," April 20, 1992, the Office of the Assistant Inspector General for Auditing, DoD, reported two conditions that relate to financial reporting. DSAA had postponed recognition of the Fund's revenues, expenses, and profits until all costs were recorded and all deliveries were made to foreign customers. The completed-contract method (without accrual accounting) was used instead of the percentage-of-completion method of accounting. We recommended that DSAA implement the procedure outlined in DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983, which requires that revenues, expenses, and profits be recorded at the time deliveries are made and title is transferred to customers. Management disagreed with our recommendation and used the completed-contract method to prepare FY 1992 financial statements for the Fund.

We also reported that DSAA needed to establish an inventory control system for Fund assets, and that the inventory control system should be reconcilable with the Military Departments' inventory systems so that the Fund inventory will be accurately reported. Management agreed with our recommendation, but our audit of the financial statements for FY 1992 showed that procedures for reporting and valuation of Fund inventory were still inadequate.

Results of Audit

We noted conditions in the internal control structure and its operations that we consider to be material and reportable under OMB No. Bulletin 93-06 and generally accepted Government auditing standards established by the Comptroller General. 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 effectively control and manage its resources and ensure reliable and accurate financial information to manage and evaluate operational performance.

A material weakness is a condition in which the design or operation of the specific internal control structure element does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The audit disclosed material conditions relating to improper recognition of profit; erroneous account offsets; inadequacies in the Fund accounting system; and a lack of standard operating procedures. We could not quantify the impact of all those deficiencies on the financial statements.

Recognition of Profit. Under the completed-contract method of accounting, the revenues, cost of sales, and profits for the Fund are recognized at case closure. This practice does not conform to generally accepted accounting principles and the "DoD Accounting Manual," without the use of accrual accounting. The "DoD Accounting Manual" requires that revenues, the cost of sales, and profits be recorded at the time deliveries are made and title is transferred to customers.

Account Offsets. The "Other Funded Liabilities" amount of \$7.4 million resulted when management offset the balance of \$1.3895 billion in the Fund's "Advances to Contractors" account with the \$1.3969 billion balance in the "Unearned Revenue" account. Because of this offset, the financial statements did not disclose the magnitude of the Fund's manager obligation to provide goods to customers and the cumulative value of the unrecognized revenue. All Fund disbursements were charged to the "Advances to Contractors" account, which included work-in-process and contracts for goods that have been delivered to DoD or foreign customers. The "Unearned Revenue" account represented amounts received from customers; those amounts are not recognized as earned until cases are closed. Generally accepted accounting principles and the "DoD Accounting Manual" do not permit the offsetting of these account balances; this practice does not disclose the Fund's obligation to provide goods to customers and the cumulative amount of unrecognized revenue. In addition, the financial statements did not disclose the value of work-in-process. The "DoD Accounting Manual" requires that these costs be reported in a separate general ledger account to establish financial control over the costs. Because we could not obtain this data from the accounting system, we could not determine the value of the work-in-process.

Accounting System. The general ledger accounting system for the Fund was not implemented until August 1992 and does not meet requirements in the "DoD Accounting Manual." The system is not a double-entry system and is not used to compute major account balances, such as inventory, revenues, and cost of sales. Computer systems and data bases at DFAS-Denver Center lacked general and application controls and could produce unreliable data. In addition, all transactions in the data bases were not properly classified. For example, all disbursements, regardless of purpose, were recorded in the "Advances to Contractors" account. As a result, large expenditures that represented Fund assets were not reported in the financial statements. Examples were \$50.0 million in payments to the Defense Logistics Agency for logistics support, \$46.0 million to make Defense articles marketable to foreign customers, and \$12.0 million for helicopters leased to foreign customers.

Standard Operating Procedures. Written procedures did not exist to ensure that:

- o all accounts receivable were recorded;
- o the fiscal year-end inventory was properly valued;
- o revenues, expenses, and profits were recognized in the proper accounting period; and
- o computer user manuals and system descriptions were available to ensure the reliability of accounting transactions.

Records of the Fund did not show amounts that are due when the Military Departments divert items for their use. Also, amounts due from customers under cases with deferred collection schedules were not recorded in accounts receivable.

The Military Departments computed year-end inventory value of the Fund at \$179.4 million. We found inconsistencies among the Military Departments' methods for determining quantities and dollar values. Also, DSAA did not review the accuracy of year-end inventory data compiled by the Military Departments.

The year-end inventory of the Fund did not include Defense articles that had been allocated to open cases but not delivered to customers as of September 30, 1992.

Under the completed-contract method, Fund managers had not established proper cut-off dates for recognizing revenues, the cost of sales, and profits. As of September 30, 1992, the Fund had received over 400 collections between FYs 1985 and 1992 for reverse Military Interdepartmental Purchase Requests (MIPRs) and recoupments of Fund investments. However, the recoupments had not been recognized in profit computations. For the MIPRs and recoupments, about \$219.0 million in revenue had not been recognized, and approximately \$14.0 million in profits had not been transferred to the U.S. Treasury by the end of FY 1992. In addition, management established an August 1992 cut-off

Internal Controls

date for FY 1992 transactions; this cut-off date excluded cases that were closed in September 1992.

Management Comments

We received management comments from the Comptroller of the Department of Defense and the Comptroller, DSAA. See Part IV for the complete text of management's comments.

The DoD Comptroller agreed with Part II, except for the accuracy of the end-of-year inventory value of \$179.4 million and our suggestion that DSAA use a different method of recognizing revenues and expenses.

The Comptroller, DSAA, agreed to establish end-of-year cut-off dates and to develop procedures for inventory reporting. However, he did not agree to change the method of recognizing revenues and expenses or to establish accounts receivable for assets diverted from the inventory of the Fund. He also did not agree with our comments on the value of the end-of-year inventory, and with our suggestion that accounts receivable be established for any deferred customer payment schedules.

Audit Evaluation of Management Comments

We disagree with the DoD Comptroller and the Comptroller, DSAA, that the Fund should not recognize profit on sales until the related foreign military sales case is closed. Our tests of revenue and expense accounts showed the use of this method to recognize profit postponed the matching of costs and revenues in a designated accounting period; postponed the recognition of costs of sales, and profits; and understated the end-of-year inventory value.

We disagree with the Comptroller, DSAA's statement that an accounts receivable should not be established for assets diverted from the Fund inventory. If an accounts receivable is not established, the accounts receivable balance is understated and the Fund inventory balance overstated.

We disagree with the DoD Comptroller and Comptroller, DSAA on the accuracy of the year-end inventory value. Our verification of on hand inventory and examination of inventory records showed the Military Departments and DSAA did not give full consideration to the physical condition and completeness of the assets on hand, the method used to value concurrent spare parts, the value of inventory sold but not delivered to foreign customers, and the value of assets diverted to the Military Departments. Further, there were inconsistencies in the methods used by the Military Departments in determining inventory quantities and related dollar values.

Part III - Compliance with Laws and Regulations

Introduction

We have tested the financial statements of the Special Defense Acquisition Fund (the Fund) of the Defense Security Assistance Agency (DSAA) for the year ended September 30, 1992, for material instances of noncompliance with laws and regulations. Such tests are required by the Chief Financial Officers Act of 1990.

Objectives and Scope

The objective of our audit was to determine whether material instances of noncompliance with laws and regulations existed. Material instances of noncompliance are failures to follow requirements of, or violations of prohibitions contained in, laws and regulations. Such failures or violations are those that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or those whose sensitive nature would cause them to be perceived as significant by others.

Compliance with laws and regulations applicable to the Fund is the responsibility of DSAA, the Military Departments, and the Defense Finance and Accounting Service. As part of obtaining reasonable assurance about whether the financial statements were free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements, and with other laws and regulations designated by OMB and DoD (see Part IV, Appendix A, "Laws and Regulations"). 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). We compared the most recent FMFIA reports for the Fund with our evaluation of the internal control system. Our objective was not to provide an opinion on overall compliance with such provisions. We did not review and test Fund policies, procedures, and systems for documenting and supporting the financial, statistical, and other information presented to us in the Overview and the Supplemental sections of the financial statements.

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 IG, DoD, and Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

Prior Audit Coverage

There have been no prior audits of compliance with laws and regulations related to the Special Defense Acquisition Fund.

Results of Audit

The results of our tests of compliance with laws and regulations disclosed noncompliances with the "DoD Accounting Manual" and are discussed in Part II of this report, Internal Controls. We could not determine whether Fund equity was in compliance with the capitalization limit of \$1.07 billion as authorized by the Arms Export Control Act. This was because of the unreliable valuation of the Fund's inventory and other assets and liabilities. We attributed unreliable account balances to inadequacies in the accounting system used for the Fund, a lack of standard operating procedures, and questionable accounting practices. We noted that Fund managers had not conducted internal control reviews, as required by FMFIA, to ensure that account balances were accurate.

The results of our tests of compliance indicated that, with respect to the items tested, the Fund did not comply with the provisions of the "DoD Accounting Manual." Therefore, the resulting conditions could have a material effect on the FY 1992 financial statements and affected our opinion on the Fund's financial statements. With respect to items not tested, nothing came to our attention to cause us to believe that the Fund had not complied, in all material respects, with those provisions.

Management Comments

We received comments on the draft of Part III from the Comptroller, Defense Security Assistance Agency. He did not agree with our decision not to express an opinion on whether the Fund equity is in compliance with the capitalization limit.

Audit Evaluation of Management Comments

The Arms Export Control Act, Chapter 5, section 51 (4)(c)(1) specifically states that the size of the Fund may not exceed the dollar amount prescribed in section 114 (c) of Title 10, U.S.C. The DoD Authorization Act of 1987 (Public Law 99-661) increased the Fund ceiling to \$1.07 billion. The DSAA method of recognizing revenues and expenses at case closure, the failure to verify the actual on hand inventory, and the policy of not including items sold but not delivered in the ending inventory balance could result in the Fund exceeding the capitalization ceiling authorized by Congress.

Part IV - Additional Information

Appendix A. Laws and Regulations

Budget and Accounting Procedures Act of 1950, P.L. 784

Foreign Assistance Act of 1961, as amended, P.L. 87-195

Arms Export Control Act of 1968, P.L. 90-629

Federal Managers' Financial Integrity Act of 1982, P.L. 97-255

Chief Financial Officers Act of 1990, P.L. 101-576

General Accounting Office "Policy and Procedures Manual for Guidance of Federal Agencies," Title 2, August 1987

OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992

OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993

OMB Circular No. A-123, "Internal Control Systems," August 4, 1986

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987

DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983

DoD Manual 7290.3-M, "Foreign Military Sales Financial Management Manual," September 18, 1986

DoD Manual 5105.38-M, "Security Assistance Management Manual," October 1, 1988

Appendix B. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Comptroller of the Department of Defense, Washington, DC

Department of the Army

Assistant Secretary of the Army (Financial Management)

Army Materiel Command, Alexandria, VA

Army Armament, Munitions and Chemical Command, Rock Island, IL

Army Aviation and Troop Command, St. Louis, MO

Army Communications-Electronics Command, Fort Monmouth, NJ

Army Missile Command, Redstone Arsenal, AL

Army Security Assistance Command, Alexandria, VA

Army Security Assistance Command, New Cumberland, PA

Army Tank and Automotive Command, Warren, MI

Anniston Army Depot, Anniston, AL

Letterkenny Army Depot, Chambersburg, PA

Lexington-Blue Grass Army Depot, Lexington, KY

Red River Army Depot, Texarkana, TX

Department of the Navy

Assistant Secretary of the Navy (Financial Management)

Naval Air Systems Command, Washington, DC

Naval Sea Systems Command, Washington, DC

Naval Surface Warfare Center, Crane, IN

Naval Undersea Warfare Center, Keyport, WA

Naval Weapons Station, Seal Beach, CA

Naval Supply Systems Command, Washington, DC

Navy Aviation Supply Office, Philadelphia, PA

Navy International Logistics Control Office, Philadelphia, PA

Navy Ships Parts Control Center, Mechanicsburg, PA

Navy International Programs Office, Washington, DC

Space and Naval Warfare Systems Command, Washington, DC

Department of the Air Force

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

Air Force International Affairs Office, Washington, DC

Air Force Security Assistance Office, Wright-Patterson Air Force Base, OH

Organizations Visited and Contacted

Defense Agencies

Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Distribution Region West, Stockton, CA
Defense Distribution Depot, Sacramento, CA
Defense Distribution Region East, Susquehanna, PA
Defense Distribution Depot, Letterkenny, PA
Defense Distribution Depot, Susquehanna, PA
Defense Distribution Depot, Tobyhanna, PA
Defense Distribution Region Central, Memphis, TN
Defense Distribution Depot, Anniston, AL
Defense Distribution Depot, Red River, TX
Headquarters, Defense Finance and Accounting Service, Washington, DC
Defense Finance and Accounting Service, Denver Center, CO
Defense Security Assistance Agency, Washington, DC

Non-Defense Federal Organization

National Security Agency, Fort George G. Meade, MD

Non-Defense Organization

Alliant Techsystems, Hopkins, MN

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Louise M. Merdinian	Auditor
Kevin T. Bobowski	Auditor
John G. Labelle	Auditor
Susanne B. Allen	Editor

Appendix C. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Research, Development and Acquisition)
U.S. Army Materiel Command
Inspector General of the Army
Auditor General, Army Audit Agency

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Assistant Secretary of the Navy (Research, Development and Acquisition)
Auditor General, Naval Audit Service
Headquarters, Naval Air Systems Command
Headquarters, Naval Sea Systems Command
Headquarters, Space and Naval Warfare Systems Command

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Assistant Secretary of the Air Force (Acquisition)
Auditor General, Air Force Audit Agency

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, Defense Security Assistance Agency

Report Distribution

Non-Defense Federal Organizations

Office of Management and Budget
U.S. General Accounting Office, National Security and International Affairs Division,
Technical Information Center

Chairman and Ranking Minority Members 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 Foreign Relations
Senate Committee on Government Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Foreign Affairs
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on
Government Operations

**Part V - FY 1992 Annual Financial
Statements Special Defense
Acquisition Fund**

The financial statements reproduced here are excerpted from the FY 1992 Annual Financial Statements as prepared by the Chief Financial Officer, Defense Security Assistance Agency.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON DC 20301 1100

MAR 25 1993

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

**SUBJECT: Transmittal of the Defense Security Assistance Agency
Financial Statements on FY 1992 Financial Activity**

The attached financial statements for the Defense Security Assistance Agency (DSAA) on FY 1992 financial activity are submitted for audit as required by the Chief Financial Officers Act of 1990.

The principal statements include consolidating and supporting financial statements for accounts 97-11X4116, 97-11X4121, 97-11X4122 and 97-11X8242 to provide an audit trail from the individual accounts to the principal statements.

My staff, and that of the Defense Security Assistance Agency, are available to provide assistance and information as you require in the upcoming audit of these financial statements. We will work with your staff to make the adjustments and improvements necessary to ensure the financial statements present fairly, in all material respects, the assets, liabilities, and net financial position, of the Defense Security Assistance Agency as of September 30, 1992.

A handwritten signature in cursive script, appearing to read "Alvin Tucker".

Alvin Tucker
Acting Chief Financial Officer

Attachment

Chief Financial Officer
FY 1992 Annual Financial Statement

Defense Security Assistance Agency

December 31, 1992

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

FY 1992 ANNUAL FINANCIAL STATEMENT DEFENSE SECURITY ASSISTANCE AGENCY

OVERVIEW AND SUMMARY - PART I

The Defense Security Assistance Agency (DSAA) administers the military segment of U.S. Government security assistance programs.

SECURITY ASSISTANCE DEFINED

Security Assistance refers to the range of programs authorized by the Foreign Assistance Act of 1961 and the Arms Export Control Act (AECA), as amended. Security assistance is a valuable instrument of U.S. national security and foreign policy. It helps friends and allies deter and defend against aggression and shoulder more of the common defense burden. It helps maintain strong and cohesive defense arrangements with friends and allies and to secure access to important military facilities throughout the world. It promotes regional stability through arms transfer controls on the volume and types of weaponry provided to security assistance recipients. It also fosters respect for human rights, democratic values and institutions.

The military component of U.S. Government security assistance includes the following programs:

- Foreign Military Sales (FMS). FMS is the government-to-government channel for the sale of U.S. defense articles and services to eligible foreign governments and international organizations. Historically, approximately eighty percent of all sales are government-to-government. Foreign governments and international organizations, in most cases, may also purchase U.S. defense articles and services directly from U.S. commercial firms, subject to State Department's issuance of the requisite munitions export license.

- Foreign Military Financing (FMF). FMF is an appropriated aid program that makes financing available to certain U.S. friends and allies to procure U.S. defense articles and services through FMS and, for a more limited number of countries, direct commercial purchases. FMF is made available on a grant and a concessional interest rate loan basis.

- International Military Education and Training (IMET). IMET is an appropriated grant aid program that makes available professional and management education and technical training to military and civilian officials of over 100 countries.

- Excess Defense Articles (EDA). EDA of the DoD may be transferred to eligible foreign governments and international organizations on a grant basis pursuant to several authorities in the Foreign Assistance Act of 1961. EDA may also be sold at its current value through FMS.

- Emergency Drawdown Authorities. Section 506 of the Foreign Assistance Act of 1961 authorizes the President, on a grant basis, to drawdown defense articles from DoD inventories and provide defense services to foreign governments and international organizations in response to military emergencies or to provide

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

assistance for international narcotics control, international disaster relief, or refugees.

- Special Defense Acquisition Fund (SDAF). SDAF is a revolving fund that procures defense articles and services in anticipation of later sale to foreign governments and international organizations through FMS. SDAF's annual obligation limit is established in annual appropriations legislation.

SECURITY ASSISTANCE RESPONSIBILITIES

Within the Executive Branch, the National Security Council, the Office of Management and Budget, the Department of the Treasury, the Department of Commerce, and others have responsibilities related to security assistance. However, the principal responsibilities fall to the Department of State and the Department of Defense.

The Secretary of State has statutory responsibility for security assistance policy. Simply put, the State Department determines what assistance will be provided or what sales will be made to what countries or international organizations. The Secretary of Defense has statutory responsibility for determining what defense articles or services are available for sale or transfer abroad and for implementing the military segment of security assistance programs. The Department of Defense also has significant input into the Department of State's decision making. The security assistance functions delegated to the Secretary of Defense have been redelegated to the Director, DSAA. The Director, DSAA reports to the Secretary of Defense and Deputy Secretary of Defense through the Assistant Secretary of Defense for International Security Affairs and the Under Secretary of Defense for Policy.

DSAA is primarily a policy and oversight organization; the Military Departments actually implement programs. DSAA functions include the following: coordinate formulation and execution of security assistance within DoD, including the development of DoD regulations governing security assistance programs and the DoD position on security assistance budget and legislative matters; monitor major systems sale competitions and technology transfer issues; manage all budgetary and financial arrangements associated with FMS on a cash or FMF basis; manage the IMET program; maintain the FMS and IMET data bases; implement drawdown authority transfers to foreign countries from DoD stock and transfers of excess defense articles; serve as DoD focal point for liaison with other Executive Branch agencies, Congress, and U.S. industry on security assistance matters; and supervise the organization, training, administrative support and staffing of DoD elements in foreign countries responsible for managing security assistance programs.

Accomplishing DSAA's management responsibilities with notable effectiveness would not be possible without clearly focused centralized program management supported by the decentralized logistics and services organizations of DoD. Security Assistance is multi-functional, requiring extensive interdepartmental, interagency and intradepartmental coordination and management outside of the Security Assistance management structure. DSAA

provides the central focus, working directly with Congress, Office of Management and Budget (OMB), Department of State, Department of Treasury, National Security Council and other Executive Agencies. This central management is supported by decentralized operational activities. The Military Departments' program offices provide a subordinate structure to manage the interface of logistics, training, transportation, technology and program management of Service-unique weapons systems and organizational performance. These program offices work directly with the over 100 FMS purchasers and with their counterpart field activities to structure their Service's assistance program within DSAA guidance.

IMPLEMENTATION OF U.S. SECURITY ASSISTANCE POLICY AND OBJECTIVES

An understanding of the functions performed by DSAA is best conveyed by examining DSAA's role in the U.S. Government. The Agency is uniquely positioned to translate the goals of national security policy into the realities of defense logistical, services, procurement and financial systems and weapons systems production lines. The ability to link the broad goals of national security policy to concrete plans coordinated through these disparate realities can only be done centrally.

DSAA continues to play a central role in support of Administration policies and Congressionally legislated actions for international security assistance. Examples include the Operation Desert Shield/Desert Storm and Operation Provide Comfort efforts. In critical international situations, past and ongoing international security relationships have proven to be essential in providing the foundation for implementation of U.S. foreign policy and international security.

During FY 1992, DSAA continued to work with our allies from the Desert Shield/Desert Storm operation and others to help them enhance their defense capabilities. Approximately \$3 billion of foreign military sales were undertaken with Egypt, Saudi Arabia, Kuwait, United Arab Emirates, and Turkey, which will lead to considerable enhancement of the air and land forces capabilities of these countries. In the case of Turkey, their major purchase of additional F-16 C/D aircraft is being facilitated financially by the implementation by DSAA of a third party contributory account whereby Desert Shield/Desert Storm allies will make available more than \$2 billion dollars which when combined with Turkish national funds will help to finance this purchase as well as anticipated follow-on buys.

In FY 1992, the Foreign Military Financing and International Military Education and Training (IMET) Program appropriations were significantly reduced from FY 1991 funding. This required significant restructuring of the security assistance grant programs and very close focus on the utility of our funding allocations. Nevertheless, we have distributed the shortfalls as equitably as possible to maintain viable security assistance relationships. In the case of IMET, we have expanded training assistance to include ten former communist block nations including Russia and the Ukraine from the former Soviet Union. These initial programs open up our military-to-military relations and will form a solid basis for the evolving security assistance relationships which are determined to be in our best interests.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

During FY 1992, DSAA initiated and conducted what will be a continuing program of in-depth country financial reviews. These reviews take a comprehensive look at the financial status of a country's Foreign Military Sales cases, with a view towards identifying funds (U.S. Security Assistance Financing or the country's national funds) which could be freed up and reallocated to other uses. The FY 1992 reviews for African, Caribbean nations, and Korea identified close to \$100 million for reallocation.

Also during FY 1992, the newly designated Foreign Military Loan Liquidating Account (FMLLA) disbursed \$541 million of additional loan funds on behalf of foreign purchasers and \$125 million in guaranty payments on defaulted loans. During the same period, it collected \$1,407 million in principal, interest and late charges on all receivables, of which the fund returned \$652 million to the Treasury Miscellaneous Receipts Account and 'paid' \$647 million to the Federal Financing Bank (FFB). The fund recognized \$275 million in accrued interest and penalty revenue.

DSAA'S EVOLVING INTERNATIONAL SECURITY ASSISTANCE ROLE

An extension of the DSAA role was the stimulation and building of international and domestic consensus for international security issues. DSAA has guided sensitive negotiations in support of the Japanese FSX fighter program to protect U.S. technology advantages, while assisting the Japanese in acquiring a mainline air defense system. This should strengthen the defense and economic bonds between our countries. DSAA oversight of negotiations during the formulation of the Korean Fighter Program was instrumental in protecting U.S. economic interests, while meeting the Korean Defense Forces needs, culminating in the FY 1992 F-16 aircraft coproduction sale valued at more than \$2.1 billion. Similar benefits were associated with the F/A-18 aircraft sale to Finland.

In addition, DSAA has provided essential leadership in maintaining the bridge between foreign security assistance requirements and maintenance of U.S. production capability. The continued long-term operation of numerous production and rebuild lines for major items of defense equipment are heavily impacted by, or dependent on, continued international security agreements. Some examples are:

- * M1A2 and M60 Tanks
- * 2 1/2-ton Trucks
- * HAWK Missiles
- * HARPOON Missiles
- * MARK 46 Torpedoes
- * Patriot Missiles
- * AH-1 Helicopters
- * UH-1 Helicopters
- * UH-60 Helicopters
- * F-15 Fighters
- * F-16 Fighters
- * F-18 Fighters
- * MLRS Rocket System

These supplements to the production base tangibly reduce the U.S. taxpayers' cost of maintaining the defense production base, while providing economic benefits to the U.S. work force and local communities where production lines operate.

SPECIFIC DSAA FUNCTIONS

DSAA is involved in numerous managerial and administrative functions relative to implementing the Security Assistance Programs. Highlights follow:

- * Develop the Congressional Presentation Document (including the extensive classified annex for reprogramming), to include the consolidated operational assessment of countries needs for equipment, training, support, financing and technology. DSAA provides central management, since the nine implementing agencies cannot individually consolidate or prioritize sales and grant requirements or reconcile these requirements to country financial resources. Examples are: Priority of distribution of excess defense equipment among various purchasers and priority of delivery of weapons systems, such as: F-16 fighter; F-18 fighter; Multiple Launch Rocket System (MLRS); and AH-64 helicopter.

- * Collect and report security assistance plans and performance under statutory requirements for the Congressional Presentation Document, Congressional security assistance surveys, Congressional Reports on commercial and military exports, and reports on FMS price and availability.

- * Develop, defend and manage requirements and resources for the over 60 countries which receive appropriated loan and grant funds assistance. Priority of appropriated fund allocations are coordinated by DSAA with other DoD offices, State and OMB throughout the programming and budgeting cycle. Execution of the program is managed singularly by DSAA. Examples are: Priority of allocation of International Military Education and Training (IMET) and Foreign Military Financing (FMF) funding among countries such as Philippines, Portugal, Turkey, and Central America.

- * Develop, present and coordinate transfers of defense articles under Sections 506(a)(2) of the Foreign Assistance Act for Colombia, Mexico, and Pakistan.

- * Negotiate, coordinate and provide representation with Department of State, Commerce, Treasury, OMB and Congress on political, program, and financial issues involving foreign assistance. Issues are as various as: (1) rescheduling and forgiveness of FMF debts for approved countries; (2) coordinating Southern Regional Amendment transfers; (3) negotiating terms and technology of weapon systems sales; (4) coordinating international narcotics control assistance; and (5) control of country ceilings for Taiwan, Greece, and Turkey.

- * Program, budget, and execute: the multi-billion dollar annual Foreign Military Financing Program (including billing and collection for the \$22 billion of repayable principal and interest); the \$43 million annual International Military Education and Training (IMET) Program; the \$9 billion dollar Foreign Military Loan Liquidating Account; the \$1.07 billion Special Defense Acquisition Fund; the multi-billion Foreign Military Sales Trust Fund; the \$300 million annual administrative fee budget; and other FMS surcharge accounts.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

- * Approve and financially execute commercial contracts totaling over \$1.1 billion annually under the Foreign Military Financing Program for ten Congressionally authorized countries.

- * Approve, coordinate, and notify the proper authorities of sales and transfers that are subject to Presidential, Department of State, and Congressional approval.

- * Coordinate, prioritize and approve procurement programs within the Special Defense Acquisition Fund for missiles, UH-1H Helicopter Refurbishment, ammunition, and vehicles to reduce the diversion of DoD equipment.

- * Staff and care for the worldwide Security Assistance Organizations in over 70 countries, providing manpower, funding, and policy.

- * Standardize DoD Security Assistance Policy and Performance in multi-functional areas, such as: sales preparation, presentation, approval and performance; logistics; financial; training; technology; leases; and information reporting.

SALES, REVENUE, AND COST MANAGEMENT

Fiscal years 1991 and 1992 Foreign Military Sales were among the highest levels of activity ever experienced in security assistance, totaling over \$39 billion, which is equivalent to twenty percent of all currently active sales cases. World-wide manpower resources for administration of the sales program have decreased eight percent.

Through more disciplined management of administration resources, DSAA has improved the matching of costs to revenues. Since 1988, the cash position of the sub-accounts that finance the administration of the Security Assistance Program has improved by over \$300 million, with a net balance at the end of FY 1992 totaling nearly \$400 million.

COMMERCIAL FUNCTIONS, REVOLVING FUNDS, AND TRUST FUNDS REPORTED

DSAA was established as a separate agency of the DoD to administer the military assistance component of the nation's security assistance programs. In fulfilling this mission, DSAA has managerial and administrative responsibility for: the Foreign Military Sales (FMS) Trust Fund; the Foreign Military Financing Program Account; the Foreign Military Loan Liquidating Account; the Foreign Military Financing Direct Loan Financing Account; the Special Defense Acquisition Fund (SDAF); and the Guaranty Reserve Fund (GRF).

FOREIGN MILITARY SALES (FMS) TRUST FUND. The FMS Trust Fund, Account 8242, was established as a means of facilitating the purchases of U.S. defense articles and services by foreign countries, as authorized in the Arms Export Control Act (AECA). The Trust Fund provides a vehicle through which the United States Government processes foreign country funds required for FMS case payments to U.S. contractors for new procurement, and to Department of Defense (DoD) components for sales from DoD stocks.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

SPECIAL DEFENSE ACQUISITION FUND (SDAF). The SDAF, Account 4116, was authorized by the International Security and Development Cooperation Act of 1981. The SDAF is a revolving fund under the control of the DoD which finances the acquisition of defense articles and services in anticipation of their transfer (pursuant to the AECA), to eligible foreign nations and international organizations. The SDAF account is replenished from the proceeds of sales of items purchased by the account.

FOREIGN MILITARY FINANCING PROGRAM ACCOUNT (FMFPA). This account is not being reported, however, the following narrative is provided to reflect its relationship to the Foreign Military Financing Direct Loan Financing Account 4122. The FMFPA, Account 1085, was established by the Credit Reform Act as an appropriated fund account to provide the funding necessary to finance the subsidy element of the loan program. Expenditures from this account finance the subsidy element of direct loan disbursements and are transferred into the Foreign Military Financing Direct Loan Financing Account (Account 4122) to make the required loan disbursements for approved FMS or commercial sales.

GUARANTY RESERVE FUND (GRF). The GRF, Account 4121, was established by Congress to provide a guaranty against country loan arrearages or defaults on the repayment of loans due to the Federal Financing Bank (FFB) and commercial banks. The nature and purpose of this account was changed on October 1, 1991, by implementation of the Credit Reform Act. It has now been replaced by the Foreign Military Loan Liquidating Account.

FOREIGN MILITARY LOAN LIQUIDATING ACCOUNT (FMLLA). The FMLLA, Account 4121, was established under the Credit Reform Act. Consolidated into this symbol were all assets, liabilities, and equities for loan balances previously recorded in accounts 11*1082, 11M1083, 11M1084, and 11X4121. This account disburses funds previously made available and accounted under the previously mentioned accounts.

FOREIGN MILITARY FINANCING DIRECT LOAN FINANCING ACCOUNT (FMFDLFA). The FMFDLFA, Account 4122, was established under the Credit Reform Act. The establishment of this account provides the vehicle for making disbursement of Foreign Military Loan funds for approved procurements and for subsequent collection of debt service due for the loans. The account uses permanent borrowing authority from the Treasury, combined with transfers of appropriated funds from account 1085 to make the required disbursements for loan recipient countries for their FMS or commercial procurements. Receipts of debt service payments from borrowers are used to repay the borrowings from Treasury.

ACCOUNTING RESPONSIBILITIES FOR THE FUNDS

The Defense Finance and Accounting Service - Denver, Security Assistance Accounting Center (SAAC), provides centralized accounting services for the FMS Trust Fund and the SDAF activity. Accounting for the FMLLA, FMFPA, and FMFDLFA and the executive agency portion of the SDAF is performed by DSAA. All accounts use approved DoD general ledger accounts and automated accounting systems in accordance with Title 2. DSAA's accounting

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

responsibilities are scheduled to be transferred to the Defense Finance and Accounting Service during FY 1993.

KEY ACCOUNTING CHANGES

During FY 1992, several key accounting changes were implemented. Although these changes were not completely separate and discrete from each other, they fall into three general categories: Credit Reform; SDAF Accounting; and SDAF Inventory.

CREDIT REFORM. During FY 1992, new accounting procedures prescribed by the Credit Reform Act of 1990 were implemented. These changes included the transfer of \$1,900 million of obligated and unobligated balances and \$8,897 million of loans and accounts receivable balances from the Foreign Military Financing Grants Account (11X1082) to the Foreign Military Loan Liquidating Account (11*4121). In addition, two new accounts, the Foreign Military Financing Program Account (11X1085) and the Foreign Military Financing Direct Loan Financing Account (11*4122), were established.

SDAF ACCOUNTING. Beginning with FY 1992, SDAF implemented within its existing accrual accounting process, an accounting procedure that more closely matches the actual operation of the fund. This procedure, known as the 'completed contract method of accounting,' recognizes that a single procurement contract represents a discrete aggregation of effort which best embodies the recordable activity of the fund, and that final costs on a procurement contract cannot be determined until the contract is legally complete and closed. Upon contract closure, all expenses are matched with the appropriate revenues.

SDAF INVENTORY. The SDAF inventory valuation was based on actual amounts reported by the Military Departments since these assets are controlled and managed by these agencies. This method of reporting replaced the previous method, which included both the constructive work-in-process and inventory held by the Military Departments.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

Department/Agency: Department of Defense
 Reporting Entity: Defense Security Assistance Agency 11X4116
STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1992
 (In Thousands)

ASSETS	1992
1. Financial Resources:	
a. Fund Balances with Treasury (Note 2)	\$ 884,132
b. Cash (Note 2)	
c. Foreign Currency (Note 2)	
d. Other Monetary Assets (Note 3)	
e. Investments, Non-Federal (Note 4)	
f. Accounts Receivable, Net - Non-Federal	
g. Inventories Held for Sale, Net (Note 5)	179,387
h. Loans Receivable, Net - Non-Federal (Note 6)	
i. Advances and Prepayments, Non-Federal	
j. Property Held for Sale (Note 7)	
k. Other, Non-Federal (Note 8)	
l. Intragovernmental Items:	
(1) Accounts Receivable, Federal	24,881
(2) Loans Receivable, Federal	
(3) Investments, Federal (Note 4)	
(4) Other, Federal	
m. Total Financial Resources	----- 1,088,400 -----
2. Non-Financial Resources:	
a. Resources Transferable to Treasury	
b. Inventories Not Held for Sale (Note 5)	
c. Property, Plant and Equipment, Net (Note 9)	
d. Other (Note 10)	
e. Total Non-Financial Resources	----- 0 -----
3. Total Assets	\$ 1,088,400 -----

The accompanying notes are an integral part of these statements.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

LIABILITIES	1992
4. Funded Liabilities:	
a. Accounts Payable, Non-Federal	\$ 8,353
b. Accrued Interest Payable	
c. Accrued Payroll and Benefits	
d. Accrued Entitlement Benefits	
e. Lease Liabilities (Note 11)	
f. Debt (Note 12)	
g. Guarantees Payable (Note 6)	
h. Other Funded Liabilities, Non-Federal (Note 13)	7,360
i. Intragovernmental Liabilities	
(1) Accounts Payable, Federal	2,687
(2) Debt (Note 12)	
(3) Deferred Revenue	
(4) Other Funded Liabilities, Federal (Note 13)	
j. Total Funded Liabilities	----- 18,400 -----
5. Unfunded Liabilities:	
a. Accrued Leave	
b. Lease Liabilities (Note 11)	
c. Pensions and Other Actuarial Liabilities (Note 14)	
d. Other Unfunded Liabilities (Note 15)	
e. Total Unfunded Liabilities	----- 0 -----
6. Total Liabilities	\$ 18,400 -----
NET POSITION	
7. Fund Balances: (Note 16)	
a. Revolving Fund Balances	\$
b. Trust Fund Balances	
c. Appropriated Fund Balances	1,070,000
d. Total Fund Balances	----- 1,070,000
8. Less Future Funding Requirements (Note 17)	-----
9. Net Position (Note 16)	1,070,000
10. Total Liabilities and Net Position	\$ 1,088,400 -----

The accompanying notes are an integral part of these statements.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

Department/Agency: Department of Defense
 Reporting Entity: Defense Security Assistance Agency 11X4116
STATEMENT OF OPERATIONS (AND CHANGES IN NET POSITION)
FOR THE PERIOD ENDED SEPTEMBER 30, 1992
 (In Thousands)

REVENUES AND FINANCING SOURCES (See notes 1E and 1R)		1992
1.	Appropriations Expensed	\$
2.	Revenues from Sales of Goods and Services	
	a. To the Public	142,007
	b. Intragovernmental	
3.	Interest and Penalties, Non-Federal	
4.	Interest, Federal	
5.	Taxes (Note 18)	
6.	Other Revenues and Financing Sources (Note 19)	
7.	Less: Taxes and Receipts Returned to the Treasury	(1,864)
8.	Total Revenues and Financing Sources	----- 140,143 -----
EXPENSES		
9.	Cost of Goods or Services Sold	
	a. To the Public	132,052
	b. Intragovernmental	
10.	Program or Operating Expenses (Note 20)	
11.	Depreciation	
12.	Bad Debts and Writeoffs	8,091
13.	Interest	
	a. Federal Financing Bank/Treasury Borrowing	
	b. Federal Securities	
	c. Other	
14.	Other Expenses (Note 21)	
15.	Total Expenses	----- 140,143 -----
16.	Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Adjustments	0
17.	Plus (Minus) Adjustments:	
	a. Extraordinary Items (Note 22)	
	b. Prior Period Adjustments (Note 22)	
18.	Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	0
19.	Plus: Unfunded Expenses	
20.	Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses	\$ 0
21.	Net Position, Beginning Balance	\$ 0
22.	Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	0
23.	Plus (Minus) Equity Transfers	
24.	Net Position, Ending Balance	\$ ----- 0 -----

The accompanying notes are an integral part of these statements.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

Department/Agency: Department of Defense
 Reporting Entity: Defense Security Assistance Agency 11X4116
 STATEMENT OF CASH FLOWS (INDIRECT METHOD)
 AS OF SEPTEMBER 30, 1992
 (In Thousands)

	1992
Cash Flows from Operating Activities:	
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	\$ -----
Adjustments affecting Cash Flow:	
2. Appropriations Expensed	(290,883)
3. Decrease (Increase) in Accounts Receivable	(19,121)
4. Decrease (Increase) in Loans Receivable	
5. Decrease (Increase) in Other Assets	
6. Increase (Decrease) in Accounts Payable	(143)
7. Increase (Decrease) in Debt	
8. Increase (Decrease) in Other Liabilities	254,405
9. Depreciation and Amortization	
10. Other Unfunded Expenses	
11. Other Adjustments	-----
12. Total Adjustments	(55,742)
13. Net Cash Provided (Used) by Operating Activities	(55,742)
Cash Flows from Non-Operating Activities:	
14. Proceeds from Sales of Investments	
15. Proceeds from Sales of Property, Plant, and Equipment	
16. Purchases of Investments	
17. Purchases of Property, Plant and Equipment	
18. Net Cash Provided (Used) by Non-Operating Activities	----- 0 -----

The accompanying notes are an integral part of these statements.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES		1992
19. Appropriations (Current Warrants)	\$	
20. Add:		
a. Restorations		
b. Transfers of Cash From Others		
21. Deduct:		
a. Withdrawals		
b. Transfers of Cash To Others		1,864
22. Net Appropriations		----- (1,864) -----
23. Borrowing from the Public		
24. Repayments on Loans		
25. Borrowing from the Treasury and the Federal Financing Bank		
26. Repayments on Loans from the Treasury and the Federal Financing Bank		
27. Other Borrowings and Repayments		-----
28. Net Cash Provided (Used) by Financing Activities		----- (1,864) -----
29. Net Cash Provided (Used) by Operating, Non-Operating and Financing Activities		(57,606)
30. Fund Balances with Treasury, Cash, and Foreign Currency, Beginning		----- 941,738 -----
31. Fund Balances with Treasury, Cash, and Foreign Currency, Ending	\$	----- 884,132 -----

The accompanying notes are an integral part of these statements.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

Department/Agency: Department of Defense
 Reporting Entity: Defense Security Assistance Agency 11X4116
 STATEMENT OF BUDGETED AND ACTUAL EXPENSES
 FOR THE PERIOD ENDED SEPTEMBER 30, 1992
 (In Thousands)

Program Name(s)	BUDGET			ACTUAL Expenses
	Total Resources	Obligations		
		Direct	Reimbursed	
11X4116	\$ 884,853	\$ 274,333	\$	\$ 140,143
Totals	\$ <u>884,853</u> *****	\$ <u>274,333</u> *****	<u>0</u> *****	\$ <u>140,143</u> *****

Budget Reconciliation

A. Total Expenses	\$ 140,143
B. Add:	
(1) Capital Acquisitions	
(2) Loans Disbursed	
(3) Other Expended Budget Authority	290,883
C. Less:	
(1) Depreciation and Amortization	
(2) Unfunded Annual Leave Expense	
(3) Other Unfunded Expenses	141,813
D. Expended Appropriations	<u>289,213</u>
E. Less Reimbursements	235,284
F. Expended Appropriations, Direct	\$ <u>53,929</u> *****

The accompanying notes are an integral part of these statements.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

FY 1992 ANNUAL FINANCIAL STATEMENT DEFENSE SECURITY ASSISTANCE AGENCY

NOTES TO THE PRINCIPAL STATEMENTS

Note 1. Significant Accounting Policies.

A. REPORTING ENTITY.

DEFENSE SECURITY ASSISTANCE AGENCY (DSAA). The DSAA was established as a separate agency of the Department of Defense (DoD) to administer the nation's Security Assistance Programs. In fulfilling this mission, DSAA has administrative responsibility for the Foreign Military Sales (FMS) Trust Fund, the Special Defense Acquisition Fund (SDAF), the Foreign Military Loan Liquidating Account (FMLLA), and the Foreign Military Financing Direct Loan Financing Account (FMFDLFA). Also, there are other financial accounts that comprise the remainder of the military components of Security Assistance.

FMS TRUST FUND, TREASURY SYMBOL CODE 8242. The FMS Trust Fund was established as a means of facilitating the purchases of U.S. defense articles and services by foreign countries, as authorized in the Arms Export Control Act (AECA). The Trust Fund provides a vehicle through which the United States Government processes foreign country funds required for FMS case payments to U.S. contractors for new procurement, and to components for sales from DoD stocks.

SPECIAL DEFENSE ACQUISITION FUND (SDAF), TREASURY SYMBOL CODE 4116. The SDAF was authorized by the International Security and Development Cooperation Act of 1981. The SDAF is to be used as a revolving fund under the control of the DoD to finance the acquisition of defense articles and services in anticipation of their transfer (pursuant to the AECA, the Foreign Assistance Act (FAA), or other legislation) to eligible foreign nations and international organizations. The SDAF account is reimbursed through sales and transfers of items carried in the account.

FOREIGN MILITARY FINANCING PROGRAM ACCOUNT (FMFPA), TREASURY SYMBOL CODE 1085. The Credit Reform Act establishment of this appropriated fund account is to provide the funding necessary to finance the subsidy element of the loan program. Expenditures from this account finance the subsidy element of direct loan disbursements and are transferred into the Foreign Military Financing Direct Loan Financing Account (4122) to make required loan disbursements for approved FMS or commercial sales. For the purpose of this report, FMFPA accounting transactions, to the extent they are relevant to the 4122 account, are included in the data reported for the 4122 account.

FOREIGN MILITARY LOAN LIQUIDATING ACCOUNT (FMLLA), TREASURY SYMBOL CODE 4121. The Credit Reform Act consolidated into this symbol: all assets, liabilities, and equities for loan balances previously recorded in accounts 11*1082, 11M1083, 11M1084, and 11X4121. This account disburses funds previously made available and accounted via the above referenced accounts.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

FY 1992 ANNUAL FINANCIAL STATEMENT DEFENSE SECURITY ASSISTANCE AGENCY

FOREIGN MILITARY FINANCING DIRECT LOAN FINANCING ACCOUNT (FMFDLFA), TREASURY SYMBOL CODE 4122. The Credit Reform Act resulted in the establishment of this account to provide the vehicle for making disbursements of Foreign Military Loan funds for approved procurements and for subsequent collection of debt service due for the loans. The account uses permanent borrowing authority from the Treasury combined with transfers of appropriated funds from account 1085 to make the required disbursements for loan recipient countries for their FMS or commercial procurements. Receipts of debt service payments from borrowers are used to repay the borrowings from Treasury.

B. ACCOUNTING STANDARDS.

These financial statements are presented in accordance with the DoD Accounting Manual, which prescribes the accrual basis as the basis of accounting to be used by DoD Components.

C. BUDGETARY ACCOUNTING PRACTICES.

The FMS program operates using contract authority. Contract authority is statutory authority to incur obligations prior to an appropriation (or the realization of revenues) for the future payment of such obligations. For the FMS program, 82 Statute 1323 (22 U.S.C. 2762) establishes its permanent indefinite authority. The total value of implemented cases is the only limiting factor in the total amount of obligations that can be incurred.

The SDAF is a revolving budget account. Congress enacts an annual program authority amount that is available for obligation for a three year period. Money to finance the approved annual program comes from sales and transfers of items purchased by the fund.

D. BASIS OF ACCOUNTING.

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

E. REVENUES AND OTHER FINANCING SOURCES.

While the Congress appropriates some funds to finance portions of the Security Assistance Program via the Foreign Military Financing appropriation, the majority of sales are funded from customers' funds.

In accordance with the DoD Acting Chief Financial Officer's memorandum of August 31, 1992, the FMS Trust Fund does not recognize nor report revenue. Funds collected into the Trust Fund are in advance of the performance of services or sale of goods. Since

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

FY 1992 ANNUAL FINANCIAL STATEMENT DEFENSE SECURITY ASSISTANCE AGENCY

various DoD components actually perform the services and sell the goods, recognition of revenue and expense occurs in the financial statements of the applicable DoD components. The financing source for both FMLLA and FMFDLFA are Congressional appropriations.

F. ACCOUNTING FOR INTRA-GOVERNMENTAL ACTIVITIES.

The Security Assistance Program, as an activity of DoD, interacts with, and is dependent upon, other financial activities of the government as a whole. In FY 1992, the Department or its Components sold assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Customers are required to make payments, in advance, to the FMS Trust Fund. The Trust Fund then reimburses, directly or indirectly, the Military Services for the cost of administering and executing the sales program. The indirect reimbursement is in the form of allowing the Military Services to cite the Trust Fund on appropriate budgetary and expenditure documents. During fiscal year 1992, the Trust Fund reimbursed the Military Services in the amount of \$12,439,844 thousand for assets and services sold under the FMS Program.

G. FUNDS WITH U.S. TREASURY AND CASH.

There are several banking relationships involved in administering, and fiduciary responsibilities associated with, the accounting for security assistance funds. Some funds are held in treasury accounts, others are with the Federal Reserve Bank, and still others are with commercial banks. As of September 30, 1992, the Security Assistance Program has a balance of \$8,775,587 thousand in the U.S. Treasury, and \$6,676,847 thousand on deposit with the Federal Reserve Bank and other commercial banks.

H. FOREIGN CURRENCY.

All payments and collections involved in the Security Assistance Program are accounted for in U.S. Dollars.

I. ACCOUNTS RECEIVABLE.

As presented in the consolidated statement of financial position, accounts receivable includes accounts, claims, and refunds receivable. The Security Assistance Program, as of September 30, 1992, has a net accounts receivable as follows:

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

Dollars in Thousands (\$ X 000)

ACCOUNTS	AMOUNT	TOTAL
<u>RECEIVABLE</u>		<u>NET</u>
Government	\$ 25,932	\$ 25,932
Public	8,971,509	8,971,509
Refunds	0	0
Claims	0	0
Total	\$8,997,441	\$8,997,441

The FMS Trust Fund's \$8,602,243 thousand portion of the public receivable is based upon its requirement to bill in advance of providing goods and services as established in the Arms Export Control Act of 1976. The amount billed to customers on DD Form 645, adjusted for both special bill arrangements and individual cases that have collections in excess of financial requirements, is the basis for the trust fund's accounts receivable value.

J. LOANS RECEIVABLE.

Loans are accounted for as receivable after funds have been disbursed. The amount of loans obligated but not disbursed are disclosed in Note 6.

K. INVENTORIES.

The FMS Trust Fund has no inventory. Items are either delivered directly to the FMS customer from the contractor, or in the case of FMS sales from U.S. stocks, they are retained as inventory in the procurement or stock fund accounts of the military departments until transferred to the ownership of the foreign customer.

Inventory in SDAF is controlled and managed by the various military departments. The SDAF inventory value is acquisition cost as reported to the DSAA by the military department. See Note 5 for specific information.

L. INVESTMENTS IN U.S. GOVERNMENT SECURITIES.

The Security Assistance Program does not invest in U.S. government securities.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

M. PROPERTY AND EQUIPMENT.

The funds and accounts that make up the Security Assistance Program have no property or equipment values. For the FMS trust fund, this policy was established by the DoD Acting Chief Financial Officer memorandum of August 31, 1992.

N. PREPAID AND DEFERRED CHARGES.

The prepayment for SDAF represents payments made to contractors where inventory has not yet been delivered. All payments are posted as a pre-paid asset. FMS trust fund 'progress payments to contractors' are accounted for by using the constructive delivery method and, accordingly, are identified as an expenditure at the time of payment.

O. BORROWINGS PAYABLE TO TREASURY.

The FMLLA portion of the Security Assistance Program has borrowed funds from the Treasury for disbursement under a valid loan program. Detailed information concerning borrowing is identified in Note 16.

P. CONTINGENCIES.

The Security Assistance Program is obligated for goods and services, which have been ordered but not yet received (i.e., undelivered orders) as of September 30, 1992, in the amount of \$23,083,293 thousand. Within that total, \$22,676,383 thousand is attributable to the FMS trust fund and \$406,910 thousand is attributable to SDAF.

Neither the FMS Trust Fund nor the SDAF is a party to any administrative proceedings, legal actions, or any other types of claims.

Q. ACCRUED LEAVE.

No fund included in these statements records any accrual of unpaid leave.

R. EQUITY.

The FMS Trust Fund has no net position. In his memorandum of August 31, 1992, the DoD Acting Chief Financial Officer stated that the FMS Trust Fund is a trust fund requiring DoD to act in a fiduciary capacity on behalf of its customers. All revenue, expense, and operational reporting for the program is the responsibility of the Military Departments. Accordingly, the FMS Trust Fund accounts only for dollars in and dollars out on a cash basis and has no net position.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

FY 1992 ANNUAL FINANCIAL STATEMENT DEFENSE SECURITY ASSISTANCE AGENCY

Equity in SDAF is not to exceed the capitalized amount of \$1,070,000 thousand. Any excess resulting from operation of the fund is transferred to the miscellaneous receipts account.

The FMFDLFA equity position consists of unexpended appropriations. The FMLLA and SDAF equity positions consist of invested capital. All equity information is contained in Note 16.

S. COMPARATIVE DATA.

Comparative data for the prior year has not been presented because this is the first year for which financial statements are prepared using the Office of Management and Budget format and would require a complete recasting of prior year's data. In future years, comparative data will be presented in order to provide an understanding of changes in the financial position and operations of the Department's reporting activities.

Note 2. Fund Balances with Treasury, Cash and Foreign Currency.

Dollars in Thousands (\$ X 000)

A. Fund Balances with Treasury.

(1)	Trust Funds	\$6,516,948
(2)	Revolving Funds	2,208,491
(3)	Appropriated Funds	50,148
(4)	Other Fund Types	
	Total	\$8,775,587

B. Cash.

(1)	Restricted Cash	\$7,000
(2)	Unrestricted Cash	6,669,847
	Total	\$6,676,847

C. Foreign Currency.

\$0

D. Other Information.

\$1,324,359 thousand of A(2) is attributable to 11X4121. Account 11X4121 is not a revolving fund, but it is a liquidating fund. Treasury instructed DSAA to classify 11X4121 as a revolving fund.

The \$50,148 thousand on A(3) is included in the 1121085 account and is applicable to 11X4122. DSAA was instructed by Treasury to classify these funds as appropriated.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

The value stated in B(2) is for the FMS Trust Fund. There are several banking relationships involved in administering, and fiduciary responsibility, of security assistance funds. Some funds are held in treasury accounts, others are held by the Federal Reserve Bank, and still others are held by commercial banks. Cash balances are in agreement with the September 30, 1992, Treasury, Federal Reserve Bank, and commercial bank balances.

Note 3. Other Monetary Assets.

The Security Assistance Program has no other monetary assets.

Note 4. Investments. NONE

Note 5. Inventories.

A. Inventory Categories.

Dollars in Thousands (\$ X 000)

<u>Inventory Categories</u>	<u>Inventory Amount</u>	<u>Allowance for Losses</u>	<u>Inventory, - Net</u>	<u>Valuation Method</u>
(1) Inventory Held for Sale	\$179,387	\$ 0	\$179,387	e
(2) Inventory Not Held for Sale				
(a) Material and Goods for Own Use	0	0	0	
(b) Stockpile Materials	0	0	0	
(c) Other	0	0	0	
Subtotal	0	0	0	
Total	<u>\$179,387</u>	<u>\$ 0</u>	<u>\$179,387</u>	

B. Restrictions on Inventory Use, Sale, or Disposition.

SDAF inventory must be used for transfers in security assistance programs unless approved by SECDEF for sale to Military Departments.

C. Other Information.

All inventory belongs to SDAF. The valuation, as reported by the military departments, is the acquisition cost of items on hand at installation level not identified to a specific sale to a foreign customer.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

Note 6. Loans and Loan Guarantees. Non Federal.

A. The entity operates the following loan and/or loan guarantee programs.

- | | |
|--|---|
| (1) Pre-1992 Direct Loan Obligations - | DSAA Direct Loans |
| (2) Pre-1992 Direct Loan Obligations - | DSAA Rescheduled Loans (Direct Portion) |
| (3) Pre-1992 Direct Loan Obligations - | DSAA Rescheduled Loans (Guaranty Portion) |
| (4) Pre-1992 Direct Loan Obligations - | FFB Loans |
| (5) Pre-1992 Direct Loan Obligations - | Subrogated Defaulted FFB Loans |
| (6) Pre-1992 Direct Loan Obligations - | Subrogated Defaulted Refinanced Loans |
| (7) Pre-1992 Loan Guarantees - | Refinanced Loans |
| (8) Pre-1992 Loan Guarantees - | Commercial Bank Loans |

B. Direct Loans Obligated Prior to FY 1992.

Dollars in Thousands (\$ X 000)

LOAN PROGRAMS	LOAN RECEIVABLE, GROSS	ALLOWANCE FOR ESTIMATED UNCOLLECTIBLE LOANS	LOAN RECEIVABLE, NET
(1) See Para A (1)	\$4,123,549	\$ 0	\$4,123,549
(2) See Para A (2)	215,594	0	215,594
(3) See Para A (3)	497,522	0	497,522
(4) See Para A (4)	4,344,273	0	4,344,273
(5) See Para A (5)	38,800	0	38,800
(6) See Para A (6)	0	0	0
TOTAL	\$9,219,738	\$ 0	\$9,219,738

C. Direct Loans Obligated after FY 1991. NONE

D. Defaults on Pre-1992 Loan Guarantees. NONE

NOTE. FFB loans are considered Direct Loans; however, \$38,800 thousand of loan principal was defaulted to FFB by various countries and DSAA paid FFB the defaulted principal.

E. Defaults on Post-1991 Loan Guarantees. NONE

F. Liability for Loan Guarantees. NONE

NOTE. DSAA expects to collect 100% of its defaulted guaranty loans.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

G. Subsidy Expense for Post-1991 Loans and Loan Guarantees.

(1) Current Year's Direct Loans.

Dollars in Thousands (\$ X 000)

	<u>Loan Programs</u>	<u>Interest Differ ential</u>	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total</u>
(a) FY 1992 -						
FMFDLFA		\$25,985	\$24,117			\$50,102

(2) Prior Year's Direct Loans. NONE

(3) Total Direct Loan Subsidy Expenses.

Dollars in Thousands (\$ X 000)

	<u>Loan Programs</u>	<u>Total</u>
(a) FY 1992 -		
FMFDLFA		\$50,102
(4) Current Year's Loan Guarantees.		NONE
(5) Prior Year's Loan Guarantees.		NONE
(6) Total Loan Guarantees Subsidy Expense.		NONE

H. Administrative Expense. NONE

I. Other Information.

(1) Other Disclosures. Of the \$9.2 billion of Loans Receivable reported in Note 6.B., a portion is currently in default and is primarily attributable to a few foreign borrowers that, for the foreseeable future, lack the ability to repay. These borrowers account for 98 percent of principal and interest defaults in excess of three years and 99 percent of defaults in excess of one year. The debts related to these foreign governments have and will continue to accrue interest (Accounts Receivable) until such time as they are repaid, officially rescheduled, or legislation is enacted to forgive the debt. A table of pertinent information related to the status of Loans and Accounts Receivable follows.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

Dollars in Thousands (\$ X 000)

<u>Description</u>	<u>Loans Receivable (Principal)</u>	<u>Accounts Receivable (Interest)</u>
Total Loans / Accounts Receivable	\$9,219,738.5	\$369,265.9
Problem Borrowers	435,323.4	255,086.3
Other Borrowers	8,784,415.1	114,179.6
Total Payments in Default	\$112,583.3	\$253,616.5
Problem Borrowers	108,184.7	246,359.1
Other Borrowers	4,398.6	7,257.4
Defaults - Three Years or More	\$12,120.4	\$89,041.6
Problem Borrowers	12,120.4	87,488.8
Other Borrowers	0.0	1,552.8

(2) Accounting Changes. During FY 1992, new accounting procedures prescribed by the Credit Reform Act of 1990 were implemented. These changes included the transfer of \$1,900 million of obligated and unobligated balances and \$8,897 million of loans and accounts receivable from the Foreign Military Financing Grant Account (11*1082) to the Foreign Military Loan Liquidating Account (11X4121). In addition, two new accounts, the Foreign Military Financing Program Account (11*1085) and the Foreign Military Financing Direct Loan Financing Account (11X4122) were established.

(3) Guaranteed Loans. Following is the status of DSAA Guaranteed Loans.

Dollars in Thousands (\$ X 000)

<u>Description</u>	<u>Amount</u>
* Face Value of Guaranteed Refinanced Loans	\$8,173,192
* DSAA Guaranteed Portion of Refinanced Loans (90% of Face Value)	7,355,873
* Portion of Refinanced Loans Secured by Country Deposits in the Financing Bank (10% Face Value)	817,319
** Face Value of Guaranteed Commercial Bank Loans	40,000
** DSAA Guaranteed Portion of Commercial Bank Loans (100% Face Value)	40,000

(4) Undisbursed Direct Loans. The undisbursed balance available for new Direct Loans Receivable is \$1,324,359,027.

Note 7. Property Held For Sale. NONE

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

Note 8. Other Financial Resources -- Non-Federal. NONE

Note 9. Property, Plant, and Equipment, Net. NONE

Note 10. Other Non-Financial Resources. NONE

Note 11. Leases. NONE

Note 12. Debt.

Dollars in Thousands (\$ X 000)

<u>Description</u>	<u>Beginning Balance</u>	<u>New Borr- owing</u>	<u>Repay- ments</u>	<u>Ending Balance</u>	<u>Refin- ance</u>
A. Gross Fed Debt: NONE	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
B Inter- governmental Debt:					
(1) Borrowing from the Treasury	0	0	0	0	0
(2) Borrowing from Federal Financing Bank	\$4,599,970	0	\$255,697	\$4,344,273	0
(3) Borrowing from Other Federal Agencies	0	0	0	0	0
Total Inter- governmental Debt	<u>\$4,599,970</u>		<u>\$255,697</u>	<u>\$4,344,273</u>	<u>0</u>
C. Total Debt	<u>\$4,599,970</u>	<u>\$0</u>	<u>\$255,697</u>	<u>\$4,344,273</u>	<u>\$0</u>

Note 13. Other Funded Liabilities.

Dollars in Thousands (\$ X 000)

<u>A. Other Funded Liabilities</u>	<u>Non- Federal</u>	<u>Federal</u>	<u>Total</u>
(1) FMS Trust Fund	\$21,608,001	\$ 0	\$21,608,001
(2) SDAF	7,360	0	7,360
(3) FMLLA	0	68,937	68,937
(4) FMFDLFA -- Estimated liability from borrowings to be made	0	294,898	294,898
(5) FMFDLFA -- Liability for subsidy related to undisbursed loans	0	50,102	50,102
Total	<u>\$21,615,361</u>	<u>\$413,937</u>	<u>\$22,029,298</u>

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

B. Other Information.

(1) The FMS Trust Fund value represents the net amount billed to and unpaid by the foreign customer. This practice is based upon the Arms Export Control Act of 1976 requirement to bill in advance of performance of services and issuance of goods. Amount is value expected to be expended by U.S. government on behalf of foreign customer.

(2) The SDAF value represents excess collections from customers over disbursements.

(3) The FMFDLFA value represents future repayments of borrowings from Treasury for credit reform loans.

Note 14. Pensions and Other Actuarial Liabilities. NONE

Note 15. Other Unfunded Liabilities. NONE

Note 16. Fund Balances.

Dollars in Thousands (\$ X 000)

Description	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended				
Appropriations	\$1,324,359	\$ 0	\$ 0	\$1,324,359
B. Invested Capital	6,252,794	0	46	6,252,840
C. Cumulative Results of Operations	0	0	0	0
D. Donations	0	0	0	0
E. Transfers	0	0	0	0
F. Total	\$7,577,153	\$ 0	\$ 46	\$7,577,199

G. Other Information.

(1) \$1,070,000 thousand of B. is attributable to SDAF. Any excess generated from the operation of the fund is returned to the Treasury miscellaneous receipts account. In FY 1992, \$1,864 thousand was returned to Treasury.

(2) FMLLA is not considered a revolving fund. It is a liquidating fund. It is being classified as a revolving fund since the Treasury is classifying it as a revolving fund for the SF 220 reports. All of A. and \$5,182,794 thousand of B. are attributable to FMLLA.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

**FY 1992 ANNUAL FINANCIAL STATEMENT
DEFENSE SECURITY ASSISTANCE AGENCY**

Note 17. Future Funding Requirements. NONE

Note 18. Taxes. NONE

Note 19. Other Revenue and Financing Sources. NONE

Note 20. Program and Operating Expenses.

All expenses (\$50,102 thousand) are other subsidy expenses incurred by the FMFDLFA.

Note 21. Other Expenses. NONE

Note 22. Extraordinary Items and Prior Period Adjustments. NONE

Note 23. Transfers (and Donations). NONE

Note 24. Intrafund Eliminations. NONE

Note 25. Other Disclosures. NONE

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT: 4116

Title Gain or Loss on Cases Closed During the Fiscal Year

DOLLARS IN THOUSANDS (\$ X 000)

FY 1992 ACTIVITY:	<u>TOTAL</u>
GROSS VALUE (GAIN)	\$9,722.3
UNSELLABLE INVENTORY ASSETS WRITTEN OFF	-8,091.0
NET GAIN	<u>\$1,631.3</u>

FY 1991 ACTIVITY:	<u>TOTAL</u>
VALUE (GAIN)	\$11,156.7

Narrative

This performance indicator is based on cases closed and profit realized during the Fiscal Year. During FY 1992 the value of \$1,863,949.08 was returned to the U.S. Treasury as profit. The comparable value for FY 1991 was \$11,156,744.47

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PROGRAM PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title	Number of Purchase Orders Issued, New and Revised	
FY 1992 ACTIVITY		<u>TOTAL</u>
MILITARY PURCHASE ORDERS ISSUED (MIPRs)		376
FY 1991 ACTIVITY		<u>TOTAL</u>
MILITARY PURCHASE ORDERS ISSUED (MIPRs)		275

Narrative

This performance indicator includes new Purchase Orders (MIPRs) that were issued with current and prior year obligation authority and revisions to existing Purchase Orders. The FY 1991 position is included for comparison.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PROGRAM PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title Number of Purchase Orders Closed

FY 1992 ACTIVITY

Age in Years	<u>TOTAL</u>
0-3	17
4-6	95
7-9	348
10+	19
TOTAL	<u>479</u>

FY 1991 ACTIVITY

Age in Years	<u>TOTAL</u>
0-3	0
4-6	1
7-9	1
10+	0
TOTAL	<u>2</u>

Narrative

This shows the number of Purchase Orders that were closed during FY's 1991 and 1992 and the relative age. The increase in activity between the Fiscal Year 1991 and 1992 was due to maturing orders and increased management oversight.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA FINANCIAL PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title OPERATING RESULTS (GAIN OR LOSS ON CASES CLOSED)

WHOLE DOLLARS (\$)

FY 1992 ACTIVITY		<u>TOTAL</u>
Net Profit Returned to U S Government Treasury		\$1,863,949 08

FY 1991 ACTIVITY		<u>TOTAL</u>
Net Profit Returned to U S Government Treasury		\$11,156,744 47

Narrative

The FY 1992 profit returned is a net figure following a \$8,091,000 write-off of unsellable inventory
There were no write-offs during FY 1991

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA FINANCIAL PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title **FINANCIAL OBLIGATIONS**

DOLLARS IN THOUSANDS (\$ X 000)

FY 1992 END OF YEAR POSITION		<u>TOTAL</u>
Assets		\$1,088,400.0
Liabilities		18,400.0
Equity		<u>\$1,070,000.0</u>
Current Ratio (Current Assets to Current Liabilities)		59 : 1
FY 1991 END OF YEAR POSITION		<u>TOTAL</u>
Assets		\$1,081,532.0
Liabilities		11,182.0
Equity		<u>\$1,070,000.0</u>
Current Ratio (Current Assets to Current Liabilities)		96 : 1

Narrative

These ratios indicate that the Special Defense Acquisition Fund, Account 4116 is very sound financially. The fund has more than enough assets to cover its liabilities.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA FINANCIAL PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title **FINANCIAL CONDITION: Asset and Liability Accounts Balances and Ratio**

DOLLARS IN THOUSANDS (\$ X 000)

FY 1992 YEAR END POSITION	<u>TOTAL</u>
ASSETS	
Cash / Fund Balance with Treasury	\$884,132 0
Inventory	179,367 0
Advances and Prepayments	0 0
Accounts Receivable, Federal	24,881.0
TOTAL ASSETS	<u>\$1,088,400 0</u>
LIABILITIES	
Accounts Payable, Non-Federal	\$8,353 0
Other Liabilities	7,360.0
Accounts Payable, Federal	2,687.0
TOTAL LIABILITIES	<u>\$18,400 0</u>
Current Ratio (Current Assets to Current Liabilities)	59 . 1
FY 1991 YEAR END POSITION	<u>TOTAL</u>
ASSETS	
Cash / Fund Balance with Treasury	\$941,738 0
Inventory	63,289 0
Advances and Prepayments	70,745 0
Accounts Receivable, Federal	5,760.0
TOTAL ASSETS	<u>\$1,081,532.0</u>
LIABILITIES	
Accounts Payable, Non-Federal	\$5,763 0
Other Liabilities	.0
Accounts Payable, Federal	5,419.0
TOTAL LIABILITIES	<u>\$11,182 0</u>
Current Ratio (Current Assets to Current Liabilities)	96 : 1

Narrative:

All assets and liabilities are considered "current" such that there are no "long term" accounts.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA FINANCIAL PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title OPERATING COSTS

DOLLARS IN THOUSANDS (\$ X 000)

	<u>TOTAL</u>
FY 1992 End of Year Position	
Net Operating Costs	
Revenues and Reimbursements	\$140,143.0
Less Total Expenses and Losses	<u>140,143.0</u>
Results of Operations (Profit)	\$0.0
FY 1991 End of Year Position	
Net Operating Costs	
Revenues and Reimbursements	\$114,850.0
Less Total Expenses and Losses	<u>114,850.0</u>
Results of Operations (Profit)	\$0.0

Narrative

Results of operations (Profit/Loss) are determined annually During FY 1992, and before the September 30 1992 accounting position was determined \$1,863,949.08 was returned to the U S Treasury as a net profit The net profit for FY 1991 was \$11,156,744.47

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA FINANCIAL PERFORMANCE INDICATORS - PART I"

SPECIAL DEFENSE ACQUISITION FUND, ACCOUNT 4116

Title **REIMBURSEMENT OF DoD FOR ARTICLES AND SERVICES**

DOLLARS IN THOUSANDS (\$ X 000)

FY 1992 ACTIVITY, END OF YEAR POSITION	<u>TOTAL</u>
COLLECTIONS	\$235,283 9
DISBURSEMENTS	\$291,025 5
FY 1991 ACTIVITY, END OF YEAR POSITION	<u>TOTAL</u>
COLLECTIONS	\$289,342 3
DISBURSEMENTS	\$167,996 1

Narrative

During the year collections were received through the FMS Trust Fund from foreign customers and from DoD Agencies for articles and services sold from the SDAF. Disbursements were to commercial contractors or DoD agencies.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT: 4116

Title **New Purchase Orders Issued**

FISCAL YEAR 1992 ACTIVITY:

Types of Orders Issued:	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>NSA</u>	<u>OTHER</u>	<u>TOTAL</u>
Major End Items	27	5	5	5		42
Support for Major End Items	4	2	17			23
Investments		1				1
Ammunition						0
Miscellaneous / Other					2	2
TOTAL	31	8	22	5	2	68

FISCAL YEAR 1991 ACTIVITY:

Types of Orders Issued	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>NSA</u>	<u>OTHER</u>	<u>TOTAL</u>
Major End Items	13	6				19
Support for Major End Items	22	4				26
Investments	4	4				8
Ammunition	9					9
Miscellaneous / Other	9	12		1		22
TOTAL	57	26		1		84

Narrative

This indicator compares the number of new purchase orders placed during FY 1991 and FY 1992. Purchase Orders, in the form of Military Interdepartmental Purchase Orders (MIPRs), are issued by DSAA to the Military Department or DOD Agency that is responsible for the procurement of the item.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT: 4116

Title: Value of Purchase Orders Issued

DOLLARS IN MILLIONS (\$ X 000 000)

FY 1992 ACTIVITY:	<u>TOTAL</u>
VALUE OF MILITARY PURCHASE ORDERS ISSUED (MIPRs)	\$538 0
FY 1991 ACTIVITY:	<u>TOTAL</u>
VALUE OF MILITARY PURCHASE ORDERS ISSUED (MIPRs)	\$322 0

Narrative:

This indicator contrasts the total dollar value of the Purchase Orders issued during each fiscal year

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT: 4116

Title Value of Purchase Orders Closed

DOLLARS IN THOUSANDS (\$ X 000)

FY 1992 ACTIVITY:		<u>TOTAL</u>
Closed Purchase Orders		600.800 0

FY 1991 ACTIVITY:		<u>TOTAL</u>
Closed Purchase Orders		2.580 3

Narrative

This performance indicator shows the value of Purchase Orders Closed during FY 1992 and FY 1991

" "

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT: 4116

Title Value of Obligations Liquidated, Fiscal Year End Position

DOLLARS IN MILLIONS (\$ X 000,000)

FY 1992 ACTIVITY:	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>OTHER</u>	<u>TOTAL</u>
VALUE	\$211.8	\$51.6	\$20.7	\$6.9	\$291.0

FY 1991 ACTIVITY:	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>OTHER</u>	<u>TOTAL</u>
VALUE	\$79.5	\$37.9	\$29.8	\$20.9	\$168.0

Narrative:

This performance indicator shows the value of obligations liquidated, i.e., disbursements made during FY 1991 and FY 1992

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT 4116

Title: Value of New Obligations

DOLLARS IN MILLIONS (\$ X 000,000)

	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>OTHER</u>	<u>TOTAL</u>
FY 1992 ACTIVITY: VALUE	\$172.0	\$80.4	\$9.8	\$12.1	\$274.3
FY 1991 ACTIVITY: VALUE	\$206.3	\$44.8	\$1.0	\$21.6	\$273.8

Narrative

This performance indicator measures new obligations placed during FY 1992 and contrasts the same activity for FY 1991

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT 4116

Title Ratio of Unsold Purchases to Total Fund Authority as of Fiscal Year End

DOLLARS IN MILLIONS (\$ X 000,000)

FY 1992 ACTIVITY - SEPTEMBER 30, 1992 POSITION: UNSOLD PURCHASES (FINISHED INVENTORY)	<u>TOTAL</u> \$179.4
TOTAL FUND AUTHORITY	\$1,070.0
RATIO	16.8%
FY 1991 ACTIVITY - SEPTEMBER 30, 1991 POSITION: UNSOLD PURCHASES (OBLIGATIONS)	<u>TOTAL</u> \$422.1
TOTAL FUND AUTHORITY	\$1,070.0
RATIO	39.4%

Narrative

This performance indicator's ratio is calculated by dividing the value of unsold purchases by the total of fund authority provided under U. S. Statute

The FY 1991 position was a "constructive" inventory position, while the FY 1992 value is a physical inventory as submitted by the Military Departments. While both fiscal years are correct, they are not comparable since different valuation methods were used to determine each

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT 4116

Title Value of Unsold Purchases (Material/Inventory) as of Fiscal Year End

DOLLARS IN MILLIONS (\$ X 000,000)

September 30, 1992 Position:	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>NSA</u>	<u>OTHER</u>	<u>TOTAL</u>
VALUE	\$128.6	\$44.1	\$3.3	\$3.3	\$0.0	\$179.4

September 30, 1991 Position	<u>ARMY</u>	<u>NAVY</u>	<u>USAF</u>	<u>NSA</u>	<u>OTHER</u>	<u>TOTAL</u>
VALUE	\$242.5	\$100.1	\$24.8	\$5.7	\$49.0	\$422.1

Narrative

This performance indicator shows the actual value of finished inventory unsold and held as of the end of the fiscal year. The FY 1991 position was a "constructive" inventory position, while the FY 1992 value represents a physical inventory as submitted by the Military Departments. While both fiscal years are correct, they are not comparable since different valuation methods were used to determine each.

FY 1992 Annual Financial Statements Special Defense Acquisition Fund

"DSAA PERFORMANCE INDICATORS - PART V"

ACCOUNT: 4116

Title: Value of Sales

DOLLARS IN MILLIONS (\$ X 000,000)

FY 1992 ACTIVITY:

Type Sale and Customer	ARMY	NAVY	USAF	NSA	OTHER	TOTAL
FMS CASES	\$111.4	\$97.1	\$33.4	\$6.1		\$248.0
REPLENISHMENT						0.0
DIRECT	0.2			0.7		0.9
TOTAL	\$111.6	\$97.1	\$33.4	\$6.8		\$248.9

FY 1991 ACTIVITY:

Type Sale and Customer:	ARMY	NAVY	USAF	NSA	OTHER	TOTAL
FMS CASES	\$133.8	\$34.5	\$3.5	\$5.3		\$177.1
REPLENISHMENT	2.0	5.5		1.1		8.6
DIRECT	10.1	0.3		9.6		19.9
TOTAL	\$145.9	\$40.3	\$3.5	\$15.9		\$205.6

Narrative

This indicator shows the dollar value of Purchase Orders Sold and is stratified into three types of sales. FY 1992 and FY 1991 variances represent normal activity.

DEFINITIONS:

FMS CASES: Sales to foreign customers or U.S. Military Departments through either Letters of Offer/Acceptance (LOA's) or "reverse" Military Interdepartmental Purchase Request (MIPRs)
REPLENISHMENT: Sales to U.S. Military Departments to replenish their inventories
DIRECT: Sales to U.S. Military Departments approved by SECDEF.

Part VI - Management Comments

Comptroller, Department of Defense Comments



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

JUN - 4 1993

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, ODDIG

SUBJECT: Draft Reports on Internal Controls and Compliance with Laws and Regulations for the Special Defense Acquisition Fund for FY 1992 (Project No. 2FA-2013) and the Foreign Military Sales Trust Fund's Financial Statements for FY 1992 (Project No. 2FD-2005)

Two DoDIG memorandums, dated May 17, 1993, forwarded the subject draft reports to the DoD Chief Financial Officer; the Director, Defense Security Assistance Agency; and the Director, Defense Finance and Accounting Service.

Attached are the Department's comments on the subject draft reports.

- Attachment 1 contains comments on the draft report on the Special Defense Acquisition Fund (Project No. 2FA-2013).

- Attachment 2 contains comments on the draft report on the Foreign Military Sales Trust Fund (Project No. 2FD-2005).

Mr. Oscar Covell is the staff contact for this office. He may be reached at 697-6149.


Alvin Tucker
Acting Chief Financial Officer

Attachments

cc: DSAA
DFAS

CHIEF FINANCIAL OFFICER COMMENTS ON
DRAFT REPORTS ON INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND
REGULATIONS FOR THE SPECIAL DEFENSE ACQUISITION FUND FOR FY 1992
(PROJECT NO. 2FA-2013)

* * * * *

Recognition of Profit. Concur. The Special Defense Acquisition Fund (SDAF) uses the completed contract method of accounting. This method, which is not in compliance with the DoD Accounting Manual, requires that revenues, cost of sales, and profits be recognized at the time the applicable Foreign Military Sales (FMS) case is closed rather than when goods are delivered to the ordering activity.

It must be recognized that the SDAF is in the process of being permanently disestablished. Effective with FY 1994, SDAF receipts, up to \$266 million, are to be deposited in the Miscellaneous Receipts Account of the Treasury. Also effective with FY 1994, obligational authority for the SDAF is not expected to be provided by OMB--obligational authority was not requested by DSAA for FY 1994. Since the fund is being disestablished, it would appear prudent, and cost beneficial, that changes to the accounting system be limited to those that are absolutely necessary, or cost effective. A change from the completed contract method, to one that recognizes revenues, cost of sales, and profits at the time goods are delivered to the ordering activity does not appear to meet that criteria.

Account Offsets. Concur that the balances in the "Advances to Contractors" account and the balances in the "Unearned Revenue account" were inappropriately offset. DFAS will take action to separately disclose, via footnote, both the amount advanced to contractors and the amount of unearned revenues in the financial statements. This action is targeted for completion by June 15, 1993.

Concur that SDAF financial statements should disclose the value of the work-in-process. DFAS will footnote the FY 1992 financial statements on or before June 15, 1993, to disclose the value of the work-in-process.

Accounting System. Concur that the SDAF system is not a double-entry accounting system and does not compute major account balances. The accounting system changes implemented in August 1992, referenced in the draft report, were considered initial improvements to the general ledger. Further system changes to properly classify all accounts are planned, and, to the extent cost beneficial or cost effective, are expected to be staffed, by the Defense Finance and Accounting Service (DFAS) prior to September 30, 1993.

Comptroller, Department of Defense Comments

Additionally, concur that expenditures identified by the auditors as representing assets to the Fund were not reported in the financial statements. DFAS will footnote the FY 1992 financial statements to correct this condition.

Standard Operating Procedures. Concur that written standard operating procedures do not exist for (1) recording accounts receivable, (2) valuing fiscal year-end inventory, (3) recognizing revenues and expenses in the proper accounting period, and (4) ensuring computer user manuals and system descriptions were available. DFAS will take action to establish written procedures for these items by November 1, 1993.

Concur that the fund records do not show the amounts that are due to the Fund from the Military Departments, and from customers under sales cases with deferred collection schedules. However, the DSAA is not aware of any receivables due from the Military Departments. DFAS will revise the FY 1992 financial statements to reflect proper recordation of receivables from customers under sales cases with deferred collection schedules.

Nonconcur with the DoDIG's assertion that the accuracy of the end-of-year inventory value of \$179.0 million is questionable. The auditors have not offered any evidence that the value of the inventory is other than that reported by the Military Departments.

As previously stated in the response to the "Recognition of Profit" finding, the SDAF uses the completed contract method for accounting. Under that method, revenues and expenses are recognized at the time an FMS case is closed. The adoption of a different method of accounting for the SDAF for the sole purpose of establishing cut-off dates for income and expense recognition--as would be required if revenues and expenses were recognized when goods are delivered to an ordering activity--would serve little useful purpose since the fund is being disestablished.

Comptroller, Defense Security Assistance Agency Comments



DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

03 JUN 1993

In reply refer to:
I-002920/93

**MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE,
DEPARTMENT OF DEFENSE, INSPECTOR GENERAL**

**SUBJECT: Draft Reports on Internal Controls and Compliance with
Laws and Regulations for the Special Defense
Acquisition Fund for FY 1992 (Project No. 2FA-2013)**

**Reference: Inspector General, Financial Management Directorate,
Memorandum of 17 May 93, same subject**

DSAA understands that the audit was required by the Chief Financial Officers Act of 1990 to report on the adequacy of internal controls, internal control weakness, and compliance with laws and regulations. We note that you made no recommendations in either Part II or Part III of the reference above.

The referenced memorandum requested comments on Parts II and III of the draft audit report. Our comments are in three categories: (1) agree with specific audit findings, (2) disagree with specific audit findings, and (3) unable to comment on specific audit findings due to a lack of sufficient data in the draft report. Also included are comments and discussion of issues that may be answered by the Department of Defense Chief Financial Officer (DoD CFO) or the Director, Defense Finance and Accounting Service (DFAS).

DSAA disagrees with your decision not to render an opinion on the compliance of the Fund's equity with the capitalization limit. While differing from your preferred technique in the timing of recognition of revenue and gain/loss, the accounting system accurately represents the financial condition of the Fund. Fund balances were available, and you could render an opinion concerning the adherence to implemented policies.

PART II - INTERNAL CONTROLS:

ACCOUNTING SYSTEM. Disagree. DSAA determined that the completed contract method of accounting most accurately represented the financial status of the SDAF, as Congress defined and codified it in Section 51 of the Arms Export Control Act. The SDAF is a revolving fund, separate from other accounts, for the procurement of long lead military articles and services. Unlike other revolving funds which replenish 3-4 times per year, the SDAF replenishes itself only every 4-6 years and, because of that, may experience extreme variances in yearly revenue and gain/loss, which could be dependent on our timing of their recognition. Therefore, we believe that the completed contract accounting

Comptroller, Defense Security Assistance Agency Comments

methodology, accruing at the point of FMS case closure, is most reflective of the true financial status of the fund at any point in time.

Management determined that case closure is the point at which sufficient accounting data are available to reasonably recognize revenue and gain/loss, consistent with the completed contract method of accounting. Even at that time, actual cost of goods sold is not finalized if the buy-in contract is incomplete or waiting a DCAA audit. Many SDAF procurements are lines on DoD contracts and these contracts may not be closed for up to 15 years. The offsetting or netting of disbursements is recognized in this accounting method.

The DoD Accounting Manual does not address a method of accounting that specifically fits the purpose of the fund as created by Congress, but does permit the use of a differing accounting system if the standard system cannot produce the desired data display. The completed contract method is a generally accepted method of accounting used in commercial accounting, and was recognized in resolution of the last audit of the SDAF. However, midway in FY 1992 (Jan 21, 1992), DoD issued accounting guidance for revolving funds, with DBOF as its example, directing accrual accounting at time of performance or inventory. DBOF, however, has not satisfied the Congress or the DODIG as to the successful implementation of these policies and procedures. The SDAF accounting has not adjusted to that guidance, nor at this time is a change in accounting methodology advantageous to the financial management of the fund. With the Administration's decision to eliminate obligation authority for FY 1994 and beyond, and to withdraw the FY 1994 collections, a major change in the accounting methodology is neither warranted nor prudent. Footnotes will, however, be provided for inclusion in the financial statements to reflect the values for advances to contractors and unearned revenue accounts, and a computed work in process value.

END OF YEAR INVENTORY VALUATION. Disagree. DSAA issued a message (Tab A) with specific directions on the valuation and reporting of year end inventory to the military departments in August 1992. Those directions were to report all "inventory on hand completed, unsold (not on implemented cases), with unit acquisition cost, extended acquisition cost per line of materiel, and total acquisition cost...Included as on hand are those unsold completed goods which a contractor may be storing for the SDAF." These directions are quite clear as to inventory valuation and what items should be counted.

DSAA did review the input from the Military Departments, as evidenced by the Air Force and NSA listings which included items that had been written off as unsalable at the end of FY 1992. These items were removed by DSAA from the totals prior to transmitting the data to DFAS-DE for inclusion in the CFO reports.

Comptroller, Defense Security Assistance Agency Comments

With regard to inventory valuation, DSAA did not need to perform physical inventory counts or sampling. Per the DoD 5105.38-M, the Military Departments have custodial responsibility for maintaining the inventory - SDAF materiel is under the same inventory control system as the rest of DoD, with significant numbers of SDAF items co-mingled with DoD stock. This is advantageous for turnover of stock and shelf life considerations, as well as from both operational and management control aspects. As the Military Departments perform physical counts, SDAF items are included in the sampling. Procedures are documented in DoD 5105.38-M, chapter 14, for investigating and reporting missing major items in accordance with DoD 7200.10-M. During the past 10 years the Military Departments have shipped equipment at our direction without reporting any missing major items. In stock issuance of non-major items, if an SDAF item is temporarily short due to inventory loss, the Military Departments have replaced the item or paid the SDAF via a reverse MIPR. Since there has never been a loss, there is no cost benefit to DSAA in requiring additional inventory accountability than currently exists.

The end of year inventory valuation intentionally did not include items allocated to implemented cases that were not delivered as of 30 Sep 92. Per DoD 5105.38-M, those items, if on hand, would have as part of the case acceptance, deposits in the total amount of the SDAF investment. Therefore, the CFO reports reflects this value within cash revenues. With the implementation of the case and the deposit, the item becomes part of the 8242 account vice the 4116 account.

DIVERSION TO MILITARY DEPARTMENTS. Disagree due to insufficient data. DoD 5105.38-M requires Military Departments to have written loan agreements for use of SDAF materiel with signatures from both the Military Department and DSAA. At the end of FY 1992, no items were in a loan status with any Military Department, so no accounts receivable were required. If the SDAF assets were being used, it was without authorization; any instance should be specifically documented in the audit for follow-up and institution of the accounts payable. Without the specific incidences of this documented in the draft audit report, materiality of the DoDIG's finding cannot be ascertained.

DEFERMENT OF COLLECTIONS. Disagree due to insufficient data. DSAA did not authorize the deferment of any collections beyond the anticipated disbursement rate. Specific documentation should be provided in the audit to substantiate this allegation.

REVERSE MIPRS. Agree. In the August - September 1992 timeframe an internal DSAA review found that over 400 reverse MIPRS had not been closed, with associated profits not returned to Treasury as excess capitalization. Database input and testing was initiated immediately to add this category of sale to the computations for the return to Treasury. Testing was completed and 15 reverse MIPRS were closed with \$1M returned to Treasury, however, the

Comptroller, Defense Security Assistance Agency Comments

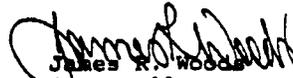
time remaining before the end of the fiscal year was insufficient to complete more than the test MIPRs. Subsequently, all totally collected reverse MIPRs have been closed in the database, and any excess collections will be recomputed at the end of FY 1993 for return to Treasury. This finding, however, has no economic impact since the funds for these transactions were already deposited in a separate U.S. Treasury account available for its use.

TIMING OF CLOSURE CUT-OFF. Agree. Cases which were closed in September 1992 by DFAS were not included in the database universe used in computation of year-end excess capitalization due to the timing of computer update cycles at DSAA and DFAS-DE. DSAA concurs with your views, but no materiel loss occurred since the funds were still available in the Treasury for use by the U.S. Government. The net of cases closed in September 1991 (used in computation of year end excess capitalization) and those closed in September 1992 (not used in the year end computation), was 12 cases representing \$1.77M of excess capitalization, which will be returned as part of the transfer to Treasury at the end of FY 93. For the end of FY 1993 we will manually update the database to reflect cases closed during September 1993, enabling the computation of any year end excess capitalization for cases closed by DFAS-DE during FY 1993 only.

STANDARD OPERATING PROCEDURES. Partially agree. Standard operating procedures will be prepared and issued to supplement guidance in the DoD 5105.38-M on inventory reporting and recognition of revenue consistent with the accounting system in place.

PART III - COMPLIANCE WITH LAWS AND REGULATIONS:

Refer to the third paragraph of this memorandum, above, which contains comments on the audit as a whole, and to comments included in Part II - Internal Controls for a discussion of compliance with laws and regulations presented in the draft report.


James R. Woods
Comptroller

Attachment:
As stated