OFFICE OF THE INSPECTOR GENERAL

DOD EDUCATION BENEFITS FUND
FINANCIAL STATEMENT FOR FY 1994

Report No. 94-165

June 30, 1994

Department of Defense

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Acronyms

DAO	Defense Accounting Office
DFAS	Defense Finance and Accounting Service
DMDC	Defense Manpower Data Center
DVA	Department of Veterans Affairs
JFMIP	Joint Financial Management Improvement Program
MGIB	Montgomery GI Bill
OMB	Office of Management and Budget

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

June 30, 1994

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

SUBJECT: Audit Report on the DoD Education Benefits Fund Financial Statements for FY 1993 (Report No. 94-165)

We are providing this report for your information and use and for use by the Congress. Financial statement audits are required by the Chief Financial Officers Act of 1990. Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," requires the Inspector General, Department of Defense, to express an opinion on the financial statements and report on the adequacy of internal controls and compliance with laws and regulations. We issued a draft report of Part II, "Internal Controls," and Part III, "Compliance With Laws and Regulations," on April 29, 1994.

The financial statements did not fairly present the financial position or results of operations of the DoD Education Benefits Fund. Therefore, we are expressing an adverse opinion. The financial statements did not include at least $650.8 million in accrued liabilities that the DoD expects to pay for education benefits. Also, the financial statements did not show the status of over $182.4 million that the DoD transferred to the Department of Veterans Affairs in FY 1993 and the $29.2 million of DoD capital on the Department of Veterans Affairs accounting records. Part I explains our opinion in more detail.

Part II discusses the lack of internal controls for obtaining accounting data from the Department of Veterans Affairs, ensuring the accuracy of contributions, maintaining program eligibility data, and enforcing eligibility requirements. Part III discusses improper accounting for liabilities, U.S. Treasury bonds, separation bonus payments, expenses, and contributions; missing elements in the Overview and Footnotes to the Principal Statements; and the lack of an adequate Internal Management Control Program. This report contains no recommendations that are subject to resolution in accordance with DoD Directive 7650.3; accordingly, comments are not required.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 604-9109 (DSN 664-9109), or Mrs. Saundra G. Elion, Project Manager, at (703) 604-9113 (DSN 664-9113). The distribution of this report is listed in Part IV, Appendix C. A list of audit team members is inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 94-165 **June 30, 1994**
(Project No. 3FH-2013)

DOD EDUCATION BENEFITS FUND FINANCIAL STATEMENTS FOR FY 1993

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires an annual audit of financial statements for funds such as the DoD Education Benefits Fund (the Fund). In FY 1993, the Fund received $37.8 million in contributions from the Services and Reserve components and $48.7 million in interest income from U.S. Treasury bonds. It transferred $182.4 million to the Department of Veterans Affairs (DVA) to pay benefits to about 153,000 participants. As of September 30, 1993, the Fund's investment assets were $581.4 million. The Under Secretary of Defense for Personnel and Readiness was designated the Fund manager on April 29, 1994.

Objectives. The objectives of the audit were to determine whether the Fund's FY 1993 financial statements were presented fairly in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We evaluated the internal control structure established for the Fund and assessed compliance with applicable laws and regulations that could have a material effect on the financial statements. Also, we identified improvements to the financial statement process that could provide beneficial data to program managers and other users of financial statements and followed up on the conditions noted in our audit of the Fund's FY 1992 financial statements.

Scope and Methodology. We examined the financial statements as of and for the year ended September 30, 1993. They included the Overview and Footnotes to the four Principal Statements: Statement of Financial Position, Statement of Operations (and Changes in Net Position), Statement of Cash Flows, and Statement of Budget and Actual Expenses. The statements upon which our opinion is based are in Part V. They were provided to us on June 23, 1994. We made limited reviews of general and application controls to test the reliability of computer-processed data. To the extent we reviewed that data, we concluded it was sufficiently reliable to meet our audit objectives. The Air National Guard did not provide information to update its contribution and eligibility procedures, therefore, we did not assess the Air National Guard's internal controls.

Independent Auditor's Opinion. The financial statements did not fairly present the financial position or the results of operations of the Fund. Therefore, we are expressing an adverse opinion on the financial statements. Our audit disclosed that at least $650.8 million of accrued liabilities were excluded from the Statement of Financial Position. In addition, the statements did not fully disclose the status of $182.4 million that the DoD transferred to the DVA or $29.2 million of DoD capital on the DVA accounting records. Such data provides an indication of the soundness of the Fund.

Internal Controls. Internal controls were not adequate to ensure that the financial statements were free of material errors. Specifically, the DoD did not require the DVA to report on the status of funds transferred to that agency, Reserve components'

contributions were inconsistent and inaccurate, the DoD provided inaccurate and untimely eligibility data to the DVA, and the Army and the Navy had different eligibility requirements for members receiving "kicker" benefits. The "kicker" benefits are additional benefits offered to encourage recruits to enlist in specialties that are difficult to fill.

Compliance With Laws and Regulations. Fund operations generally complied with applicable laws and regulations. (See Part IV, Appendix A, for the applicable laws and regulations tested.) Exceptions were that the Defense Finance and Accounting Service (DFAS) did not record $650.8 million of accrued liabilities for the Fund, amortized premiums on U.S. Treasury bonds to the call date instead of the maturity date, incorrectly reduced expenses by $2.8 million for separation bonuses, incorrectly reported $1.1 million of benefit expenses, and incorrectly accounted for a $353,000 overcontribution as FY 1993 revenue; the Overview and Footnotes did not adequately describe Fund operations and accounting policies; and DoD Components did not have adequate Internal Management Control Programs for the Montgomery GI Bill.

Followup on Prior Audit Issues. The Services' and Reserve components' contribution procedures and the financial reporting practices of the DVA were discussed in our report on the Fund's FY 1992 financial statements and a subsequent performance audit report. However, those issues were not resolved in the FY 1993 statements and are therefore included in this report.

Management Comments and Audit Response to Management Comments. In response to a draft report of Part II, "Internal Controls," and Part III, "Compliance With Laws and Regulations," issued on April 29, 1994, we received comments from three organizations. Part VI contains the full text of management comments.

The Office of the Under Secretary of Defense for Personnel and Readiness stated that by March 1995 it will establish procedures to obtain financial data from the DVA; that the Office of the DoD Actuary does not base projections on the DoD Accounting Manual; and that it will validate $1.6 million the DVA charged to the Fund for some individuals receiving education benefits as a separation bonus. Those actions should correct the noted conditions. As requested, the statement that the actuarial projections were based on the DoD Accounting Manual was deleted in the final report.

The DFAS agreed that the value of education benefits earned should be reported as a liability and the purchase price of U.S. Treasury bonds should be disclosed. It nonconcurred with our suggested accounting method for U.S. Treasury bonds, that a $353,000 overcontribution by the Army be reported as deferred income, and that some Footnotes were inadequate. We disagreed with the DFAS, since Federal accounting standards require Federal agencies to amortize premiums to maturity dates. Also, the Army's overcontribution should be reported as deferred income. Footnotes should state the source of the accounting principles and provide a better description of accounts receivable.

The Office of the Assistant Secretary of Defense for Reserve Affairs stated that issues pertaining to Reserve components' contributions should not be reported since those issues were reported in Audit Report No. 94-052 and DoD Instruction 1322.17 is being revised. Also, the Defense Manpower Data Center provides Reserve components listings that can be used to verify the accuracy of the eligibility data. We included those issues because contributions were not accurate during FY 1993. Until DoD has consistent policies for making contributions and controls to ensure the accuracy of the eligibility data base, we must report those issues as internal control weaknesses.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

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

Adverse Opinion

The Defense Finance and Accounting Service (DFAS) did not include a liability for the actuarial present value of benefits earned in the financial statements or include a footnote to the financial statements on the actuarial valuation of the DoD Education Benefits Fund (the Fund). As a result, liabilities were understated and the net position was overstated. We cannot quantify the effect on those accounts on the FY 1993 financial statements since DoD's actuaries had not completed the FY 1993 valuation of the Fund by June 15, 1994. However, as of September 30, 1992, the present value of education benefits totaled $650.8 million. We believe that the FY 1993 actuarial valuation will materially impact the FY 1993 liabilities and net position.

The DoD had not established requirements for the Department of Veterans Affairs (DVA) to report accounting data. As a result, the DoD did not know how the $182.4 million transferred to the DVA in FY 1993 was used by that agency. In addition, the DoD was not aware of the status of the $29.2 million of DoD capital the DVA established for the Fund. We believe that accounting data is needed to provide the status of Fund resources and operations.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the financial statements do not present fairly, in conformity with the other comprehensive basis of accounting described in Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, the financial position of the DoD Education Benefits Fund (the Fund) as of September 30, 1993, or the results of operations, cash flows, or budget and actual expenses for the year then ended.

Background

The Veterans Assistance Act of 1984, Public Law 98-525 (codified in 10 U.S.C. Chapter 106 for Selected Reserve and 38 U.S.C. Chapter 30 for active duty Services) established the DoD Education Benefits Fund (the Fund) to finance education benefits for active and reserve military personnel. That law was later renamed the Montgomery GI Bill (MGIB).

During FY 1993, the Fund financed the MGIB benefits for members of the Selected Reserve, "kicker" benefits for active duty members, and basic benefits for active duty members who enlisted before July 1, 1985, and who became eligible for the MGIB as a bonus to separate from the Services. The Army, Navy, and Marine Corps offer "kicker" benefits to encourage recruits to enlist in Military Occupational Specialities that are difficult to fill. The Air Force does not offer "kicker" benefits.

In FY 1993, the Fund received $37.8 million in contributions from the Services' and Reserve components' appropriations and $48.7 million in interest income from U.S. Treasury bonds. It transferred $182.4 million to the DVA to pay benefits to about 153,000 participants. As of September 30, 1993, the

Fund's investment assets were $581.4 million. On April 29, 1994, the Deputy Secretary of Defense designated the Under Secretary of Defense for Personnel and Readiness as the Fund manager. Although active duty members pay $1,200 to obtain the MGIB benefits, those payments are transferred to the U.S. Treasury and are not part of the Fund.

The Chief Financial Officers Act requires an annual audit of funds such as the DoD Education Benefits Fund. The DFAS prepares the Fund's principal statements and footnotes and manages the investments in U.S. Treasury bonds. The Fund manager prepared the Overview. Our responsibility is to express an opinion on the financial statements based on our examination.

Scope and Methodology

We examined the Overview, Principal Statements, and Footnotes to the Principal Statements of the DoD Education Benefits Fund as of and for the year ended September 30, 1993. The Principal Statements include the Statement of Financial Position, Statement of Operations (and Changes in Net Position), Statement of Cash Flows, and Statement of Budget and Actual Expenses. The statements upon which our opinion is based were transmitted to us on June 23, 1994. Part V of this report contains a copy of those financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, including the accompanying overview and footnotes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements.

Scope of the Review of Internal Controls. We updated our FY 1992 client profile and cycle memorandums and assessed the internal controls over contributions and eligibility, treasury functions, expenditures, and financial reporting. We documented the contributions and eligibility process for the Army and the Marine Corps.

We performed various reviews to determine the reliability of computer-processed data provided to us. We limited our review of general and application controls for computer-processed data to tracing transactions through the accounting system, observing operations, conducting interviews, and verifying the balances of securities to Department of the Treasury reports. We also performed limited reviews of other systems that generated payment and accounting data. We compared contributions made to listings of 6-year contracts, and for expenditures we compared DoD eligibility data for the MGIB to the DVA Target System. Of the 1,399 DVA records reviewed, 185 had inconsistent eligibility data provided by DoD (see Part II, "Internal Controls," for details). To the extent that we reviewed the computer-processed data, we concluded that they are sufficiently reliable to meet the audit objectives.

Scope of the Review of Compliance With Laws and Regulations. As part of our examination to obtain reasonable assurance that the Fund's financial

statements were free of material misstatements, we performed tests of compliance with the laws and regulations listed in Part IV, Appendix A. At the Defense Accounting Office (DAO) Arlington, Virginia, we traced the Statement of Financial Position and Statement of Operations line-item account balances to the general ledger trial balances and reviewed accounting transactions to determine whether the transactions were valid, accurate, and properly classified and recorded in accordance with the other comprehensive basis of accounting.

We reviewed the Overview and Footnotes to determine compliance with OMB Bulletin No. 94-01. We also reviewed the DVA general ledger trial balances and the procedures used to determine the amounts to bill the Fund. To assess compliance with DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, we obtained and reviewed available assurance statements from the DAO Arlington and the DoD offices responsible for managing the MGIB.

Limitations on Scope of Review. Scope limitations occur when restrictions are placed on the audit examination. The restrictions, which may be imposed by management or by circumstances such as the timing of the audit tests or the ability to obtain sufficient competent evidence, may require auditors to qualify their opinion or disclaim an opinion. Although the scope of our review was limited by several factors, none of those factors prevented us from expressing an opinion. Those factors that were limitations on the scope of our review follow.

o We did not receive a legal representation letter from the Fund manager, as requested.

o The management representation letter provided by the Deputy Assistant Secretary of Defense for Requirements and Resources did not contain several key assurances. That office failed to provide assurance that:

o accounting and nonaccounting systems used to produce the Principal Statements met DoD and OMB standards,

o regulatory agencies or auditors had communicated instances of noncompliance with deficiencies in financial reporting practices having a material affect on the financial statements,

o all material liabilities had been accrued or disclosed,

o account balances used to prepare the financial statements were accurate, and

o adjustments made to the account balances were fully documented.

o We did not receive an update to the Air National Guard's procedures for making contributions to the Fund and for establishing the MGIB eligibility for its members. We also did not receive a list of individuals for whom the Air National Guard made contributions to the Fund during FY 1993.

o We did not evaluate the DVA's compliance with Public Law 97-365, "Debt Collection Act of 1982," since that evaluation should be performed by the Office of the Inspector General, DVA.

Time Period and Locations. This financial statement audit was made during the period July 1993 through June 1994. We believe our audit efforts provide a reasonable basis for our results. A complete list of the locations we visited or contacted is in Part IV, Appendix B.

Auditing Standards

We conducted our audit in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and OMB Bulletin No. 93-06, "Audit Requirement for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatements. We relied on the guidelines suggested by the General Accounting Office and our professional judgment in assessing the materiality of matters impacting the fair presentation of the financial statements and related internal control weaknesses.

Accounting Principles

Accounting principles and standards for the Federal Government remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General; who are principals of the Joint Financial Management Improvement Program (JFMIP). Specific standards agreed on by those three officials are issued by the Director, OMB, and the Comptroller General.

Until accounting standards that will govern all aspects of financial statement reporting have been issued, which will constitute "generally accepted accounting principles for the Federal Government," agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements." The hierarchy constitutes an "other comprehensive basis of accounting" to be used for preparing Federal agency financial statements. A summary of the hierarchy defined and approved by the JFMIP Principals, follows:

o standards agreed to and published by the JFMIP Principals,

o form and content requirements of the OMB,

o accounting standards contained in agency accounting policy guidance, and

o accounting principles published by other authoritative sources.

To date, three accounting standards have been published by the JFMIP Principals, so most accounting standards for the DoD's "other comprehensive basis of accounting" are contained in DoD accounting policy guidance. The DoD accounting guidance is primarily DoD 7220.9-M, "DoD Accounting Manual" (DoD Accounting Manual). During FY 1993, the Comptroller of the Department of Defense (DoD Comptroller) updated portions of the DoD Accounting Manual and incorporated those sections into a new regulation, DoD 7000.14-R, "DoD Financial Management Regulation" (DoD Financial Regulation).

The DoD Financial Regulation will eventually serve as the single DoD-wide financial management regulation for use by all DoD Components for accounting, budgeting, finance, and financial management education and training. In the interim, unless superseded by published Federal accounting standards or requirements of the OMB, the policy contained in the DoD Accounting Manual or in the DoD Financial Regulation, as applicable, is the authoritative basis for preparing financial statements in accordance with an "other comprehensive basis of accounting."

Additional Information

The Overview to the Fund's FY 1993 financial statements did not comply with OMB guidance. Fund operations, condition of the Fund, and performance measures were not clear or concise. Based on OMB guidance, the Overview should describe Fund management, entitlement to benefits financed by the Fund, and recent changes to legislation. Performance measures should include the number of individuals eligible to receive benefits, the number of individuals who received benefits, the amount of benefits, and the number of individuals for whom DoD does not know the eligibility status.

Part II - Internal Controls

Introduction

We examined the internal control structure of the DoD Education Benefits Fund (the Fund) for the year ended September 30, 1993. The Fund finances DoD's liabilities under the Montgomery GI Bill (MGIB). Management and operation of the Fund is decentralized and involves the Services and Reserve components.

On April 29, 1994, the Deputy Secretary of Defense designated the Under Secretary of Defense for Personnel and Readiness as the Fund manager. (That office is referred to as the Fund manager in this report.) The Fund manager has responsibility for establishing DoD policy for the MGIB and for managing the active duty MGIB program. While the Assistant Secretary of Defense for Reserve Affairs establishes policy for and manages the Reserve MGIB program, the Comptroller of the Department of Defense establishes accounting, budgeting and funding policy for the Fund. Accounting and investing for the Fund is done by the Defense Accounting Office (DAO) Arlington, Virginia, a division of the Defense Finance and Accounting Service (DFAS) Cleveland Center. The Department of Veterans Affairs (DVA) is responsible for making education benefit payments to eligible individuals and collecting any overpayments. Various offices within the Services and Reserve components are responsible for managing the MGIB and making contributions to the Fund.

The DoD Components are responsible for establishing and maintaining an internal control structure for the Fund. In fulfilling that responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that the following are met:

o transactions are properly recorded and accounted for to allow the preparation of reliable financial statements and to maintain accountability over assets;

o funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation;

o transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and any other laws and regulations that the Office of Management and Budget (OMB), Fund management, or the Inspector General, Department of Defense, has identified as being significant for which compliance can be objectively measured and evaluated;

o data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information; and

o questions are answered as to whether performance measures existed and whether those performance measures were adequate to enable the Fund to fulfill its purpose.

Objective

The audit objective was to determine whether the internal controls over the Fund were adequate to ensure that the financial statements were free of material error. In planning and performing our audit of the Fund, we evaluated the Fund's internal control structure, including implementation of the DoD Internal Management Control Program. The purposes of the evaluation were to:

o determine our auditing procedures for expressing an opinion of the financial statements and

o determine whether the internal control structure was established to ensure that the statements were free of material misstatements.

That determination included obtaining an understanding of the internal control policies and procedures, as well as assessing the level of control risk relevant to all significant cycles, classes of transactions, and account balances. For those significant control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective.

For the purposes of this report, we have classified the significant internal controls, policies, and procedures into the following categories: contributions and eligibility, treasury, expenditures, and financial reporting. The DoD offices did not report the conditions noted in this report in their Annual Statements of Assurance for FY 1993.

Prior Audit Coverage

The Office of the Inspector General, Department of Defense, issued Audit Report No. 93-137, "DoD Education Benefits Trust Fund Financial Statements for FY 1992," June 30, 1993. We disclaimed an opinion on those financial statements because management did not provide representation letters. That report said that controls over contributions were inadequate and that the DoD had not established requirements for the DVA to report accounting data. That report did not include recommendations.

The Office of the Inspector General, Department of Defense, Audit Report No. 94-052, "Contributions and Financial Reporting for the DoD Education Benefits Trust Fund," March 11, 1994, provided more details on the internal control weaknesses addressed in Audit Report No. 93-137. That report included recommendations for corrective actions. The Comptroller of the Department of Defense agreed to clarify contribution requirements in volume 4, chapter 15, section 4, of the draft "DoD Financial Management Regulation," and the Assistant Secretary of Defense for Reserve Affairs agreed to modify its instructions to comply with the Comptroller's requirements. The Under

Secretary of Defense for Personnel and Readiness agreed to include financial reporting requirements in a memorandum of understanding with the DVA. Action is expected to be completed by March 1995.

The General Accounting Office issued Report No. AFMD-90-30, "DoD and VA Need to Improve Operation of the Montgomery GI Bill Reserve Program," August 1990. That report stated that the DoD did not report timely and accurate eligibility data to the DVA, contributions to the Fund were inaccurate, the per capita's normal cost calculated by the Office of the DoD Actuary was unreliable, and neither the DoD nor the DVA collected penalties owed by program participants. The DoD partially concurred with the findings and recommendations. Collection of penalties remains an open issue and is being negotiated with DoD managers through the audit mediation process.

We identified several of those same conditions during this audit. Findings related to those conditions are repeated in this report to show the impact of the conditions on the FY 1993 financial statements.

Results of Audit

Internal controls were not adequate to ensure that the financial statements were free of material errors. We consider those internal control weaknesses to be material and reportable conditions under standards established by OMB Bulletin No. 93-06. We believe, however, that the entity's internal control structure meets our internal control audit objectives.

Reportable Conditions. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our opinion, 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 reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors would be in amounts that would be material to the statements being audited, or material to a performance measure or aggregation of related performance measures, and not be detected within a timely period by employees in the normal course of performing their functions.

Conditions Noted. Internal controls over financial reporting, contributions, and program eligibility were inadequate to ensure that the financial statements were free of material errors. The DoD had not developed requirements for the DVA to report accounting data, issued conflicting guidance on when Reserve components should make contributions, and did not provide accurate or timely eligibility data to the DVA.

Financial Reporting. The DVA has not reported accounting data on the status of the funds transferred to it from the Fund. That occurred because the DoD had not established requirements for the DVA to report such accounting

data. As a result, the DoD did not have financial information on how the DVA used the $182.4 million that it transferred to the DVA, the status of the $29.2 million of DoD capital on DVA's accounting records as of September 30, 1993, or sufficient information to identify that the DVA may have inappropriately charged the Fund $1.6 million for some Service members who received the MGIB benefits as a separation bonus. The charges appear to include benefits paid to service members that joined the Service after June 30, 1985, and should be financed by the DVA. Without adequate accounting data, the DoD does not have sufficient information to manage the Fund.

The internal control weaknesses over financial reporting were reported in our prior audit reports, No. 93-137 and No. 94-052. The Fund manager agreed to include financial reporting requirements in a memorandum of understanding with the DVA. The Fund manager estimates that the memorandum of understanding with the DVA will be completed by March 1995.

Without adequate accounting data, the DoD does not have sufficient information to manage the Fund. That accounting data will provide important information on the soundness of the Fund, on the DVA debt collection procedures, and will give the DoD sufficient detail to evaluate the timeliness and accuracy of eligibility data given to the DVA as well as make actuarial projections.

Contributions to the Fund. Reserve components inconsistently and inaccurately made contributions to the Fund. Inconsistencies occurred because the DoD had conflicting guidance, and the inaccuracies occurred because the Reserve components did not verify that all transactions were counted. As a result, the DoD had no assurance that contributions or actuarial projections were accurate.

Some components made contributions each time a reservist signed a 6-year contract, in accordance with chapter 47 of the DoD 7220.9-M, "DoD Accounting Manual" (DoD Accounting Manual), as amended, October 6, 1987. Other components made a one-time contribution when reservists signed more than one 6-year contract (in accordance with DoD Instruction 1322.17, "'Montgomery GI Bill' for the Selected Reserve," November 21, 1991). To ensure that Reserve components follow DoD guidance, the Assistant Secretary of Defense for Reserve Affairs' instructions should be consistent with the Comptroller's guidance.

In addition to using inconsistent policies, the Army Reserve, Naval Reserve and Air Force Reserve could not adequately support the number of transactions for which they made contributions in FY 1993. The Air National Guard did not provide any information on FY 1993 transactions; however, the Army, Navy, Marine Corps, and Marine Corps Reserve provided adequate supporting documentation.

All components used a computer query to count the number of eligible transactions for making contributions to the Fund; however, most Reserve components did not produce concurrent listings of transactions. We requested

the Services and Reserve components to provide a listing of eligible 6-year contracts to support the number of transactions the computer counted. The table illustrates the major differences identified.

Comparison of Computer Counts and Contract Listings

	Army Reserve	Naval Reserve	Air Force Reserve
Computer Count	22,923	9,525	25,743
Contract Listing	6,171 *	11,380	27,623
Difference	16,752	(1,855)	(1,880)
Percentage of Difference	73.1%	(19.5%)	(7.3%)

*Although the Army Reserve made contributions for each new 6-year obligation, a list it provided contained only names of first-time eligibles for which it made contributions during FY 1993.

Not using consistent contribution procedures caused a related problem. The Air National Guard recouped $3.8 million that it contributed during FY 1992. The recoupment was based on the Air National Guard's belief that it had overcontributed during FY 1992. Since the Air National Guard did not provide us any information on how it determined its contributions during FY 1993, we are unable to assess the accuracy of the FY 1993 contributions.

Until Reserve components produce a listing of transactions that agrees with the computer count of transactions for which they make contributions, we will not be able to verify the accuracy of the contributions.

Program Eligibility. The DoD provided inaccurate and untimely Selected Reserve eligibility data to the DVA. Although inherent system problems existed that delayed the submission of accurate data to the DVA, many problems with data quality could be corrected if the Defense Manpower Data Center (DMDC) provided better edit reports to the Reserve components.

Each week, the DoD provided the MGIB eligibility data on members of the Selected Reserve to the DVA. The data, which come from the DMDC's MGIB file, are used by the DVA to verify eligibility, the eligibility period, and changes to previously reported eligibility data. The DoD provided incorrect or inconsistent eligibility data to the DVA for 185 of the 1,399 files we reviewed. The DoD at various times:

o changed the MGIB eligibility start date;

o reported that a reservist received benefits but did not sign a 6-year contract, then corrected the status to show that the reservist left the Selected Reserve, transferred to a different Reserve component, or received an officer's commission;

o reported that a reservist left the Selected Reserve, but did not provide the date; or

o incorrectly reported that a reservist received a high school diploma after completing initial active duty for training or that the reservist had a bachelor's degree.

The problems with data quality occurred, in part, because the DMDC did not produce and submit adequate edit reports to the Reserve components for review and correction. Edit reports should show blank data fields for information critical to the MGIB eligibility, show conflicting eligibility data submitted by Reserve components when an individual transfers between components, and identify individuals who receive the MGIB benefits but are later reported as not having a 6-year contract.

Untimely and inaccurate data often delayed issuance of benefit payments and recoupment of overpayments. Also, the DVA sometimes unnecessarily demanded repayment of benefits paid. Repayment demands, based on erroneous DoD data, caused the DVA to overstate Accounts Receivable. Those demands may also impact credit histories of affected reservists.

Eligibility Requirements. The Army and Navy had different requirements for members who received enhanced ("kicker") MGIB benefits. Offering "kicker" benefits, in addition to the basic MGIB benefits, allowed the Services to recruit individuals for critical or hard-to-fill military occupation specialties.

The Army required a member recruited for a critical or hard-to-fill specialty to remain qualified for that specialty through completion of the enlistment. However, the Army had no system to determine whether those members remained qualified. The Navy allowed members to change occupational specialties while remaining eligible to receive "kicker" benefits. The differences between the Army and the Navy policies existed because the DoD had not established a standard policy for determining the eligibility for separating members to receive "kicker" benefits. Without a standard policy, the DoD had no assurance that the Services were properly complying with the provisions of 38 U.S.C. 3015.

Reportable Conditions Not Noted. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. Some of the weaknesses discussed in this report were addressed in Audit

Reports No. 93-137 and No. 94-052. Except for matters noted, we believe there is reasonable assurance that the internal control structure meets the internal control objectives.

Management Comments and Audit Response to Management Comments

The Director of Accession Policy, DoD, responded for the Office of the Under Secretary of Defense for Personnel and Readiness (the Fund manager). The Deputy Assistant Secretary of Defense for Manpower and Personnel responded for the Office of the Assistant Secretary of Defense for Reserve Affairs. See Part VI for the full text of management comments.

Under Secretary of Defense for Personnel and Readiness. The comments from the Under Secretary's office disagreed with our statement that the Fund did not have a single Fund manager since the Deputy Secretary of Defense designated the Under Secretary of Defense for Personnel and Readiness as the Fund manager on April 29, 1994. Based on that action we changed the audit report to show that the Deputy Secretary of Defense designated a Fund manager on April 29, 1994. However, the Fund did not have a single manager during the period covered by this audit.

The Under Secretary nonconcurred with our repeating financial reporting findings from audit Report No. 94-052 since a memorandum of understanding with the DVA would be completed by March 1995. Although we agree with the action taken to develop a memorandum of understanding with the DVA, the repeat findings for financial reporting were internal control weaknesses for the period audited and had an impact on FY 1993 account balances.

Based on concerns raised by the Office of the DoD Actuary, the Under Secretary nonconcurred with our statement that actuarial projections are based on the DoD Accounting Manual. As a result, we changed our audit report to focus on the need for the DoD to establish one contribution policy for the Reserve components.

The Under Secretary agreed to develop a standard policy for earning "kicker" benefits. That policy would apply the provisions of 38 U.S.C. 3015 and be completed by December 1994. We agree with the planned actions.

Reserve Affairs. The comments on behalf of the Assistant Secretary of Defense for Reserve Affairs nonconcurred that we should include the repeat finding on contributions because those issues will be resolved when the revised DoD Instruction 1322.17 is staffed. We agree that revising DoD Instruction 1322.17 should eliminate inconsistent methods for making contributions; however, the planned revisions for that instruction were not in place during FY 1993. As a result, this internal control weakness must be noted until the corrective action has been implemented.

The Assistant Secretary nonconcurred that the DoD provided inaccurate and untimely Selected Reserve eligibility data to the DVA. He stated that the instances noted were examples of Reserve components correcting data errors and such corrections were appropriate and planned for within the system. We disagree. Our examples were instances of inaccurate eligibility data reported to the DVA. Furthermore, managers at the DVA offices we visited stated that incorrect eligibility data delayed benefit payments and in some instances adversely affected the credit ratings of some Selected Reservists. Therefore, we did not change that finding.

The Assistant Secretary also disagreed that the DMDC did not produce adequate edit reports. He stated that the DMDC sends monthly and quarterly reports that can be used by the Reserve components to check the accuracy of the data they submit to the DMDC. We are aware of the referenced reports; however, those reports are not adequate since they do not specifically identify incorrect or incomplete data. To correct this problem, the DMDC needs to perform edit checks to identify data that is incomplete or incorrect and track the length of time it takes Reserve components to make corrections.

Part III - Compliance With Laws and Regulations

Introduction

We evaluated the DoD Education Benefits Fund (the Fund) for material instances of noncompliance with laws and regulations for the year ended September 30, 1993. Such tests are required by the Chief Financial Officers Act of 1990. The statements on which we based our evaluation were transmitted to us on June 23, 1994. The list of laws and regulations we reviewed is in Part IV, Appendix A.

To obtain reasonable assurance about whether the financial statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements. We also tested compliance with other laws and regulations designated by the Office of Management and Budget (OMB) and the DoD. At the Defense Accounting Office (DAO) Arlington, Virginia, a division of the Defense Finance and Accounting Service (DFAS) Cleveland Center, we traced the Statement of Financial Position and Statement of Operations account balances to the general ledger trial balances and reviewed accounting transactions to determine whether the transactions were valid, accurate, and properly classified and recorded. We reviewed the Overview and Footnotes to determine compliance with OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We also reviewed the Department of Veterans Affairs' (DVA's) general ledger trial balances and the procedures used to determine the amounts to bill the Fund. To assess compliance with DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, we obtained and reviewed available assurance statements from the DAO Arlington and the DoD offices responsible for managing the Montgomery GI Bill (MGIB).

Objective

The objective of the audit was to assess compliance with laws and regulations for those transactions and events that have a direct and material effect on the financial statements. Material instances of noncompliance are failures to follow requirements or violations of prohibitions in laws or 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.

On April 29, 1994, the Deputy Secretary of Defense designated the Under Secretary of Defense for Personnel and Readiness as the Fund manager. (That office is referred to as the Fund manager in this report.) The Fund manager has responsibility for establishing DoD policy for the MGIB and managing the active duty MGIB program. While the Assistant Secretary of Defense for Reserve Affairs establishes policy for and manages the Reserve MGIB program, the Comptroller of the Department of Defense establishes accounting, budgeting and funding policy for the Fund. Accounting and investing for the Fund is done by the DAO Arlington. The DVA is responsible for making education benefit

payments to eligible individuals for the DoD. It also collects overpayments to individuals. Various Service offices are responsible for managing the MGIB and making contributions to the Fund. The above DoD Components and the DVA are responsible for complying with the laws and regulations applicable to the Fund.

As part of our audit, we reviewed managements' compliance with DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. We also compared managements' most recent Annual Statements of Assurance, when available, with our evaluation of the Fund's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented to us in the Overview to the financial statements. It was not our objective, however, to provide an opinion on overall compliance with such provisions.

Prior Audit Coverage

The Office of the Inspector General, Department of Defense, Audit Report No. 93-137, "DoD Education Benefits Trust Fund Financial Statements for FY 1992," June 30, 1993, reported that the Overview and Footnotes did not disclose information required by OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992. That report did not include recommendations.

Results of Audit

Fund operations generally complied with applicable laws and regulations. Most of the issues related to noncompliance with accounting standards. In addition, the Fund's Internal Management Control Program did not comply with DoD directives. Except the instances cited below, Fund operations generally complied with all applicable laws and regulations.

Improper Accounting. The DAO Arlington did not account for liabilities, U.S. Treasury bonds, separation bonus payments, benefit expenses, and overcontributions as required by the Statements of Federal Financial Accounting Standards and DoD 7220.9-M, "DoD Accounting Manual," (DoD Accounting Manual), as amended October 6, 1987.

Unrecorded Liabilities. The financial statements did not include the value of benefits earned for individuals enrolled in the MGIB. The value of those benefits at the end of FY 1993, known as the present value of accumulated benefits, was not available. The Office of the DoD Actuary, however, determined that the present value of that liability was $650.8 million on September 30, 1992. The DAO Arlington did not include the liability on the financial statements because it believed that the requirement did not apply to the Fund, since the Fund is not a pension fund. When a fund provides annuity

benefits, OMB Bulletin No. 94-01 and the DoD Accounting Manual, chapter 47, require that the fund include a liability for the actuarial present value of accumulated benefits. As a result, the Net Financial Position as of September 30, 1992, is overstated by $650.8 million. Moreover, when the FY 1993 actuarial valuation has been completed, we believe that the Net Financial Position will be overstated by a similar amount.

Valuation of U.S. Treasury Bonds. The DAO Arlington amortized premiums on U.S. Treasury bonds to the call date instead of maturity date as required by the DoD Accounting Manual, chapter 37, and Statement of Federal Financial Accounting Standards No. 1. The DAO Arlington believed that amortizing to the call date was proper since the DoD Accounting Manual is silent on amortizing the premiums to the call date and since the financial community amortizes premiums on callable bonds to the call date. We believe, however, that the DoD Accounting Manual and the Statement of Federal Financial Accounting Standard are silent on amortizing premiums to the call date because those criteria specifically require all premiums on U.S. Treasury bonds to be amortized to maturity date. By amortizing to the call date, the DAO Arlington understated investments by about $1,551,000 and understated interest income by about $483,000.

Separation Bonus Payments. The DAO Arlington reduced program expenses by $2.8 million when it recorded payments to the DVA for individuals that received the MGIB as a separation bonus. Those payments were recorded as Refunds Receivable because Service components reimburse the Fund at a later date. By reducing expenses, however, the DAO Arlington did not recognize those payments as a program expense and did not recognize the income due from the Services. Those payments should be recorded as an expense to the Fund since 38 U.S.C. 3035 requires the Fund to pay those benefits. Furthermore, since the DoD uses Refunds Receivable to record erroneous payments, the amounts due from the Services should be recorded as Accounts Receivable. Recording the amounts due as Refunds Receivable incorrectly suggests that the Fund expended more funds than it obligated.

FY 1992 Expenses Reported in FY 1993. As discussed in Audit Report No. 93-137, the DAO Arlington reported $1.1 million of FY 1992 expenses as FY 1993 expenses. On September 30, 1992, the DVA requested a payment of $1.1 million from the Fund. Since the DAO Arlington was not able to make the payment until October 1, 1992, it did not record the request until then. We believe that since the DAO Arlington received the request in FY 1992, it should have recorded the request as an FY 1992 expense.

Overcontributions. The DAO Arlington accounted for a $353,000 overcontribution from the Army as revenue instead of as deferred income. The overcontribution, due to an Army administrative error, was identified in September 1993, and the Army withdrew the excess contribution in October 1993. Since the DoD Accounting Manual, chapter 46, states that revenue received but not earned should be recorded as a deferred credit, revenue was overstated and liabilities were understated by $353,000.

Incomplete Overview and Footnotes to the Principal Statements. The financial statements did not include adequate descriptions of the Fund and its operations, explanations of accounting policies, or the cost to administer the DoD Education Benefits program. OMB Bulletin No. 94-01 identifies the type of information that should be included in the Overview and the Footnotes.

The Overview did not provide a clear and concise picture of the Fund operations and did not contain performance measures. Instead, the Overview primarily provided details on the DoD Board of Actuaries' valuation of the Fund. The Overview should provide a concise description of Fund management, benefit recipients, and any recent changes in legislation that affect the Fund. Performance measures should include the number of individuals eligible to receive benefits, the number of individuals who received benefits, the amount of benefits paid during the fiscal year, and the number of individuals for whom the DoD does not know the eligibility status. The Overview did not contain essential information because the Comptroller of the Department of Defense did not identify specific program performance measures in the form and content guidance, and the Fund manager assigned responsibility for the Overview to the Office of the DoD Actuary instead of to its program office.

The Footnotes to the Principal Statements do not adequately describe significant accounting policies. Specifically, Note 1 does not state the basis of the accounting methods used, Note 3 does not adequately describe Accounts Receivable, and the Footnotes do not include an actuarial valuation of the Fund. The actuarial valuation is described in the Overview. In addition, the Footnotes do not report DoD's cost of administering the Fund.

DoD Internal Management Control Program. Most DoD Components did not have an adequate Internal Management Control Program for the MGIB as required by DoD Directive 5010.38. The Fund manager, the Assistant Secretary of Defense for Reserve Affairs, the Services, and the Reserve components were unaware that the MGIB should be identified as part of the internal control program. The Naval Reserve, the Marine Corps Reserve, and the DAO Arlington had an Internal Management Control Program in place. The Naval Reserve and the Marine Corps Reserve did not identify contributions to the Fund as an internal control area, and the DAO Arlington did not identify any of the accounting errors we identified as internal control weaknesses. The Army Reserve limited its program to the unit level and did not address contributions or automated systems. Without an adequate internal control program for the MGIB, the DoD does not have assurance that the Fund resources are adequately protected or that the MGIB is administered effectively and efficiently. Part of the program is to perform vulnerability assessments of areas identified as assessable units and periodically conduct management control reviews by evaluating the relative risk as identified by the vulnerability assessment. This process of self inspection is critical to effective fund management.

With respect to items not tested, nothing came to our attention that caused us to believe that managers had not complied, in all material respects, with the laws and regulations that apply to the Fund.

Management Comments and Audit Response to Management Comments

The Director of Accession Policy responded for the Office of the Under Secretary of Defense for Personnel and Readiness. The Deputy Director for General Accounting responded for the DFAS. See Part VI for the full text of management comments.

Under Secretary of Defense for Personnel and Readiness. The comments from the Under Secretary's office agreed it was necessary to learn the DVA's method to charge the MGIB benefits as a separation bonus. We agree with the action taken by the Fund manager, however, he did not give a completion date.

The Under Secretary agreed that an Internal Management Control Program should be an integral part of Fund operations and that the Office of Accession Policy would work with the Services and Reserve components to develop one. We agree that the Director should work with the Services and Reserve components to correct the noted conditions. However, the comments did not give a completion date and it was not clear whether the operations within the Offices of the Under Secretary of Defense for Personnel and Readiness and the Assistant Secretary of Defense for Reserve Affairs would be included in the Internal Management Control Program. Those two offices should be included.

Defense Finance and Accounting Service. The DFAS concurred that a liability for the present value of accumulated education benefits should be reported in the financial statements and planned to obtain permission from the Comptroller of the Department of Defense to establish a liability account for the Fund by May 26, 1994. The DFAS changed Note 1 to show that the Fund had a liability for the present value of benefits of $650.8 million, but did not include the liability in the Statement of Financial Position. Until the liability is shown on the Statement of Financial Position, the Net Financial Position will continue to be overstated.

The DFAS nonconcurred that premiums on bonds be amortized to the maturity date, because the financial community amortizes premiums on bonds to the call date, and the DoD Accounting Manual was silent on how to amortize premiums on bonds with call dates. We believe that the DoD Accounting Manual does not mention callable bonds, because it only intended DoD Components to amortize premiums to the maturity date of the security. This position is supported by the Federal Financial Accounting Standards Statement No. 1, which also requires Federal agencies to amortize premiums to the maturity date.

The DFAS partially concurred that benefit expenses were incorrectly reported because the DFAS relies on the DVA to provide accurate benefit expense data. The DFAS agreed that contributions due from the Services should be recorded as accounts receivable when the contributions result from payments to individuals receiving the MGIB as a separation bonus. Also, the DFAS was testing software changes that would accomplish this; however, no completion date was given. When we asked for a clarification, a DFAS official stated that the proposed change would still reduce expenses and not show additional

contribution income. Since the Fund is required to finance those MGIB benefits, the DFAS should record the benefit payments as an expense and income. Further, we believe that the DFAS had received sufficient information from the DVA to record benefit expenses when the DVA requested a $1.1 million payment on September 30, 1992.

The DFAS disagreed that the Army's overcontribution of $353,000 should be classified as a deferred credit because the DoD Accounting Manual allows the Services to estimate contributions to the Fund. Although DoD allows the Services to estimate contributions, the Army's excess contribution in August 1993 was due to an error, not the result of estimating contributions. Further, contributions based on estimates should be reported as income only to the extent that the estimates are reasonable.

The DFAS disagreed that Note 1 and Note 3 did not provide adequate disclosures, but agreed to change Note 4 by including the original cost of Treasury securities. For Note 3, the DFAS said that there was no specific requirement to identify the sources of accounts receivable. We believe that Note 1 should state the source of the accounting principles used by the DFAS. The Note should, for example, say that the statements were based on accounting principles found in the DoD Accounting Manual. Note 3 was changed in the report to state that the DFAS did not adequately describe Accounts Receivable. OMB Bulletin 94-01 states that the Footnotes should summarize accounts receivable. Note 3 only states that the Statement of Financial Condition for FY 1992 includes $91,000 of accounts receivable that was previously reported as an expense. The Note does not disclose that the $18.0 million in accounts receivable includes $15.1 million of accrued interest on U.S. Treasury securities and $2.9 million of contributions due from the Services for members that received education benefits as a separation bonus. Including that information would disclose the source of the accounts receivable and provide important information about Fund operations. We also removed a reference that Note 4 did not include the original cost of U.S. Treasury securities since the DFAS revised that Note.

Part IV - Additional Information

Appendix A. Laws and Regulations Reviewed

Public Law 101-576, "Chief Financial Officers Act of 1990"

10 U.S.C., Chapter 106, "Educational Assistance for Members of the Selected Reserve"

10 U.S.C. 2006, "Department of Defense Education Benefits Fund"

38 U.S.C., Chapter 30, "All Volunteer Force Educational Assistance Program"

OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993

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

Statements of Federal Financial Accounting Standards

Treasury Financial Manual

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

DoD Directive 1322.16, "Veterans' Educational Assistance Act of 1984 (GI Bill)," March 25, 1985

DoD 7220.9-M, "DoD Accounting Manual," as amended, October 6, 1987

DoD Instruction 1322.17, "'Montgomery GI Bill' for the Selected Reserve," November 21, 1991

Appendix B. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Personnel and Readiness[1]
- Deputy Assistant Secretary of Defense for Military Manpower and Personnel Policy
  - Defense Manpower Data Center, Monterery, CA
  - Office of the Actuary, DoD, Arlington, VA
- Assistant Secretary of Defense for Reserve Affairs, Washington, DC
  - Deputy Assistant Secretary of Defense for Manpower and Personnel, Washington, DC

Comptroller of the Department of Defense
- Deputy Comptroller for Management Systems, Washington, DC

Department of the Army

Deputy Chief of Staff for Personnel
- Enlisted Accessions Division, Director of Military Personnel Management, Washington, DC

Office of the Chief of the Army Reserve, Personnel Division, Washington, DC
U.S. Total Army Personnel Command
- Adjutant General Directorate, Education Division, Alexandria, VA
- Personnel Information Systems Command, Alexandria, VA
- U.S. Army Enlisted Records and Evaluation Center, Indianapolis, IN
- Internal Review and Audit Compliance Office, Alexandria, VA

Department of the Navy

Bureau of Naval Personnel, Arlington, VA
Naval Reserve Force, New Orleans, LA

Department of the Air Force

Office of the Air Force Reserve, Personnel Division, Washington, DC
Office of the Air National Guard, Andrews Air Force Base, MD
Directorate of Personnel, Andrews Air Force Base, MD

[1]Formerly, Assistant Secretary of Defense for Personnel and Readiness

Marine Corps

Deputy Chief of Staff for Manpower and Reserve Affairs
  Reserve Affairs Division, Arlington, VA
Marine Corps Recruiting and Recruit Training Command[2]
  Enlisted Recruiting Operations Section, Arlington, VA

Defense Agencies

Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
Defense Finance and Accounting Service Cleveland Center
  Defense Accounting Office Arlington, Arlington, VA

Non-Defense Federal Organizations

Department of Veterans Affairs, Washington, DC
  Veterans Affairs Regional Processing Office, Atlanta, GA
  Veterans Affairs Regional Processing Office, Buffalo, NY
  Veterans Affairs Regional Processing Office, Muskogee, OK
  Veterans Affairs Regional Processing Office, St. Louis, MO
  Veterans Affairs Regional Office, Detroit, MI
  Veterans Affairs Regional Office, Huntington, WV
  Veterans Affairs Regional Office, Indianapolis, IN
  Veterans Affairs Regional Office, Jackson, MS
  Veterans Affairs Regional Office, Louisville, KY
  Veterans Affairs Regional Office, Newark, NJ
  Veterans Affairs Regional Office, New Orleans, LA
  Veterans Affairs Regional Office, New York, NY
  Veterans Affairs Regional Office, Seattle, WA
  Veterans Affairs Regional Office, St. Paul, MN
  Veterans Affairs Regional Office, St Petersburg, FL
  Hines Finance Center, Hines, IL
Federal Accounting Standards Advisory Board, Washington, DC

[2]Formerly, Marine Corps Recruiting Command

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Personnel and Readiness
Comptroller and Chief Financial Officer of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)
Assistant Secretary of Defense (Reserve Affairs)

Department of the Army

Secretary of the Army
Auditor General, Department of the Army
Chief, Army Reserve
Chief, Army Comptroller Division, National Guard Bureau
Chief, Comptroller Division, Army Reserve

Department of the Navy

Commandant of the Marine Corps
Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Auditor General, Department of the Navy
Deputy Chief of Staff for Finance, Naval Reserve Force

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Defense Agencies

Director, Defense Finance and Accounting Service

Non-Defense Federal Organizations

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

Non-Defense Federal Organizations (cont'd)

Department of Veterans Affairs, Education Services

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Subcommittee on Force Requirements and Personnel, Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on Defense, Committee on Appropriations
- House Committee on Armed Services
- House Subcommittee on Military Forces and Personnel, Committee on Armed Services
- House Committee on Government Operations
- House Subcommittee on Legislation and National Security, Committee on Government Operations

Part V - Department of Defense Education Benefits Fund Financial Statements - FY 1993

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON DC 20301-1100

JUN 23 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DODIG

SUBJECT: Transmittal of Adjusted Financial Statements on FY 1993 Financial Activity

Attached are the final financial statements on FY 1993 financial activity which have been amended to reflect audit adjustments. Included herein are the financial statements for the following general, revolving and trust fund accounts of the Department of Defense:

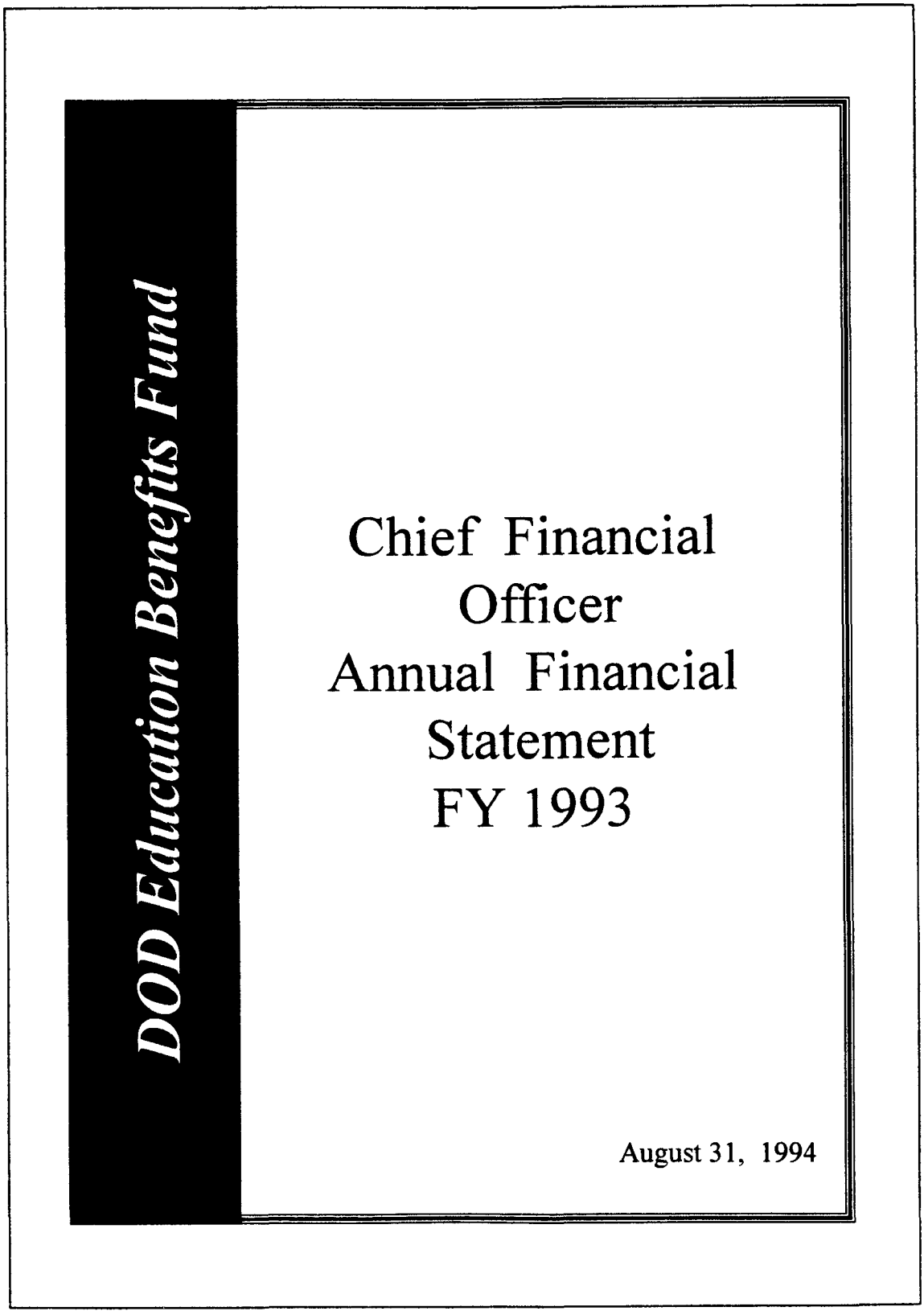
- Department of the Air Force
- Air Force--DBOF
- Defense Security Assistance Agency
- National Security Education Trust Fund
- DoD Military Retirement Trust Fund
- Defense Education Benefits Fund
- Voluntary Separation Incentive Trust Fund

Coordination has been obtained from the individual program managers and the financial statement adjustments are effective as of June 20, 1994.

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

Alvin Tucker
Deputy Chief Financial Officer

Attachments


DOD Education Benefits Fund
Chief Financial Officer Annual Financial Statement FY 1993
August 31, 1994

DOD Education Benefits Fund

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DOD EDUCATION BENEFITS FUND

OVERVIEW

Summary of DoD Education Benefits
Overview of the Reporting Entity

Introduction

The "Veterans Educational Assistance Act of 1984" (Public Law 98-525), established a new educational assistance program for the armed forces The program provides basic educational benefits to persons entering active duty, with incentives for hard-to-fill occupations, and potential supplements for additional service The program also includes benefits to Selected Reservists who take on new or additional six-year obligations

A unique feature of the law is that all but the basic active duty program is prefunded A Department of Defense Education Benefits Fund was established under the Department of the Treasury Each month the Secretary of Defense deposits in the Fund an amount equal to the present value of the benefits for persons entering the prefunded programs in the preceding month These present values, or "normal costs" as they are termed by the legislation, are estimated using methods and assumptions approved by the Department of Defense Education Benefits Board of Actuaries

It is the purpose of this publication to report the normal costs, unfunded liabilities (or surpluses), and amortization schedules for the various programs paid from the Fund and to describe the methods and assumptions used

The valuation is based on the status of the programs as of September 30, 1992, but takes into account benefit changes resulting from Public Laws 102-568 (October 29, 1992) and 103-66 (August 10, 1993)

Valuation Data

The valuation data are taken from files maintained at the Defense Manpower Data Center (DMDC) Data on users and potential users of the Chapter 30 (active duty) and Chapter 106 (Reserve) programs are taken from the GI Bill data base at DMDC.

An overview of the number of persons in the programs and their status follows

Overview

Chapter 30 "Kicker" Program	Number of Persons As of September 30 1991	1992
On Active Duty in "Kicker" Programs		
Army 2-year[1]	20,867	22,881
Army 2-year, w/2 years of college	161	119
Army 3-year	19,221	17,608
Army 4-year	23,780	25,280
Navy 2-year	511	150
Navy 4-year	1,322	4,139
No Longer Active, but Eligible and Has Not So Far Used the Benefit		
Army 2-year[1]	8,496	12,964
Army 2-year, w/2 years of college	239	290
Army 3-year	8,735	11,882
Army 4-year	6,733	11,387
Navy 2-year	740	739
Navy 4-year	45	196
Has Used the Benefit		
Army 2-year	15,729	20,143
Army 2-year, w/2 years of college	925	975
Army 3-year	11,198	15,839
Army 4-year	6,261	9,718
Navy 2-year	2,877	2,859
Navy 4-year	1	10
Chapter 106 Program		
Eligible for the Benefit		
Army National Guard	208,818	200,637
Army Reserve	94,883	96,909
Navy Reserve	42,281	39,554
Marine Corps Reserve	26,879	26,301
Air Force National Guard	61,056	67,872
Air Force Reserve	52,545	55,257

[1]Includes the "2+2+4" test program

Chapter 30 Involuntary Separatees[2]	Number of Persons As of September 30 1991	1992
Involuntary Separatees Enrolled[3]		
Army	18	403
Navy	21	262
Marine Corps	5	152
Air Force	108	610
Has Used the Benefit		
Army	0	17
Navy	0	15
Marine Corps	0	9
Air Force	0	25

[2]This includes only those involuntary separatees whose basic benefit is paid from the Department of Defense Education Benefit Fund This includes voluntary separatees who entered the service after December 31, 1976, and before July 1, 1985

[3]The number of enrolled involuntary separatees at the end of fiscal 1991 has been revised downward (from 174 to 152), primarily by eliminating those who had appropriate enrollment codes but had not yet left the service

Normal Costs

To determine the normal cost, the Department of Defense Office of the Actuary uses a computer model that calculates the present value of benefits for a hypothetical cohort of new entrants The model follows the cohort through certain states or statuses, using expected rates of retention, etc. If benefits are paid from one of those states, they are discounted using an interest rate back to the time of entry

Rates include probabilities, such as the probability of leaving military service or the probability of using a benefit Also included in the rates are the average benefit amounts

Using these rates and an interest discount of 8 0%, the per capita normal costs for the Chapter 30 and Chapter 106 programs are given below These normal costs are appropriate for benefit levels during fiscal 1992 and the first half of fiscal 1993

Overview

Chapter 30[4]	Fiscal 1992	Fiscal 1993
Army 2-year program	$2,270	$2,342
Army 2-year program with 2 years of college[5]	3,696	3,981
Army 3-year program	2,276	2,736
Army 4-year program	1,656	2,014
Navy 2-year program[5]	2,584	2,708
Navy 4-year program	1,663	1,970
Marine Corps 4-year program	1,656	2,014
Chapter 106		
Army National Guard	$731	$ 772
Army Reserve	594	705
Navy Reserve	715	783
Marine Corps Reserve	804	1,108
Air Force National Guard	606	690
Air Force Reserve	237	214

[4]Assuming no change in benefit levels
[5]No longer open to new entrants

It is possible to compare four components of the Chapter 30 normal costs based on the 1991 and 1992 rates as follows

Item	Valuation Year	Army 2-Year	Army 2+2	Army 3-Year	Army 4-Year	Navy 2-Year	Navy 4-Year
% becoming eligible	1991	87 2	87 2	77 1	75 8	72.7	76.9
	1992	86 4	86 4	76 5	75 0	71 3	80 3
% eligibles using	1991	74 6	74 6	69 8	54 9	82.1	54 9
	1992	72 7	81 0	69.9	58.3	85.8	58 3
% benefit used	1991	67 3	71 7	60 2	51 8	76.7	51.8
	1992	73 9	74 0	74.2	58 0	81.1	58.0
discount factor	1991	.648	.660	586	534	.706	.529
	1992	631	.641	574	552	682	504

From this it appears that the substantial increase in the normal cost for the Army 3-year program can be attributed to the proportion of the benefit used, for those who use the benefit This in turn can be attributed to rates based on an additional year of MGIB experience, particularly for the fifth year since separation where earlier VEAP data led us to believe usage would drop considerably Also the benefit usage rates are based substantially on fiscal years 1990-92 So it is possible the normal costs may change if the 1990-92 period is atypical The 2-year and 4-year programs also show an increase in the percent of the benefit used, although a less dramatic increase The 4-year program also shows a slight increase in the percent of persons who use the benefit

The Chapter 106 normal costs are applied to Reservists who make six-year commitments and thereby may qualify for the Chapter 106 benefit The normal costs take into account several recent benefit improvements Reservists who signed a six-year contract after October 1, 1990 are eligible for vocational or technical training as well as for the previously available educational benefits Benefits increased to $170 a month for those going to school full-time beginning in October 1991, with less than full-time benefits increasing proportionately.

The computation of the Chapter 106 normal cost is based on the same modeling technique used in the previous valuation Persons eligible for the benefit were projected and decrement rates appropriate for them were used A preliminary normal cost was developed for eligibles This was adjusted by the number of eligibles per contract for each reserve component and by projected interest earnings between contract date and the date of eligibility

Unfunded Liability or Surplus

The unfunded liability (or surplus) represents the difference between the amount of money in the fund on the valuation date and the present value of benefits that currently eligible military members are projected to receive If the fund exceeds the present value, there is a surplus Otherwise there is an unfunded liability The present value of benefits is based here only on people already in the system New entrants after the valuation date are not included For this reason, the population is called a "closed" group

Determining the present value of benefits for the closed group is similar to determining a normal cost In both cases there is a model with various states or statuses and rates that represent the probability of moving from one state to another If benefits are paid to persons in one of the states, the benefits are discounted for interest

What distinguishes the normal cost determination from the closed group valuation is the initial population For the normal cost, we start with 100,000 hypothetical persons at the point of entry in each program This is either the point of enrolling in a "kicker" program for the Chapter 30 benefit or the point of signing the six-year enlistment, reenlistment, or extension for one of the reserve components under Chapter 106 All other model states start out with zero participants

Overview

For the closed group valuation, the initial population comes from a census of actual people that were in the various states on the valuation date. A second difference between the normal cost determination and the closed group valuation is the point in time to which benefits are present valued. For the normal cost, present values are discounted to the point of entry. For the closed group valuation, values are discounted to the valuation date As mentioned, the valuation date used here is September 30, 1992

Using these censuses and the rates (given in Appendix B), we computed the present value of benefits for the Chapter 30 "kicker" and Chapter 106 programs The Chapter 30 involuntary separatee payments from the Fund are amortized in a special way (described in section 6) that needs no present value computation.

For Chapter 106, the present value of the benefits includes the April 1, 1993 benefit increase and projected future CPI adjustments It includes vocational or technical benefits only for those who signed six-year contracts after the end of fiscal year 1990.

The value of assets on the valuation date (September 30, 1992) was obtained from the fund manager for the Department of Defense Education Benefits Fund The programs' unfunded liabilities or surpluses are as follows

Chapter 30 "Kicker" Benefits

Program	Present Value of Benefits	Assets	Unfunded Liability or (Surplus)
Army	$389,605,583	$308,638,360	$ 80,967,223
Navy	18,151,847	13,400,461	4,751,386
Total	407,757,430	322,038,821	85,718,609

Chapter 106

Program	Present Value of Benefits	Assets	Unfunded Liability or (Surplus)
Army Nat Guard	$ 88,539,510	$153,261,498	$ (64,721,988)
Army Reserve	68,466,508	81,257,694	(12,791,186)
Navy Reserve	18,901,019	38,594,062	(19,693,043)
M C Reserve	24,332,857	15,662,670	8,670,187
A F Nat Guard	25,384,676	36,236,208	(10,851,532)
A F Reserve	17,452,224	45,370,626	(27,918,402)
Total	243,076,794	370,382,758	(127,305,964)

In addition to the above eight line items there are an additional four, one for each service for involuntary separatees paid from the fund. It should be mentioned here that there are not twelve different Department of Defense Education Benefits Funds, as this might suggest. However, we do intend to keep track of the transactions by each of the twelve categories So it is possible to make additions, deduct expenditures, carry forward assets, and allocate earnings by category

The Chapter 30 "kicker" program assets cannot be further subdivided Although the normal cost contributions are recorded by program, the expenditures obtained from the Department of Veterans Affairs are not.

Amortization of the Unfunded Liability or Surplus for the "Kicker" and Chapter 106 Programs

Where the Fund has an unfunded liability, the Board has sought to amortize the unfunded liability with a series of payments made into the Fund at the beginning of each fiscal year Surpluses, on the other hand, are amortized by means of an offsets to the normal costs

Initially unfunded liabilities or surpluses were determined afresh each year (eg previously scheduled payments ignored) At the July 23, 1992, meeting, the Board changed this process, so that large last minute budget changes would not be needed The Board decided to treat the previously determined normal costs, offsets, and amortization payments for fiscal 1993 (decided at the July 17, 1991 meeting) as locked-in Following this policy the Board decided on August 13, 1993, to use previously determined fiscal 1994 amounts (decided in the summer of 1992), with minor changes An adjustment was made to the Army "kicker" normal costs to reflect a change in benefit levels The normal cost for the Marine Corps, which implemented a 4-year program in fiscal 1993, was set to that of the Army 4-year program

Principal Statements

DOD EDUCATION BENEFITS FUND

PRINCIPAL STATEMENTS

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Financial Position
as of September 30, 1993
(Dollars)

ASSETS	1993	1992
1. Financial Resources:		
a Fund Balances with Treasury (Note 2)	$1,974	$2,809
b Cash		
c Foreign Currency		
d Other Monetary Assets		
e Investments, Non-Federal		
f Accounts Receivable, Net - Non-Federal		
g Inventories Held for Sale, Net		
h Loans Receivable, Net - Non-Federal		
i Property Held for Sale		
j Other, Non-Federal		
k Intragovernmental Items:		
(1) Accounts Receivable, Federal (Note 3)	17,990,001	17,261,786
(2) Loans Receivable, Federal		
(3) Investments, Federal (Note 4)	581,419,550	675,153,001
(4) Other, Federal		
l. Total Financial Resources	$599,411,525	$692,417,596
2. Non-Financial Resources:		
a Resources Transferable to Treasury		
b Advances and Prepayments, Non-Federal		
c Inventories Not Held for Sale		
d Property, Plant and Equipment, Net		
e Other		
f. Total Non-Financial Resources	$0	$0
3. Total Assets	$599,411,525	$692,417,596
LIABILITIES		
4. Funded Liabilities		
a Accounts Payable, Non-Federal		
b Accrued Interest Payable		
c Accrued Payroll and Benefits		
d Accrued Entitlement Benefits		
e Lease Liabilities		
f Liabilities for Loans Guarantees		
g Deferred Revenue- Non-Federal		
h Pensions and Other Actuarial Liabilities		

The accompanying notes are an integral part of these statements. 13

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Financial Position
as of September 30, 1993
(Dollars)

LIABILITIES Continued	**1993**	**1992**
i Other Funded Liabilities, Non-Federal		
j Intragovernmental Liabilities		
(1) Accounts Payable, Federal		
(2) Debt		
(3) Deferred Revenue		
(4) Other Funded Liabilities, Federal		
k. Total Funded Liabilities	$0	$0
5. Unfunded Liabilities:		
a Accrued Leave		
b Lease Liabilities		
c Debt		
d Pensions and Other Actuarial Liabilities		
e Other Unfunded Liabilities		
f. Total Unfunded Liabilities	$0	$0
6. TOTAL LIABILITIES	$0	$0
NET POSITION		
7. Fund Balances:		
a Revolving Fund Balances		
b Trust Fund Balances (Note 5)	$599,411,525	$692,417,596
c Appropriated Fund Balances		
d. Total Fund Balances	$599,411,525	$692,417,596
8. Less Future Funding Requirements	0	0
9. Net Position	$599,411,525	$692,417,596
10. Total Liabilities and Net Position	$599,411,525	$692,417,596

The accompanying notes are an integral part of these statements.

14

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Operations (and Changes in Net Position)
for Period Ended September 30, 1993
(Dollars)

		1993	1992
	REVENUES AND FINANCING SOURCES		
1	Appropriations Expensed		
2	Revenues from Sales of Goods		
	a To the Public		
	b Intragovernmental		
3	Interest and Penalties, Non-Federal		
4	Interest, Federal	$48,741,326	$57,046,036
5	Taxes		
6	Other Revenues and Financing Sources (Note 6)	37,782,604	41,329,942
7	Less Taxes and Receipts Returned to the Treasury		
8.	**Total Revenues and Financing Sources**	$86,523,930	$98,375,978
	EXPENSES		
9	Program or Operation Expenses (Note 7)	$179,530,000	$170,371,672
10	Cost of Goods or Services Sold		
	a To the Public		
	b Intragovernmental		
11	Depreciation and Amortization		
12	Bad Debts and Write-offs		
13	Interest		
	a Federal Financing Bank/Treasury Borrowing		
	b Federal Securities		
	c Other		
14	Other Expenses		
15.	**Total Expenses**	$179,530,000	$170,371,672
16	Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Adjustments	($93,006,070)	($71,995,694)
17	Plus (Minus) Adjustments:		
	a. Extraordinary Items		
	b Prior Period Adjustments		
18	Excess (Shortage) of Revenues and Financing Sources over Total Expenses	($93,006,070)	($71,995,694)
19	Plus: Unfunded Expenses		
20.	**Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses**	($93,006,070)	($71,995,694)

The accompanying notes are an integral part of these statements.

15

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Operations (and Changes in Net Position)
for Period Ended September 30, 1993
(Dollars)

EXPENSES Continued	**1993**	**1992**
21. Net Position, Beginning Balance	$692,417,596	$764,413,289
22 Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(93,006,070)	(71,995,694)
23 Plus (Minus) Equity Transfers		
24. Net Position, Ending Balance	$599,411,525	$692,417,595

The accompanying notes are an integral part of these statements. 16

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Cash Flows (Indirect)
for the Period Ended September 30, 1993
(Dollars)

		1993	1992
	Cash Flows from Operating Activities:		
1	Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($93,006,070)	($71,995,694)
	Adjustments affecting Cash Flow:		
2	Appropriations Expensed		
3	Decrease (Increase) in Accounts Receivable	($728,216)	$2,383,126
4	Decrease (Increase) in Loans Receivable		
5	Decrease (Increase) in Other Assets		
6	Increase (Decrease) in Accounts Payable		
7	Increase (Decrease) in Other Liabilities		
8	Depreciation and Amortization		
9	Other Unfunded Expenses		
10	Other Adjustments		
11.	**Total Adjustments**	($728,216)	$2,383,126
12.	**Net Cash Provided (Used) by Operating Activities**	($93,734,286)	($69,612,568)
	Cash Flows from Non-Operating Activities:		
13	Proceeds from Sales of Investments		
14	Proceeds from Sales of Property, Plant and Equipment		
15	Purchases of Investments	$93,733,451	$69,615,114
16	Purchases of Property, Plant and Equipment		
17.	**Net Cash Provided (Used) by Non-Operating Activities**	$93,733,451	$69,615,114
	CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES		
18	Appropriations (Current Warrants)		
19	Add:		
	a Restorations		
	b Transfers of Cash from Others		
20	Deduct		
	a. Withdrawals		
	b Transfers of Cash to Others		
21	Net Appropriations	$0	$0

The accompanying notes are an integral part of these statements. 17

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Cash Flows (Indirect)
for the Period Ended September 30, 1993
(Dollars)

		1993	1992
22	Borrowing from the Public		
23	Repayments on Loans to the Public		
24.	Borrowing from the Treasury and the Federal Financing Bank		
25.	Repayments on Loans from the Treasury and the Federal Financing Bank		
26	Other Borrowings and Repayments		
27	Net Cash Provided (Used) by Financing Activities	$0	$0
28	Net Cash Provided (Used) by Operating, Non-Operating and Financing Activities	($835)	$2,546
29.	**Fund Balance with Treasury, Cash, and Foreign Currency, Beginning**	2,809	263
30.	**Fund Balance with Treasury, Cash, and Foreign Currency, Ending**	$1,974	$2,809

Supplemental Disclosure of Cash Flow Information:

31 Total Interest Paid

Supplemental Schedule of Financing and Investing Activity:

32 Property and Equipment Acquired Under Capital Lease Obligations

33 Property Acquired Under Long-term Financing Arrangements

34 Other Exchanges of Noncash Assets or Liabilities

The accompanying notes are an integral part of these statements. 18

Principal Statements

Department/Agency: DoD Education Benefits Fund
Reporting Entity: Principal Statements
Statement of Budget and Actual Expenses
for the Period Ended September 30, 1993
(Dollars)

Program Name(s)	BUDGET Resources	BUDGET OBLIGATIONS Direct	BUDGET OBLIGATIONS Reimbursed	ACTUAL Expenses
DoD Education Benefits	$763,779,321	$179,439,309		$179,530,000
Totals	$763,779,321	$179,439,309	$0	$179,530,000

Budget Reconciliation

A	Total Expenses	$179,530,000
B	Add:	
	(1) Capital Acquisitions	
	(2) Loans Disbursed	
	(3) Other Expended Budget Authority	
C	Less:	
	(1) Depreciation and Amortization	
	(2) Unfunded Annual Leave Expense	
	(3) Other Unfunded Expenses	
D	Expended Appropriations	$179,530,000
E	Less Reimbursements	90,691
F	Expended Appropriations, Direct	$179,439,309

The accompanying notes are an integral part of these statements. 19

DOD EDUCATION BENEFITS FUND

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Footnotes

DoD Education Benefits Fund
Footnotes to the Principal Statements

Note 1. Significant Accounting Policies

The DoD Education Benefits Fund was authorized in PL98-525 for the accumulation of funds in order to finance a new educational assistance program which includes benefits for both active duty (additional benefits above basis benefits) and selected reserve personnel The accounting is accomplished by the Defense Finance and Accounting Service - Defense Accounting Office - Arlington Reports are prepared from Trial Balance data generated by an automated system on the accrual basis Balances are reconciled monthly with U S Treasury records

The program is funded by

(1) Actuary determined per capita normal cost multiplied by number of eligible members Funds received from active duty and reserve pay appropriations

(2) Interest on investments

The DoD Actuary has determined that the present value of benefits that currently eligible military members are projected to receive is $650 8 million on September 30, 1992 (September 30, 1993 data is not available) Determination is being made if the data will be required in future reports, to recognize the present value of benefits

Note 2. Fund Balances with Treasury

Trust Funds	$ 1,974

Note 3. Accounts Receivable, Federal

Includes receivables from Services for 1992 of $90,691 47 Chapter 30 Category 3 payments reported as an expense on prior 1992 reports

Note 4. Investments

	(1) Cost	(2) Market Value	(3) Amortization Method	(4) Amortized Premium/ (Discount)	(5) Investment Net Book Value
B Federal Securities Non-Marketable	621,523,896	645,783,616	Effective Interest	(40,104,346)	581,419,550

Footnotes

The method used to determine amount amortized, book value of Investments currently held and related yield on investments conforms to the prevailing practice in the financial community. The calculated yields match up with yields in published security tables of U. S Treasury securities

Note 5. Fund Balances

	1993	1992
Cumulative Results of Operations (Trust Funds)	$ 599,411,525	$692,417,596

Data for 1992 revised, see Note 3 above.

Note 6. Other Revenues and Financing Sources

	1993	1992
(1) Per Capita normal cost Contributions from Services	$ 37,782,604	$ 41,329,942

As provided for in approved procedures, the majority of per capita normal cost contributions received from the Services are estimates The above contribution amounts are reported on the transaction date received from the services Revised amounts are also reported on the transaction date they are received from the services which is normally at some later date

Note 7. Program or Operating Expenses

	1993	1992
A Operating Expenses by Object Classification See Note 3		
Other ---- Education Benefits	$179,530,000	$170,371,672

The above amounts represent actual dollar amounts transferred from the Fund in the applicable fiscal year for education benefits An Interagency Agreement is presently being developed with the Department of Veterans Affairs which will determine if DVA will be required to report related payables/receivables to DoD on a monthly basis

Part VI - Management Comments

Under Secretary of Defense for Personnel and Readiness Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D C 20301-4000

07 JUN 1994

PERSONNEL AND READINESS

(Military Personnel Policy)

MEMORANDUM FOR ACTING DIRECTOR, FINANCIAL MANAGEMENT
OFFICE OF INSPECTOR GENERAL, DOD

SUBJECT: Audit Report on Internal Controls and Compliance with Laws and Regulations for the DoD Education Benefits Fund Financial Statements for FY 1993 (Project No. 3FH-2013)

In response to your April 29, 1994 memorandum concerning the subject IG audit, our comments are attached. Comments from the Office of the Assistant Secretary of Defense (Reserve Affairs) and the Defense Finance and Accounting Service will be provided to you under separate cover. For further information, please contact Mr Ron Liveris or LTC Nancy S. Stanley at (703) 697-9267.

W. S. Sellman
Director
Accession Policy

Attachment:
As Stated

Final Report Reference

OUSD(P&R) COMMENTS ON DRAFT AUDIT REPORT
INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS
FOR THE DOD EDUCATION BENEFITS FUND FINANCIAL STATEMENTS FOR
FY 1993

Part II-Internal Controls

Page 2, Paragraph 2. Introduction — Page 8

Nonconcur with statement, "Fund does not have a single fund manager." On April 29, 1994, the Deputy Secretary of Defense designated the Under Secretary of Defense for Personnel and Readiness as the Fund Manager for the Education Benefits Fund. — Revised

Page 5, Paragraph 5. Results of Audit — Page 11

Nonconcur with statement regarding repeat findings from Report No 94-052. Since the Under Secretary of Defense for Personnel and Readiness has already responded that the Memorandum of Understanding (MOU) with the Department of Veterans Affairs (DVA) will be completed by March 1995, there is no need to repeat the requirement again in this report.

Page 6, Paragraph 1. Financial Reporting

Nonconcur with requirement to repeat finding from Report No 94-052. The Under Secretary of Defense for Personnel and Readiness already addressed this issue in the prior audit report The MOU currently is being prepared.

Page 6, Paragraph 2. Contributions to the Fund — Page 11 Revised

Nonconcur with statement that actuarial projections are based on the DoD Accounting Manual. The projections are adjusted for the actual number of normal cost payments, rather than the number of 6-year contracts. We do not dispute the contention that all components should pay normal costs under the same rules. However, the various parties have not agreed on what these rules should be, despite numerous attempts to reconcile this issue.

Page 8, Paragraph 4 and 5. Eligibility Requirements — Page 13

Concur with the need for a standard policy to apply the provisions of 38 U.S.C. 3015. In accordance with DoD Directive 1322.16, "Montgomery GI Bill (MGIB) Program", May 11, 1994, "kickers" must be approved by the Secretary of Defense. The Under Secretary of Defense for Personnel and Readiness, in coordination with the Services, will develop a policy, by December 1994, that will ensure the provisions of 38 U.S C. 3015 are followed. Currently, the DoD planning, programming and budgeting process is used to revalidate "kicker" requirements.

Final Report Reference

Part III-Compliance with Laws and Regulations

Page 11

Page 13, Paragraph 1. Results of Audit

Cannot validate the comment regarding improper DVA charges to the fund We agree that this is an important finding; however, it requires further research on the validity of the comment and the associated cost or savings. We are currently working with the Department of Veterans Affairs to verify their methodology for determining the $1.6 million charge to the fund.

Page 21

Page 14, Paragraph 1. DoD Internal Management Control Program

Concur with statement that the Internal Management Control Program should be an integral part of the Fund resources. We will work with the active and Reserve Components to establish an IMCP for the Montgomery GI Bill.

Assistant Secretary of Defense for Reserve Affairs Comments

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON DC 20301-1500

RESERVE AFFAIRS

21 JUN 1994

MEMORANDUM FOR ACTING DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, DOD INSPECTOR GENERAL

SUBJECT: Audit Report on Internal Controls and Compliance with Laws and Regulations for the DoD Education Benefits Fund Financial Statements for FY 1993 (Project No. 3FH-2013

Attached please find our comments as requested in your memorandum dated April 29, 1994, subject as above. For further information on this response, please contact Lieutenant Colonel Patricia M. Forest at (703) 695-7429.

Francis M. Rush, Jr
Deputy Assistant Secretary
(Manpower and Personnel)

Attachment:
As stated

Final Report Reference

Department of Defense Inspector General
Project Number 3FH-2013

Audit Report on Internal Controls and Compliance with Laws and Regulations for the DoD Education Benefits Trust Fund Financial Statements for FY 1993.

****

General - We appreciate the opportunity to provide comments on this report.

Page 11

Page 6, Paragraph 2

Nonconcur This finding is a repeat of the finding in Report 94-052. Since the Deputy Assistant Secretary of Defense for Reserve Affairs (Manpower and Personnel) has already responded that the issue of counts for contributions to the fund will be resolved during staffing of DoDI 1322.17, there is no need to repeat the requirement again in this report.

Pages 12 and 13

Page 7, Paragraph 2

Nonconcur with the broad statement that DoD provided inaccurate and untimely Selected Reserve eligibility data to the DVA. The reason given that 185 of the 1399 records have incorrect or inconsistent data does not substantiate the noted "untimely" quality of the data. Further, with the exception that some records reported the reservist left the Selected Reserve but did not report a separation date, all cases cite instances where Reserve components were correcting data errors that had been discovered. Such corrections are appropriate and planned for within the system

Although DMDC does not send reports specifically called "edit reports" to the Reserve components, they prepare and distribute data extracts that contain eligibility data, current DVA benefit data, and a data element that identifies any shift in eligibility by examining the interrelationship between the DVA master record status, the eligibility code and the expedited correction. Each reserve component receives the extract monthly Additionally, a report that lists personnel reported as unsatisfactory in one component and reported as eligible in another is distributed to each component quarterly. These two tools allow managers to check the accuracy of the data they report to DMDC.

Defense Finance and Accounting Service Comments

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

MAY 19 1994

DFAS-HQ/G

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
INSPECTOR GENERAL, DoD

SUBJECT: DoD Inspector General's Draft Report, "Internal Controls and Compliance with Laws and Regulations for the DoD Education Benefits Fund Financial Statements for FY 1993," dated April 29, 1994 (Project No. 3FH-2013)

We have reviewed the subject draft report and we partially concur with your findings related to the Defense Finance and Accounting Service. Our comments are attached.

My point of contact for this matter is Mr. Charles McIntosh on (703) 607-1120.

Arnold R. Weiss
Deputy Director for
General Accounting

Attachment

DoDIG Draft Report on Internal Controls and Compliance with Laws and Regulations for the DoD Education Benefits Fund Financial Statements for FY 1993 (Project 3FH-2013)

Comments

The following are comments on the subject draft report, Part III - Compliance with Laws and Regulations, Results of Audit - Improper Accounting.

Unrecorded Liabilities. The present value of the benefits earned for individuals enrolled in the Montgomery GI Bill (MGIB) was not shown as a liability on the financial statements. As a result, the Net Financial Position is overstated by $650.8 million.

DFAS POSITION: Concur. We are drafting a letter to the Comptroller, Department of Defense to obtain permission to use the "Other Actuarial Liabilities" account to recognize the actuarial present value of the accumulated benefits. The anticipated completion date is May 26, 1994.

Valuation of Treasury Bonds. The DAO-Arlington amortized premiums on Treasury Bonds to the call date instead of maturity date. Investment understated by about $1,551,000 and interest income understated by $483,000.

DFAS POSITION: Nonconcur. The DoD Manual, Chapter 37, states that "Security discounts and premiums shall be amortized over the life of an investment security." The manual is silent on how to handle the amortization of premium and discount on securities with a call date. The prevailing practice in the financial community is for all prices at a premium, yields are figured to the first optional date and for prices at a discount, yields are figured to the final maturity date. The calculated yields conform to yields in the Bond tables used to manage the Trust Fund.

Expenses. DAO-Arlington incorrectly reported benefit expenses totaling $3.2 million. Payments of about $2.1 million were for separation bonus payments, and payments of $1.1 million were for FY 1992 expenses. DAO-Arlington recorded the separation bonuses as Refunds Receivable instead of Accounts Receivable. In effect, the DAO-Arlington did not account for benefits paid to individuals receiving the separation bonus or for contribution revenue, even though 38 U.S.C. 3035 requires the Fund to pay those benefits. They reported $1.1 million of FY 92 expenses as FY 93 expenses (FY 93 overstated).

DFAS POSITION: Partially Concur. We are dependent upon the Veterans Administration to pass accurate benefit expense data. Contributions due from the Service Components are classified as Accounts Receivable on the CFO reports and the General Ledger has been reprogrammed to also report these receivables in this manner. The software is currently being tested and evaluated.

Overcontributions. DAO Arlington accounted for $353,000 overcontribution from Army as revenue instead of as deferred income. Revenue was overstated and liabilities were understated by $353,000.

DFAS POSITION: Nonconcur. DoD Manual Chapter 47 provides that contributions to this Fund can be determined on an estimated basis to be adjusted when actual data is available. We are not convinced that estimates come under the definition of Deferred Credits. We are researching this issue.

Notes to the Financial Statements. The Notes to the Financial Statements do not adequately describe significant accounting policies. Specifically, Note 1 does not describe the accounting methods used, Note 3 does not adequately describe the sources of Accounts Receivable, Note 4 does not include the original cost of the Treasury securities, and the Notes do not include an actuarial valuation of the Fund.

DFAS POSITION: Partial Concur. Note 1 - We feel the note is adequate according to OMB Bulletin No. 94-01. Note 3 - OMB Bulletin No. 94-01 does not require a description of the sources of Accounts Receivable. We will correct Note 4 to comply with OMB Bulletin No. 94-01. The anticipated completion date is May 27, 1994.

Audit Team Members

Russell A. Rau
Terry L. McKinney
Raymond D. Kidd
Saundra G. Elion
Donney J. Bibb
Stanley J. Arceneaux
Cordelia A. Williams
Stacey L. Volis
Jill P. Beck
Joan E. Fox
Judy L. White