

**A** *udit*



**R** *eport*

DATA SUPPORTING THE ENVIRONMENTAL LIABILITY REPORTED  
ON THE FY 2000 FINANCIAL STATEMENTS

Report No. D-2001-172

August 10, 2001

Office of the Inspector General  
Department of Defense

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### **Acronyms**

AFAA	Air Force Audit Agency
DERP	Defense Environmental Restoration Program
DUSD	Deputy Under Secretary of Defense
GAO	General Accounting Office
IG	Inspector General
USD	Under Secretary of Defense



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August 10, 2001

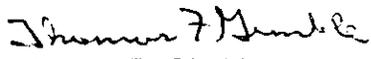
MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
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ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT & COMPTROLLER)  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY  
NAVAL INSPECTOR GENERAL

SUBJECT: Audit Report on the Data Supporting the Environmental Liability Reported  
on the FY 2000 Financial Statements (Report No. D-2001-172)

We are providing this report for your review and comment. We conducted this audit in support of our audit of the DoD Agency-Wide financial statements for FY 2000 as required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered comments from the Under Secretary of Defense (Comptroller) and the Assistant Secretary of the Navy (Installations and Environment), in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we revised and redirected Recommendation 1. to the Assistant Secretary of the Army (Financial Management and Comptroller), Assistant Secretary of the Navy (Financial Management and Comptroller), and Assistant Secretary of the Air Force (Financial Management and Comptroller). We deleted Recommendation 2., and revised, renumbered, and redirected Recommendation 3. to the Assistant Secretary of Defense (Comptroller). We request that they provide comments on the recommendations by September 10, 2001.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Hoa H. Pham at (703) 604-9588 (DSN 664-9588) (hpham@dodig.osd.mil). See Appendix C for the report distribution. The team members are listed inside the back cover.

  
Thomas F. Gimble  
Acting  
Deputy Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. D-2001-172  
(Project No. D2001FC-0007)

August 10, 2001

### Data Supporting the Environmental Liability Reported on the FY 2000 Financial Statements

#### Executive Summary

**Introduction.** We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare consolidated financial statements. This audit supports our audit of the FY 2000 DoD Agency-Wide Financial Statements, specifically the line item for environmental liabilities. The Army, the Navy, and the General Accounting Office also issued audit reports related to the reliability, completeness, and supportability of environmental liabilities for FY 2000. Environmental liabilities included estimated amounts for future cleanup of contamination resulting from waste disposal methods, leaks, spills, and other past activity which have created a public health or environmental risk. The FY 2000 DoD Agency-Wide Financial Statements reported an environmental liability of \$63.2 billion, which included \$37.4 billion for accrued environmental restoration costs, and \$25.8 billion for other disposal liabilities.

**Objectives.** The audit objective was to evaluate the reliability and completeness of the data used to calculate the DoD environmental liability for FY 2000. This audit focused on the accrued environmental restoration costs. We also reviewed the adequacy of the internal control program as it applied to the audit objective.

**Results.** DoD is continuing to make commendable progress in establishing policy and identifying environmental liabilities. However, the \$63.2 billion reported in the FY 2000 DoD Agency-Wide Financial Statements for environmental liabilities was inadequately supported and incomplete. Specifically, the cost-to-complete estimates of \$23.4 billion that support environmental restoration liabilities were not adequately documented and the \$14 billion accrued environmental restoration liability for training ranges was not based on a complete training range inventory. As a result, the environmental liability line item was unverifiable, unreliable, and understated. The environmental liabilities reported in the DoD Agency-Wide financial statements will continue to be incomplete and misstated until the DoD completes and revises standard policy guidance for reporting of training ranges and recognizes all associated liabilities.

**Prior Recommendations and Ongoing Actions.** We are not making recommendations involving the verification, validation, and accreditation of cost-to-complete models, because the Military Department audit agencies previously made recommendations to correct the deficiencies. Also, DoD is aware of and working on amending guidance for identifying and reporting information for the Defense Environmental Restoration

Program, which is used to support environmental liabilities on the financial statements. In addition, the General Accounting Office has made recommendations to correct the timeliness of guidance, the lack of inventory of the reported estimates, and the lack of guidance to recognize certain active and inactive training ranges on the financial statements. See Appendix A for a list of these reports.

**Summary of Recommendations.** We recommend that the Army, Navy, and Air Force require personnel estimating environmental liabilities for annual financial statements be trained on what constitutes an adequate audit trail, documentation, and narratives necessary to support estimates provided. We also recommend that the Under Secretary of Defense (Comptroller) revise DoD Regulation 7000.14-R, to include specific guidance for the recognition of an environmental liability when expected costs related to preservation and maintenance at active and inactive ranges exceed the scope of the routine compliant maintenance.

**Management Comments.** The Deputy Chief Financial Officer, DoD, stated that the report contained misleading and incorrect statements, and nonconcurred with all recommendations. The Office of the Under Secretary of Defense (Comptroller) stated that the draft report did not reflect an awareness of past, current, and planned actions for improving the recognition and reporting of environmental liabilities. The Office of the Under Secretary of Defense (Comptroller) nonconcurred with our original recommendation to design training courses explaining audit trails for personnel preparing and estimating environmental liabilities because engineering estimates should not have the same audit trail requirements as accounting transactions. The Office of the Under Secretary of Defense (Comptroller) also nonconcurred that the Military Departments should identify, accrue, and report environmental liabilities related to preservation and maintenance of active and inactive ranges because the auditors did not provide examples to support the assertion that the Military Departments were noncompliant. The Navy agreed that better training was needed on required documentation to support liability estimates, but the training courses should be designed by the Services. The Navy did not agree to accrue and report environmental liabilities related to the preservation and maintenance of active and inactive ranges. See the Finding section and Appendix B for a discussion of the management comments and the Management Comments section for the complete text.

**Audit Response.** The Deputy Chief Financial Officer, DoD, comments were not responsive to the recommendations because no alternative actions were proposed. We considered the revised DoD policy and procedures during the audit and we agree that the revised policy and procedures have improved controls over financial statement liability. However, we also recognized the need for further improvement. Past, current, and planned actions for improving and reporting DoD environmental liabilities are addressed in the executive summary, and on pages 4, 8, and 10 of the report. An environmental estimate that will affect the financial statements should have a sufficient audit trail to enable anyone to clearly trace the information to a source document. Environmental liabilities often are based on estimates rather than actual costs. Nevertheless, persons preparing the estimates should recognize that adequate source documentation and narrative descriptions of the basis of the estimates are needed. Our conclusion on the need for additional training on what constitutes an audit trail was based on numerous audit reports. In addition, our discussion with Army installations personnel responsible

for computing and reporting environmental estimates during the audit clearly indicated that there was a misconception on the issue of what constitutes an audit trail, and the methods required to maintain an audit trail to support the estimate. The lack of training and the lack of supporting documentation is a continuing problem and should be addressed as DoD seeks to improve the reliability of its financial statements.

The reporting of an environmental liability for maintenance and preservation of active and inactive ranges is being significantly changed in DoD Regulation 7000.14-R since our draft report was published. We support clarification of this issue and have revised our original recommendation in the draft report. Our revised recommendation stresses the need for DoD Regulation 7000.14-R to require the Military Departments to recognize that an environmental liability should be recognized when a significant problem is discovered on an active range that would exceed the scope of routine preservation and maintenance.

We request that the Under Secretary of Defense (Comptroller) and the Army, Navy, and Air Force, provide comments to the final report by September 10, 2001.

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## Background

**Reporting Requirements.** Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD to prepare annual audited financial statements. Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” October 16, 2000, establishes the requirements for audits of these financial statements. This Bulletin requires the Inspector General (IG), DoD, to express an opinion on the DoD Financial Statements and to report on the adequacy of internal controls and compliance with laws and regulations. This report discusses the reliability and completeness of the information used to compute and report the DoD environmental liability for the FY 2000 DoD Agency-Wide Financial Statements.

**Statutory Requirements for Environmental Cleanup.** The Comprehensive Environmental Response, Compensation, and Liability Act (Liability Act) of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986, established a comprehensive framework to identify, investigate, and clean up releases of hazardous materials. The Liability Act provides statutory authority for cleanup of hazardous material that could endanger public health, public welfare, or the environment. The Resource Conservation and Recovery Act of 1976, sections 6901 through 6992, title 42, United States Code, created a comprehensive Federal Regulatory program for hazardous waste control.

**DoD Implementation of Liability Act.** The Deputy Under Secretary of Defense (DUSD) (Installations and Environment)<sup>1</sup> is responsible for environmental cleanup within DoD. The DoD Office of Environmental Cleanup, as part of the Office of the DUSD (Installations and Environment), manages the Defense Environmental Restoration Program (DERP). The DERP includes active installations, formerly used Defense sites, and the base realignment and closure installations. The Army, Navy, Air Force, and the Defense National Stockpile Center all report environmental restoration activities in the DERP.

**Standardization of Measurement.** To ensure a consistent standard within DoD, the DERP cost-to-complete<sup>2</sup> computer models within each DoD Component must conform to DoD Instruction 5000.61, “DoD Modeling and Simulation Verification, Validation, and Accreditation,” April 29, 1996. This guidance instructs the heads of the DoD Components to plan and provide

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<sup>1</sup>The DUSD (Installations and Environment) replaced the DUSD (Environmental Security) on May 15, 2001. Future references to the DUSD in this report, including past actions by the DUSD (Environmental Security), will show the new title.

<sup>2</sup>The “cost-to-complete” is a term commonly used to refer to the cost to completely restore, contain, or monitor a site that has been identified as an environmental hazard.

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resources to carry out the functional responsibilities of verification, validation, and accreditation. Some estimates can not be developed using a computer model; therefore, it is necessary that these estimates be developed based on engineering studies instead of relying on computer models.

**Liability for Environmental Cleanup.** DoD is required to clean up contamination resulting from waste disposal practices, leaks, spills, and other past activities which have created a public health or environmental risk. DoD also is required to clean up certain contamination in coordination with regulatory agencies, their responsible parties, and current property owners. The FY 2000 DoD Agency-Wide Financial Statements reported an environmental liability of \$63.2 billion. Of the \$63.2 billion, \$37.4 billion was for the accrued environmental restoration costs, and \$25.8 billion was for other environmental disposal costs.

## Objectives

The objective was to evaluate the reliability and completeness of the data used to calculate the environmental liability shown on the FY 2000 DoD Agency-Wide Financial Statements. This audit focused on the accrued environmental restoration costs. We also reviewed the adequacy of the internal control program as it applied to the audit objective. Appendix A discusses the audit scope and methodology and our review of the management control program.

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## Environmental Liabilities

The \$63.2 billion reported as environmental liabilities in the FY 2000 DoD Agency-Wide Financial Statements was inadequately supported and incomplete. Specifically, the cost-to-complete estimates of \$23.4 billion that support environmental restoration liabilities were not adequately documented and the \$14 billion accrued environmental liability for cleanup of training ranges was not based on a complete training range inventory. The reported environmental liabilities were not adequately supported and complete because:

- the Military Departments did not fully implement the requirement to maintain an adequate audit trail documenting the procedures for estimating environmental liabilities;
- cost-to-complete models used to generate environmental liabilities were not verified, validated, and accredited as required by DoD Instruction 5000.61;
- DoD has not completed its proposed range rule guidance, which defines a process to identify and clean up closed, transferred, and transferring ranges. Also, DoD did not amend and issue the DERP management guidance in time for the Military Departments to implement in the FY 2000 financial statements;
- DoD guidance needed clarification on recognition of cleanup costs for certain active and inactive training ranges; and
- personnel responsible for computing environmental liability estimates did not have sufficient training on how to maintain complete audit trails to support the estimates.

As a result, the environmental liability line item in the FY 2000 DoD Agency-Wide Financial Statements was unverifiable, unreliable, and understated.

## Guidance for Reporting Environmental Liabilities

**Federal Accounting Standards Advisory Board Guidance.** Statement of Federal Financial Accounting Standards No. 5, “Accounting for Liabilities of the Federal Government,” December 20, 1995, provides guidance for recognition of liabilities, including those arising from past environmental events, where the future outflow of resources is probable and reasonably estimable. Also, Statement of Federal Financial Accounting Standards No. 6, “Accounting for Property, Plant, and Equipment,” June 1996, provides accounting guidance for environmental cleanup and disposal liabilities related to property, plant, and equipment.

**DoD Guidance.** In response to recommendations made in IG, DoD, Report No. D-2000-168, “Data Supporting the Environmental Liability Line Item on the FY 1999 DoD Financial Statements,” July 27, 2000, and IG, DoD, Report

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No. 99-209, "Data Supporting the DoD Environmental Line Item Liability on the FY 1998 Financial Statements," July 9, 1999, the Under Secretary of Defense (USD) (Comptroller) revised DoD Regulation 7000.14-R, "Financial Management Regulation," volume 4, chapters 13 and 14, in October 1999. These revised chapters provide guidance on reporting environmental and disposal liabilities. Also, in August 1999, DUSD (Installations and Environment) issued the Supplemental Management Guidance for the DERP requiring that all cleanup cost estimates be documented and each DoD Component ensure that its computer models conform to DoD Instruction 5000.61. The Supplemental Management Guidance for the DERP provides procedures for documenting estimates developed both with, and without the use of a computer model.

**DoD Proposed Range Rule.** In September 1997, DoD proposed a new regulation to address training range issues in response to the November 1995 Environmental Protection Agency requirement, which discusses Military munitions including unexploded ordnance on ranges. The purpose of the proposed regulation was to define a process to identify closed, transferred, and transferring ranges and address risk to human health and the environment posed by unexploded ordnance. Other Federal agencies, such as the Office of Management and Budget, Environmental Protection Agency, and Federal land managers were extensively involved in the process. However, the process was put on hold in November 2000, because DoD, the Environmental Protection Agency and Federal land managers could not agree on several key issues, such as how to safely handle explosives and who would decide the remedy. As a result, as of March 2001, DoD did not have definitive guidance on how to estimate the environmental liabilities for training ranges.

## **Reliability and Completeness of Reported Environmental Liabilities**

DoD is continuing to make progress in establishing, revising policy guidance and identifying environmental liabilities. As a result, environmental liabilities declined from \$79.7 billion to \$63.2 billion or approximately \$16.5 billion between FY 1999 and FY 2000. However, DoD continued to have difficulty maintaining sufficient support for the reported amount. DoD reported \$63.2 billion as environmental liabilities in the FY 2000 DoD Agency-Wide Consolidated Financial Statements. Of the \$63.2 billion, \$37.4 billion was for the restoration cleanup costs, and the remaining \$25.8 billion was for other disposal liability costs. The following table shows the reported environmental liabilities by each category.

**Reported Environmental Liabilities in the FY 2000 DoD  
Agency-Wide Financial Statements**  
(in millions)

**Accrued Environmental Restoration Costs**

<u>Description</u>	<u>Army</u>	<u>Navy</u>	<u>Air Force</u>	<u>DoD Agency Wide</u>
Active Installations-DERP Funds	\$ 5,011.5	\$ 3,990.0	\$ 4,844.0	\$ 13,845.5
Active Installations-Other Funds	1,361.3	0.0	175.5	1,539.0*
Base Realignment and Closure				
Installations	815.5	1,209.5	1,863.2	3,888.2
Formerly Used Defense Sites	4,155.1	0.0	0.0	4,155.1
Closed, Transferred, and Transferring				
Ranges	<u>13,101.1</u>	<u>53.6</u>	<u>829.4</u>	<u>13,984.1</u>
<b>Subtotal</b>	<b>\$24,444.5</b>	<b>\$ 5,253.1</b>	<b>\$ 7,712.1</b>	<b>\$ 37,411.9</b>

**Other Environmental Disposal Liabilities**

<u>Description</u>	<u>Army</u>	<u>Navy</u>	<u>Air Force</u>	<u>DoD Agency Wide</u>
Nuclear Powered Aircraft Carriers	\$ 0.0	\$ 4,890.0	\$ 0.0	\$ 4,890.0
Nuclear Powered Submarines	0.0	5,270.7	0.0	5,270.7
Other Powered Nuclear Ships	0.0	269.1	0.0	269.1
Other National Defense Weapon				
Systems	0.0	82.2	3.1	85.3
Chemical Weapons Disposal	14,874.8	0.0	0.0	14,874.8
Other	<u>0.0</u>	<u>300.8</u>	<u>0.0</u>	<u>411.8*</u>
<b>Subtotal</b>	<b>\$14,874.8</b>	<b>\$10,812.8</b>	<b>\$ 3.1</b>	<b>\$ 25,801.7</b>
<b>Total</b>	<b>\$39,319.3</b>	<b>\$16,065.9</b>	<b>\$ 7,715.2</b>	<b>\$ 63,213.6</b>

\*DoD Agency-Wide totals include \$113.1 million reported by other Defense organizations for environmental liabilities.

**Maintaining an Audit Trail for Environmental Liability Estimates.** DoD Regulation 7000.14-R, volume 1, "General Financial Management Information Systems and Requirements," chapter 3, May 1993, states that accounting systems must have audit trails that allow transactions to be traced from initiation through processing to the financial statements. In response to our recommendations in IG, DoD, Report No. D-99-209, the DUSD (Installations and Environment) issued supplementary guidance for the DERP, on August 6, 1999, to ensure that DoD Components use a consistent model for developing cost estimates and that an adequate audit trail is maintained to document the cost estimating procedures. However, audit work performed by the Military

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Department audit agencies showed that Military Departments had not fully implemented that guidance when estimating their environmental liabilities.

**Army.** The Army reported \$24.4 billion of accrued environmental restoration costs for FY 2000. However, the Army Audit Agency could not attest to the accuracy and completeness of the reported amount because of the lack of supporting documentation.<sup>3</sup> For example, the Army Audit Agency could not locate supporting documentation for 94 projects valued at \$1.2 billion. In addition, although the Army reported a \$13 billion liability for cleaning unexploded ordnance for its training ranges, the Army disclosed in note 14 to the financial statements its inability to provide a complete liability cost estimate for cleanup of the training ranges. As a result, the amount of environmental liabilities reported by the Army was unverifiable, and may be materially misstated.

**Navy.** The Navy reported \$5.3 billion for accrued environmental restoration costs for FY 2000. However, Navy organizations with environmental cleanup sites did not maintain adequate support for the cleanup estimates. For example, the Naval Audit Service reported that supporting documentation for 35 of the 85 environmental projects reviewed was not adequate.<sup>4</sup> The 85 projects reviewed, valued at \$1.1 billion, included unsupported data of \$453 million and errors of at least \$25.9 million. Accordingly, the Naval Audit Service determined that documentation for transactions that make up this liability did not satisfy requirements issued by the Office of Management and Budget. As a result, the Navy environmental liabilities reported in the DoD Agency-Wide Financial Statements were not reliable and were misstated.

**Air Force.** The Air Force reported \$7.7 billion for accrued environmental restoration costs for FY 2000. The Air Force Audit Agency (AFAA) did not perform audit work to attest to the reliability of the FY 2000 reported amount because they believed that the Air Force needed additional time to fully implement the new requirements. However, AFAA stated in its FY 1999 audit report<sup>5</sup> that most of the Air Force restoration managers did not maintain accurate or complete cost data in the Air Force Restoration Information Management System. Also, the Air Force restoration managers generally relied on unsupported cost data from the Air Force Restoration Information Management System for managing environmental restoration programs. Management concurred with AFAA recommendations to revise guidance to require justification for cleanup requirements. Based on management comments, we concluded that the deficiencies disclosed in FY 1999 would continue occurring in FY 2000, because the Air Force would not be able to

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<sup>3</sup>Army Audit Agency Report No. AA01-332 "Army's General Fund Principle Financial Statements for Fiscal Year 2000, Financial Reporting of Liabilities Compilation and Data Collection," June 20, 2001.

<sup>4</sup>Naval Audit Service Report No. N2001-0011, "Department of the Navy Principal Statements for Fiscal Year 2000: Environmental Liabilities," February 6, 2001.

<sup>5</sup>Air Force Audit Agency Report No. 99052004, "Installations Support of the Environmental Restoration Program," September 13, 2000.

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complete its corrective action until sometime in FY 2001.

**Information on Training Ranges.** The FY 2000 DoD Agency-Wide Financial Statements include \$14 billion in restoration costs for clearing unexploded ordnance on training ranges. However, the General Accounting Office (GAO) stated in Report No. GAO-01-0479 “Environmental Liabilities: DoD Training Range Cleanup Cost Estimates are Likely Understated,” April 11, 2001, that the amounts reported for training range cleanup could not be relied on and are likely significantly understated<sup>6</sup> because DoD does not have a complete inventory and has not used a consistent methodology to compute the costs. Finally, the GAO concluded that without complete and accurate data, it is impossible to determine whether these amounts represent a reasonable estimate of the long-term budget implication of cleaning up DoD training ranges.

## Reasons for Unreliable and Incomplete Reporting of Environmental Liabilities

Audits performed by the IG, DoD, the Military Department audit agencies, and GAO have continually reported the lack of reliable documentation to support the environmental liability line item of the financial statements.

**Cost-to-Complete Model.** Cost-to-complete environmental cleanup estimates are the source of the environmental liability line item in the financial statements. Because the DoD Components often use computerized models to compute DERP cost estimates for environmental cleanup projects, the Supplemental Management Guidance for the DERP requires each DoD Component to ensure that its computer models conform to DoD Instruction 5000.61. The Instruction requires that DoD Components establish verification, validation, and accreditation policies and procedures for their models and simulations, and that they document the results of these procedures and make them available to other DoD Components. Verification is the process of determining that a model’s implementation accurately represents the developer’s concepts and specification. Validation is the process of determining the degree to which a model accurately represents the real world from the perspective of the model’s intended use. Accreditation is the official certification that a model or simulation is acceptable for use for a specific purpose. Audits performed by the Military Department audit agencies showed that cost-to-complete models used to compute the DERP cost estimates did not always conform to DoD Instruction 5000.61. For example, Navy organizations used the cost-to-complete system, Normalization of Data, version 4.0, to develop budgetary requirements and estimate financial statement liabilities for environmental restoration costs, but did not have the model verified, validated, and accredited. We are not making a

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<sup>6</sup>GAO cited DoD estimates developed in 2000 showing cleanup costs at about \$40 billion to \$140 billion for closed, transferred, and transferring ranges. USD(Comptroller) personnel strongly disagreed with this estimate shown in the GAO report, which we cited in our draft report. USD (Comptroller) stated that the estimate was misleading, because it was based on a proposed, but not approved nor implemented, Range Rule that included estimates for cleaning up unexploded ordnance.

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recommendation to correct deficiencies because the Military Department audit agencies have already made recommendations in their reports.

**Timeliness and Adequacy of DoD Guidance.** DoD did not promptly issue detailed guidance to enable the Military Departments to identify and report potential environmental liabilities.

**DoD Proposed Range Rule.** Military Departments did not consistently or fully report liabilities for unexploded ordnance on training ranges. Neither DoD nor the Military Departments could provide a complete listing of the acreage on training ranges and the amounts reported were not supported by an inventory of the relevant ranges. The reported amounts varied significantly among Military Departments. For example, the Army reported \$13.1 billion of cleanup costs of closed, transferred, and transferring ranges as liabilities in the financial statements in the FY 2000 Army Financial Statements while Air Force and Navy only reported \$830 million and \$54 million as liabilities in their financial statements, respectively. Although the Army reported \$13.1 billion of cleanup costs, it acknowledged its inability to determine a complete cost for cleaning unexploded ordnance on ranges. This occurred because DoD did not provide Military Departments with definitive guidance on how to consistently identify and report cleanup costs for closed, transferred, and transferring ranges. DoD proposed a range rule in September 1997 that defined a process to identify and report liabilities related to training ranges. However, as of March 2001, DoD had not been able to finalize the proposed guidance. We are not making a recommendation to correct the deficiencies related to the timeliness of the guidance because GAO Report No. GAO-01-479 already made those recommendations.

**Amending the Supplemental Guidance.** DoD had not amended and issued detailed guidance to address problems identified. IG, DoD, Report No. D-2000-168, recommended that DUSD (Installations and Environment) amend the supplemental guidance. DUSD (Installations and Environment) concurred with the recommendations and stated that the revision would be updated during calendar year 2000. However, as of March 20, 2001, the supplemental guidance had not been amended. We are not making a new recommendation to address this issue because DUSD (Installations and Environment) was rewriting the entire DERP guidance. When the guidance is issued, we will evaluate it to determine whether it will enhance the Military Departments in identifying, compiling, and reporting environmental liabilities.

**Adequacy of DoD Regulation 7000.14-R.** Although USD (Comptroller) revised the DoD Regulation 7000.14-R to require the reporting of the cleanup costs for closed, transferred, and transferring ranges, the revised guidance did not clearly include instructions for recognizing a liability in the financial statements for certain active and inactive ranges when the Government is legally liable and the cost associated with the cleanup efforts is reasonably estimable. For example, the Navy disclosed in note 14 to its financial statements that based on their research and investigation of DoD Regulation 7000.14-R, volume 4, chapter 13, only liabilities associated with inactive and transferring ranges should be recorded. However, GAO Report

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No. GAO-01-0479 advised that certain active and inactive training ranges may have contamination that should also be recorded as a liability in the financial statements because it meets the reporting criteria as defined in Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," December 20, 1995. We are not making a recommendation to revise DoD guidance because the GAO report already addressed this issue and made recommendations.

**Compliance with DoD Guidance.** Military Departments did not have procedures to ensure that environmental liability costs were computed and reported in accordance with applicable DoD guidance. DoD Regulation 7000.14-R, volume 6B, chapter 10, December 2000, states that costs incurred related to management and preservation of active and inactive ranges at active installations, but not expected to be paid until future periods, should be accrued and included as an environmental cleanup liability. However, note 14 of the FY 2000 DoD Agency-Wide Financial Statements and the financial statements issued by the Military Departments did not show that any of those costs were included in the reported environmental liability. According to the USD (Comptroller) personnel, DoD plans to significantly revise its guidance in this area to delete this requirement for FY 2001 because the costs incurred in this area are considered to be insignificant. We support this proposal and have revised and redirected our recommendation to the USD (Comptroller).

**Environmental Liability Training.** Environmental liability estimates were not prepared or supported because personnel responsible for performing the cost estimates did not have training on how to maintain an adequate audit trail or how to operate the computer models used to generate the cost estimates. For example:

- AFAA reported that restoration managers were not proficient using computer models and did not understand the need to document requirements beyond the Future Year Defense Program. Also, the AFAA determined that command restoration managers generally did not understand proper uses of the Air Force Restoration Information Management Systems cost data field. Accordingly, managers posted cost data to the system without understanding reporting implications of these fields.
- The Navy attributed the documentation inadequacies and reporting errors to staff turnover and learning curves associated with updates to computer modeling programs used to estimate restoration costs.

These practices resulted in overstated and understated environmental liabilities. DoD Instruction 4715.10, "Environmental Education, Training and Career Development," April 24, 1996, states that DUSD (Installations and Environment) is responsible for establishing an education and training program for Armed Forces and DoD civilian employees whose responsibilities include planning and executing the environmental security mission. The instruction further states that the training program should provide appropriate training so each person could meet environmental responsibilities. Considering the magnitude of the reported environmental liabilities and the continuing difficulty

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of the Military Departments to provide reliable documentation, a defined knowledge of what is considered adequate documentation is needed. Military Departments should design training courses to provide basic training on the type of documentation and narratives appropriate to provide support for the environmental liability estimates.

## **Management Comments on the Finding and Audit Response**

The Office of the USD (Comptroller) provided lengthy comments to the draft report and stated that the report contained misleading, and in some instances, incorrect statements. Summaries of those comments along with an audit response are shown in Appendix B.

## **Conclusion**

The DUSD (Installations and Environment) and USD (Comptroller) have taken actions to correct some deficiencies identified by auditors by issuing additional guidance or revising existing guidance to improve the reliability and integrity of the financial statement liability. However, the definitive guidance was not fully implemented by the Military Departments, needed further revision, or may not be completed until FY 2002 at the earliest. Until standard policy guidance for reporting of training ranges is issued, and DoD Regulation 7000.14-R is revised to recognize the environmental liability for certain active and inactive ranges that meet criteria in Federal accounting standards for recording a liability, the environmental liabilities reported in the DoD Agency-Wide financial statements will continue to be incomplete and misstated.

## **Recommendations, Management Comments, and Audit Response**

**Revised, Deleted, and Redirected Recommendations.** As a result of management comments and additional discussions with the USD (Comptroller) and DUSD (Installations and Environment) personnel, we deleted Recommendation 2., and revised and redirected Recommendation 3. to reflect DoD recent proposals on reporting costs incurred related to management and preservation of active and inactive training ranges.

**1. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), Assistant Secretary of the Navy (Financial Management and Comptroller), and Assistant Secretary of the Air Force (Financial Management and Comptroller) require that personnel preparing and estimating environmental liabilities be trained on the type of documentation and narratives necessary to provide an adequate audit trail.**

**Management Comments.** The Office of the USD (Comptroller) nonconcurred with the original recommendation because he believes that the audit trail

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requirements for accounting transactions should not apply to engineering estimates. The Navy concurred with the recommendation but believes that the training should be designed by the Services.

**Audit Response.** The Office of the USD (Comptroller) comments were not responsive to the recommendation. An environmental estimate that will affect the financial statements should have a sufficient audit trail to enable anyone to clearly trace the information to a source document. Environmental liabilities often are based on estimates rather than actual costs. Nevertheless, persons preparing the estimates should recognize that adequate source documentation and narrative descriptions of the basis of the estimates are needed. The recommendation, originally directed to the USD (Comptroller) and the DUSD (Installations and Environment), has been redirected to the Military Departments to place the responsibility more closely to the source of the estimates. We request that the Army, Navy, and Air Force comment on the revised recommendation.

**2. We recommend that the Under Secretary of Defense (Comptroller) revise DoD Regulation 7000.14, “Financial Management Regulation,” volume 6B, chapter 10, to include specific guidance for the recognition of an environmental liability when the costs incurred related to preservation and maintenance at active and inactive ranges exceed the scope of the routine compliant maintenance.**

**Management Comments.** The Office of the USD (Comptroller) nonconcurred with the original recommendation and stated that it is inappropriate for the auditors to assert that the Military Departments were noncompliant without giving any specific examples on noncompliance. Also, it is not appropriate to recommend corrective actions based on deficiencies that might occur in the future. The Navy also nonconcurred, stating that it does not plan on closing its active and inactive ranges in the foreseeable future. Therefore, any estimate of environmental restoration would be highly speculative and subject to much change as technology advances.

**Audit Response.** We revised the recommendation based on management comments and subsequent discussions. However, it is important for the Military Departments to recognize an environmental restoration liability when the costs incurred related to preservation and maintenance at active and inactive ranges exceed the scope of the routine compliant maintenance. We request that the USD (Comptroller) comment on the revised recommendation.

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# Appendix A. Audit Process

## Scope and Methodology

**Audit Work Performed.** To fulfill our responsibilities under the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, and Office of Management and Budget Bulletin No. 01-02, we reviewed the information supporting the \$63.2 billion environmental liability reported on the FY 2000 DoD Agency-Wide Financial Statements. Specifically:

- we assessed compliance by the Military Departments with DoD Regulation 7000.14-R and the Supplemental Management Guidance for the DERP;
- we reviewed note 14 to the financial statements related to the environmental liability for the FY 2000 financial statements issued by the Military Departments and the DoD Agency-Wide financial statements;
- we evaluated the procedures used to measure the environmental liabilities and the existence of policies and guidance available to assist in the recognition of the liability;
- we reviewed the internal controls executed to ensure proper measurement of environmental liabilities and evaluated the implementation of cost-to-complete models within the environmental program at each activity visited; and
- we followed up on progress in implementing the recommendations contained in IG, DoD, Report No. D-2000-168.

We also performed limited oversight of the audit work of Military Department audit agencies and monitored the audit processes by discussing the audit objectives and reviewing the audit programs, summary working papers, conclusions about significant issues, findings, and recommendations. Our audit report includes information reported by the Military Department audit agencies and the GAO.

**DoD-Wide Corporate-Level Government Performance and Results Act Goals.** In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following corporate-level goal, subordinate performance goal, and performance measure.

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- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-02)**
  - **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
  - **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

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

**Financial Management Area. Objective:** Strengthen internal controls.  
**Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

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

**Use of Computer-Processed Data.** We did not use computer-processed data to support the audit conclusions.

**Audit Type, Period, and Standards.** We performed this financial-related audit from October 2000 through April 2001, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did our work in accordance with generally accepted Government auditing standards except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review.

**Contacts During the Audit.** We visited or contacted individuals and organizations in the DoD audit community. Further details are available on request.

## **Management Control Program Review**

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a

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comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of the Review of the Management Control Program.** We reviewed the adequacy of the Military Departments' management controls over generating, compiling, and reporting the FY 2000 environmental liability line item. Specifically, we reviewed the implementation of the Army and Navy management controls used to develop and maintain documentation of cost-to-complete estimates. Our review involved acquiring information from the annual statements of assurance and reviewing analysis performed by the Service audit agencies.

**Adequacy of the Management Controls.** We identified material management control weaknesses for the Military Departments as defined by DoD Instruction 5010.40. The Military Departments management controls were not adequate to assure that installations managers maintained adequate documentation for environmental liability estimates. The DUSD (Installations and Environment) has developed guidance to improve the documentation of cost estimates; however, the Military Departments needed to improve the internal controls to fully comply with applicable guidance. The recommendations, if implemented, will improve the accuracy and reliability of the environmental liability line item on the DoD Agency-Wide financial statements in the future years.

**Adequacy of Management's Self-Evaluation.** We reviewed management's self-evaluation program for the Military Departments. DoD has not issued the FY 2000 Annual Statement of Assurance; however, the DoD FY 1999 Annual Statement of Assurance reported the lack of policies addressing the environmental safety management of active and inactive ranges and the cleanup of unexploded ordnance and residue of closed, transferred, and transferring ranges. The Army FY 2000 Annual Statement of Assurance reported systematic deficiencies in the management of unexploded ordnance and other constituents. Specifically, the Army does not effectively address the full life cycle perspective of ranges, land withdrawal, munitions, and unexploded ordnance and other constituents. The Services reported the inability to provide documented environmental cost estimates. The Army Audit Agency review identified that although the Army established a quality assurance program, the assessments were concerned more with the appropriateness of actions taken and quantities of estimated variables than with estimated cost to complete dollar amounts for the financial statements. The Navy FY 2000 Annual Statement of Assurance reported no material weaknesses for environmental liabilities. However, the Naval Audit Service reported a material internal control weakness in the assembling and reporting procedures to provide accurate and timely financial reporting of environmental liabilities. The Air Force FY 2000 Annual Statement of Assurance reported a material weakness in the reliability of supporting documentation of environmental liabilities.

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## Prior Coverage

For FY 2000, Inspector General, DoD, GAO and the Military Department audit agencies issued the following reports related to the environmental liabilities:

Inspector General, DoD, Report No. D-2000-168, "Data Supporting the Environmental Liability Line Item on the FY 1999 DoD Financial Statements," July, 27, 2000

General Accounting Office Report No. GAO-01-0479 (OSD Case No. 3052), "Environmental Liabilities: DoD Training Range Cleanup Cost Estimates are Likely Significantly Understated," April 11, 2001

Army Audit Agency Report No. AA01-332, "Army's General Fund Principal Financial Statements for Fiscal Year 2000," June 29, 2001

Naval Audit Service, Report No. N2001-0011, "Department of the Navy Principal Statements for Fiscal Year 2000: Environmental Liabilities," February 6, 2001

GAO, the IG, DoD, and the Military Department audit agencies have also conducted numerous audits relating to environmental liabilities and other issues affecting the DoD financial statements. GAO reports can be accessed on the Internet at <http://www.gao.gov>. IG, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil/audit/reports>. Army Audit Agency reports can be accessed on the Internet at <http://www.aaa.army.mil>. Naval Audit Service reports can be accessed on the Internet at <http://hq.navy.mil/naualaudit>. AFAA reports can be accessed on the Internet at <http://www.afaaf.hq.af.mil>.

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## Appendix B. Summary of Management Comments on the Finding and Audit Response

**Introduction.** The Office of the USD(Comptroller) provided combined comments that were coordinated with the DUSD(Installations and Environment) and the Military Departments. The Office of the USD (Comptroller) comments were extremely critical of the audit report. This appendix summarizes the Office of the USD (Comptroller) comments and provides our responses to the comments. The Office of the USD (Comptroller) comments are also included in their entirety in the Management Comments section.

**Management Comments.** The audit did not recognize the past, current, and planned actions for improving and reporting of environmental liabilities within DoD. The draft report contained misleading and, in some instances, incorrect statements. Therefore, the report should be revised to give the reader a more balanced perspective on the DoD ongoing efforts to improve the reporting of environmental liabilities.

**Audit Response.** We considered the revised DoD policy and procedures during the audit and we agree that the revised policy and procedures have improved controls over financial statement liability. However, we also recognized the need for further improvement. Past, current, and planned actions for improving and reporting DoD environmental liabilities are addressed in the executive summary, and on pages 4, 8, and 10 of the report. In addition, on page 8 of the report, we state that we are not making a recommendation to address the delay in amending the DERP guidance because we recognized that DUSD (Installations and Environment) was in the process of rewriting the entire DERP guidance.

**Management Comments.** The audit statement that DoD guidance does not require the Military Departments to recognize cleanup cost for certain active and inactive ranges is misleading and incorrect. Active and inactive ranges are included in the “operating installations” category of sites that are included in environmental restoration activities of DoD Regulation 7000.14-R, volume 6B, chapter 10. The report implies that the Navy underreported environmental liabilities associated with its active and inactive ranges without offering any data to support the implication. Because DoD does not plan to close its ranges in the foreseeable future, costs to maintain the safety of its ranges are considered an ongoing maintenance expense and are not accrued as a liability.

**Audit Response.** We agree that DoD is not required to report cleanup costs for active and inactive ranges because DoD assumes that these ranges will continue to operate indefinitely. However, certain active and inactive ranges may pose a threat to public health and the environment due to the improper maintenance or failure to remove contamination occurring through the routine operation. The cost to restore the land to a level where there is no longer a danger to public health and welfare, or the environment, should be reported as an environmental

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liability. DoD Regulation 7000.14-R, volume 4, chapter 14, did not provide any instruction for recognizing a liability for the cleanup cost for this situation.

Also, DoD Regulation 7000.14-R, volume 6B, chapter 10, paragraph 101502, is subject to interpretation. For example, the regulation states that environmental restoration activities may be conducted at operating installations, at base realignment and closure, at former used Defense sites, at closed, transferred and transferring ranges, or at other non-range sites containing unexploded ordnance. However, the regulation later states that environmental cleanup does not include the cost of environmental compliance or pollution prevention. Expenses paid in the current year which are associated with the preservation and maintenance of active and inactive ranges at active installations are not included as environmental liabilities. Furthermore, DoD Regulation 7000.14-R, volume 4, chapter 13, states that preservation and maintenance costs at active and inactive ranges should be included as environmental disposal.

Because the Navy does not intend to dispose of any active and inactive ranges, they thus decided not to include a liability for preservation and maintenance that was not expensed in the current period. The Navy interpreted that costs related to the preservation and maintenance of active and inactive ranges should be excluded from the reporting requirements whether or not they were contaminated beyond the scope of routine maintenance and could result in a potential environmental liability because those ranges would continue to be used indefinitely. This interpretation was evident in note 14 of the FY 2000 DoD Agency-Wide Financial Statements when the Navy stated that based on the guidance contained in DoD Regulation 7000.14-R, volume 4, chapter 13, they determined that only inactive and transferring ranges should be reported as environmental liabilities. This shows that guidance is unclear that active and inactive ranges are excluded from the reporting requirement even if the contamination could pose a threat to public health and the environment.

**Management Comments.** The draft report was misleading by stating that the “Military Departments did not have adequate procedures to ensure that the environmental liability pertaining to preservation and maintenance of active and inactive training ranges was reported as required.” However, the auditors did not note any instances associated with preservation and maintenance of active and inactive ranges that were incorrectly reported. It is inappropriate for auditors to allege that the Military Departments did not have adequate procedures in place if they have not identified any instances of noncompliance.

**Audit Response.** DoD Regulation 7000.14-R, volume 6B, chapter 10, paragraph 101502, requires costs incurred related to management and preservation of active and inactive ranges at active installations, but not expected to be paid until future periods, should be accrued and included as an environmental cleanup liability. Our conclusion was based on note 14 of the FY 2000 DoD Agency-Wide Financial Statements and financial statements issued by the Military Departments. Note 14 provided detailed lists of environmental restoration liabilities and the environmental portion of disposal liabilities as required by volume 6B, chapter 10. However, costs incurred related to management and preservation of active and inactive ranges, but not expected to be paid until future periods, were not mentioned in note 14. In our

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opinion, the Military Departments should have disclosed in the note whether or not such costs were incurred to be in compliance with the guidance. The auditors do not need examples to prove that Military Departments did incur such costs because this was a compliance issue. Therefore, we did not attempt to obtain an actual example. Based on discussions with USD (Comptroller) personnel in July 2001, the USD (Comptroller) plans to significantly revise its guidance in this area to delete this requirement because the cost incurred in this area was insignificant based on the feedback from the Military Departments. We agree with the proposed revision. However, we will review the costs in this area to determine whether the amounts are insignificant.

**Management Comments.** The statement in the draft report that DoD estimates cleanup costs for training ranges as high as \$140 billion did not provide the readers with a informed or balanced view of the nature of the estimate, and is misleading. That estimate was based on a proposed “Range Rule” that was never approved nor implemented. The Range Rule was intended to define DoD responsibilities and requirements in the event of an unexploded ordnance response at closed, transferring, or transferred sites. Due to a lack of consensus between DoD and other Federal agencies, DoD withdrew the proposed Range Rule from negotiations and it was never finalized or implemented. It is inappropriate to base liability estimates on requirements contained in a rule that has not been approved or implemented.

**Audit Response.** The intent of the report is to inform DoD that they need to have complete information on the training ranges and a consistent costing methodology to compute environmental liabilities; otherwise, the amount reported in the financial statements will be incorrect and cannot be relied upon. Our report cited a statement made by GAO in Report No. GAO-01-0479 giving a DoD estimate of \$140 billion as an example to show that the \$14 billion reported as the cleanup costs for closed, transferred, and transferring ranges in the FY 2000 DoD Agency-Wide Financial Statements could be significantly understated. However, in response to management comments, we removed the \$140 billion from the narrative, and added a footnote explaining that DoD did not agree with the use of its estimate as shown in the GAO report.

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Deputy Under Secretary of Defense (Installations and Environment)

### **Department of the Army**

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

### **Department of the Navy**

Assistant Secretary of the Navy (Financial Management and Comptroller)  
Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

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

### **Other Defense Organizations**

Director, Defense Finance and Accounting Service

### **Non-Defense Federal Organizations**

Office of Management and Budget

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform  
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

# Under Secretary of Defense (Comptroller) Comments



COMPTROLLER

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

JUL 3 2001

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

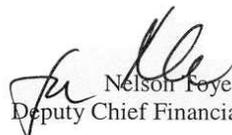
**SUBJECT:** Office of the Inspector General Draft Audit Report, "Data Supporting the  
Environmental Liability Line Item on the FY 2000 Financial Statements," Dated  
April 20, 2001 (Project No. D2001FC-0007)

This memorandum is in response to your request for comments on the subject draft audit report. Specific comments applicable to the recommendations are contained in the attachment.

The Department acknowledges that, for a number of reasons, it fully has not complied with recent requirements to report, in its financial statements, the estimated cost of all future costs that might be incurred to eliminate all environmental hazards at all DoD locations. The Department is in process of developing the required estimates. The Department, however, does not concur with the actions suggested in the recommendations contained within the report. Further, parts of the report contain misleading and, in some instances, incorrect statements.

This office appreciates the opportunity to comment on this draft report. This response was coordinated with Office of the Under Secretary of Defense (Environmental Security) and the Military Departments, and their comments are incorporated.

Questions regarding this matter may be directed to my staff member, Mr. Frank Murphy. He may be reached by e-mail: [murphyfj@osd.pentagon.mil](mailto:murphyfj@osd.pentagon.mil) or by telephone at (703) 697-0538.

  
Nelson Foye  
Deputy Chief Financial Officer

Attachment

**DEPARTMENT OF DEFENSE COMMENTS ON AN OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, DRAFT REPORT ENTITLED “DATA SUPPORTING THE ENVIRONMENTAL LIABILITY LINE ITEM ON THE FY 2000 FINANCIAL STATEMENTS” (PROJECT NO. D2001FC-0007)**

**Summary:** Parts of the draft report appear to reflect a lack of awareness of the Department’s past, current and planned actions for improving the recognition and reporting of environmental liabilities within the Department. Additionally, as currently written, parts of the draft report contain misleading and, in some instances, incorrect statements. The comments that follow identify those statements. Such statements detract from the progress made to date and focus more attention on past problems than on current and planned solutions. Such an approach does a disservice to serious readers of the report and needlessly confuses those who care about the matters involved or the additional actions required to improve the reporting of environmental liabilities within the Department. To give the reader a more balanced perspective on the Department’s ongoing efforts to improve the recognition and reporting of environmental liabilities, the draft report should be revised. Specific comments on the recommendations contained within the draft report, and general comments on the draft report, follow.

**GENERAL COMMENTS**

**OIG, DoD Statement:** Page 3, fourth bullet: “DoD guidance did not require Military Departments to recognize cleanup costs for certain active and inactive training ranges;”

Revised

**DoD Comments:** The Office of the Inspector General, Department of Defense (OIG, DoD) statement is misleading and incorrect. It is the Department’s policy to recognize a liability for the cleanup of environmental liabilities. The “Department of Defense Financial Management Regulation” (“DoDFMR”) Volume 4, Chapter 14 provides guidance on the recognition of environmental liabilities. Additionally, in Volume 6B of the “DoDFMR,” Chapter 10, paragraph 101502, further defines accrued restoration (cleanup) liabilities, and states that “Environmental restoration activities may be conducted at operating installations, at Base Realignment and Closure (BRAC) installations, at Formerly Used Defense Sites (FUDS), at Closed, Transferred, and Transferring (CTT) Ranges, or at other nonrange sites containing unexploded ordnance in accordance with applicable statutes and implementing regulations.” By definition, active and inactive ranges are included in the “operating installations” category, and the estimation and recordation of environmental liabilities are clearly required by existing “DoDFMR” guidance.

**OIG, DoD Statement:** Page 3, fifth bullet: “the Military Departments did not have adequate procedures to ensure that the environmental liability pertaining to preservation and maintenance of active and inactive training ranges was reported as required.

Deleted

**DoD Comments:** The OIG, DoD statement is misleading. In discussions with the OIG, DoD on April 5, 2001, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) requested the OIG, DoD auditors to provide examples that would support the assertion that the Military

Changed

Deleted, but added a footnote to explain that DoD no longer supports its estimate was determined

Departments were noncompliant. The auditors stated that they did not have any examples. Further, the OIG, DoD report did not note any instances associated with the Military Departments' ongoing operations related to preservation and maintenance of active and inactive training ranges that were incorrectly reported. It is inappropriate for the OIG, DoD to allege that the Military Department's did not have adequate procedures in place if the OIG, DoD has not identified any instances of noncompliance.

**OIG, DoD Statement:** On pages 5 and 6 of the draft report, the OIG, DoD cites DoD 7000.14-R, Volume 1, Chapter 3, June 1999, which states that accounting systems must have audit trails that allow transactions to be traced from initiation through processing to the financial statements.

**DoD Comments:** The reference cited by the OIG, DoD is incorrect. The correct citation for this accounting system requirement is an addendum to Volume 1, Chapter 3 of the "DoDFMR," dated May 1993.

**OIG, DoD Statement:** Page 7, first full paragraph. The OIG, DoD indicates that the \$14 billion cleanup liability reported on the FY 2000 Agency-wide financial statements is significantly understated, and that "other DoD estimates put the cleanup costs of training ranges as high as \$140 billion."

**DoD Comments:** The OIG, DoD statement does not provide the reader with an informed or balanced view of the nature of the liability estimate and, therefore, is misleading. As stated by the OUSD(C) during a discussion with the OIG, DoD on April 5, 2001, the liability cited in the report was generated based on a proposed, but not approved nor implemented, Range Rule.

The Range Rule was a DoD rulemaking, intended to define the Department's responsibilities/requirements in the event of an Unexploded Ordnance (UXO) response at a closed, transferring (i.e., BRAC) or transferred site. The Rule also defined the Department's formal relationships, regulatory drivers, and decision process among federal or state agencies and the public in the conduct of UXO responses. In the process of the rulemaking, a draft Regulatory Impact Assessment (RIA) was developed and put out for public comment that defined the cost of implementation of the proposed Rule. This RIA estimate is the higher liability estimate quoted in the report. Due to a lack of consensus between the Department and other federal agencies (i.e., the Environmental Protection Agency, the Department of the Interior, the Department of Agriculture, and the Department of Energy), as well as state regulators, the DoD withdrew the proposed Range Rule from negotiations at the Office of Management and Budget in October 2000. Neither the Rule nor the RIA were finalized or implemented.

It is inappropriate to base liability estimates on the requirements contained within a Rule that has not been approved and implemented. The \$14 billion cleanup liability reported on the FY 2000 financial statements was based on the best information available--at the time the financial statements were prepared--in support of approved policy. The reference to the "\$140 billion" estimate should be removed from the draft report.

**OIG, DoD Statement:** Pages 8 and 9, “Adequacy of DoD Regulation 7000.14-R.” The OIG, DoD report states that the guidance “did not clearly include instructions for recognizing a liability in the financial statements for certain active and inactive ranges when the government is legally liable and the cost associated with the cleanup efforts is reasonably estimable. For example, the Navy disclosed in note 14 to its financial statements that based on their research and investigation of DoD Regulation 7000.14-R, volume 4, chapter 13, only liabilities associated with inactive and transferring ranges should be recorded. This led to a decrease from the FY 1999 amount of \$30.7 billion to the amount reported in FY 2000 of \$53.6 million (a decrease of \$30.7 billion). However, the GAO draft report (GAO-01-0479) advised that certain active and inactive training ranges may have contamination that should also be recorded as a liability in the financial statements because it meets the reporting criteria as defined in Statement of Federal Financial Accounting Standards No. 5, “Accounting for Liabilities of the Federal Government,” December 20, 1995.”

**DoD Comments:** This paragraph contains several misleading statements. It is the Department’s policy to recognize a liability associated with the cleanup of environmental liabilities. The “DoDFMR” Volume 4, Chapter 14 provides guidance on the recognition of environmental liabilities. Additionally, “DoDFMR” Volume 6B, Chapter 10, paragraph 101502, further defines accrued restoration (cleanup) liabilities, and states that “Environmental restoration activities may be conducted at operating installations, at Base Realignment and Closure (BRAC) installations, at Formerly Used Defense Sites (FUDS), at Closed, Transferred, and Transferring (CTT) Ranges, or at other nonrange sites containing unexploded ordnance in accordance with applicable statutes and implementing regulations.” By definition, active and inactive ranges are included in the “operating installations” category, and the estimation and recordation of environmental liabilities are clearly required by existing “DoDFMR” guidance.

Further, the OIG, DoD report implies that the Navy underreported the environmental liabilities associated with its active and inactive ranges. However, the OIG, DoD offers no data to support this implication. During the April 5, 2001 meeting with the OIG, DoD, the OUSD(C) explained that the Navy’s 1999 estimate was not based on specific site reviews; rather, the estimate was derived by using a cost per acre estimate and applying that cost to all acreage--active and inactive, closed, transferred and transferring--used by the Navy as training ranges. This information also is included in the footnote disclosure of the FY 2000 financial statements.

Because the Department intends to continue to use its ranges in the foreseeable future, the removal of ordnance to maintain range safety and usability is considered an on-going maintenance expense. This expense, which is accrued and paid annually, is not accrued as a liability except in those few specific instances where environmental response actions--beyond what is necessary to keep the range in operation--is probable and the costs of such a response is measurable. Therefore, it was not improper for the Navy to revise its estimate in FY 2000.

Finally, the OIG, DoD report, by citing the GAO draft report language that “...certain active and inactive training ranges **may** have contamination that should also be recorded as a liability...” [boldface added for emphasis] incorrectly suggests to the reader that the Department

of the Navy erroneously understated its liability by \$30.7 billion. This is not supported by the audit findings. As stated during the April 5, 2001, meeting, the GAO assertion was based on a single example--the Massachusetts Military Reservation--and the policy governing the reporting of such liabilities is already covered in the "DoDFMR." It is inappropriate for the OIG, DoD to cite a single example to infer that the liability estimates for all training ranges in the Department's inventory are understated.

**OIG, DoD Statement:** Page 10, Conclusion. The OIG, DoD report states that until "...DoD Regulation 7000.14-R is revised to recognize the environmental liability for certain active and inactive ranges that meet criteria in federal accounting standards for recording a liability...the environmental liabilities reported in the DoD Agency-Wide Financial Statements will continue to be incomplete and misstated."

**DoD Comments:** The OIG, DoD conclusion is misleading and incorrect. It is the Department's policy to recognize a liability associated with the cleanup of environmental liabilities. The "DoDFMR" Volume 4, Chapter 14 provides guidance on the recognition of environmental liabilities. Additionally, "DoDFMR" Volume 6B, Chapter 10, paragraph 101502, further defines accrued restoration (cleanup) liabilities, and states that "Environmental restoration activities may be conducted at operating installations, at Base Realignment and Closure (BRAC) installations, at Formerly Used Defense Sites (FUDS), at Closed, Transferred, and Transferring (CTT) Ranges, or at other nonrange sites containing unexploded ordnance in accordance with applicable statutes and implementing regulations." By definition, active and inactive ranges are included in the "operating installations" category, and the estimation and recordation of environmental liabilities are clearly required by existing "DoDFMR" guidance.

#### **RESPONSES TO OIG, DoD RECOMMENDATIONS**

**OIG, DoD Recommendation 1:** We recommend that the Deputy Under Secretary of Defense (Environmental Security) and the Under Secretary of Defense (Comptroller) jointly design a training course on the type of documentation and narratives necessary to provide an adequate audit trail in accordance with DoD Regulation 7000.14-R, Volume 1, "General Finance Management Information, Systems and Requirements," August 2000, for personnel preparing and estimating environmental liabilities.

**DoD Comments:** Nonconcur. This office believes that it is inappropriate to apply, to engineering estimates, the same audit trail requirements as is applied to accounting transactions or systems.

The OIG, DoD report cites, and appears to draw conclusions based on, three Military Department audit reports. Copies or applicable excerpts of the referenced audit reports were not provided to this office. Based on subsequent research by this office, it appears that the recommendations contained in the OIG, DoD report that were based on the Military Department three audit reports are flawed.

Revised and  
redirected

- The Army Audit Agency, on page 16 of its report, indicates that the root cause of the deficiency related to support documentation for environmental liabilities is the resistance of installation-level personnel to prepare and maintain the required documentation, not a lack of Office of the Secretary of Defense guidance nor a lack of training.
- The Naval Audit Service report indicates that the Naval Auditors were looking for documentation that is not usually found in an accounting system, such as narrative discussion, names and signatures of reviewing and approving officials. These issues are not resolved and the report has been elevated to the Chief of Naval Operations.
- The Air Force Audit Agency (AFAA) recommendations to the Air Force Deputy Chief of Staff, Installations and Logistics (AF/IL), included recommendations to revise Air Force guidance, provide training where appropriate, and conduct periodic reviews to verify compliance with existing requirements. The AF/IL concurred and described several steps taken or planned to correct the problems identified by AFAA. The AFAA, on page 8 of its report, stated that the management comments and actions planned are responsive to the issues and recommendations. The corrective actions are satisfactory to AFAA; therefore, this office believes it is inappropriate and wasteful to undertake additional, separate actions on this matter.

This office believes that the OIG, DoD's analysis of the three Military Department audit reports cited in the OIG, DoD's report led to conclusions and recommendations that are inappropriate.

**OIG, DoD Recommendation 2:** We recommend that the Deputy Under Secretary of Defense (Environmental Security) revise DoD Instruction 4715.10, "Environmental Education, Training and Career Development," April 24, 1996. Specifically, the Instruction should:

- a. Require training programs to specify documentation required and the need to support environmental liability estimates.
- b. Require all personnel responsible for generating, compiling, and reporting environmental liabilities attend the required training course.

**DoD Comments:** Nonconcur. DoD Instruction 4715.10 is a broad Instruction that "implements policy, assigns responsibilities, and prescribes procedures" for training programs. The Instruction is designed to ensure that there are procedures for DoD organizations to provide training to environmental, as well as nonenvironmental, personnel. The Instruction does not prescribe specific courses for any one training discipline. To implement the recommendation, the Instruction also should be changed to include other kinds of specific training such as pollution prevention acquisition courses, hazardous waste disposal, toxic release inventory reporting, etc. The design of specific courses to meet specific needs is the responsibility of those officials identified in section 5 of the instruction. Moreover, the recommendation is not necessary because the Instruction states in section 4.6: "Ensure that all non-environmental

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Revised,  
redirected, and  
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managerial functional areas receive appropriate environmental education, training, or awareness for their activities and responsibilities. **Particular emphasis should be given to installation commanders, acquisition and financial management and contract communities.** [Boldface added for emphasis.]

**OIG, DoD Recommendation 3:** We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller), Assistant Secretary of the Navy (Financial Management and Comptroller), and Assistant Secretary of the Air Force (Financial Management and Comptroller) identify, accrue, and report environmental liabilities related to preservation and maintenance of active and inactive ranges as an environmental liability as required by DoD Regulation 7000.14--R, Volume 6B.

**DoD Comments:** Nonconcur. In discussions with the OIG, DoD on April 5, 2001, the OUSD(C) requested the OIG, DoD auditors to provide examples that would support the assertion that the Military Departments were noncompliant. The auditors stated that they did not have any examples. Although the Department agrees that the DoD Components need to follow the guidance published in the "DoDFMR," it is not appropriate for the OIG, DoD to recommend corrective actions to the DoD Components based on deficiencies that might occur in the future.

# Department of the Navy Comments

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DEPARTMENT OF THE NAVY  
OFFICE OF THE ASSISTANT SECRETARY  
(INSTALLATIONS AND ENVIRONMENT)  
1000 NAVY PENTAGON  
WASHINGTON, D.C. 20350-1000

18 June 2001

## MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Data Supporting the Environmental Liability Reported on the FY 2000 Financial Statements (Project No. D2001FC-0007)

Reference: (a) DODIG memo of 20 Apr 01, above subject

Reference (a) requested comments on the subject draft audit report that conform to the requirements of DoD Directive 7650.3. Department of the Navy comments are as follows:

### Recommendations 1 and 2

Recommendation number 1 states that the Deputy Under Secretary of Defense (Environmental Security) and the Under Secretary of Defense (Comptroller) jointly design a training course on the type of documentation and narratives necessary to provide an adequate audit trail in accordance with DoD Regulation 7000.14-R, Volume 1, "General Finance Management Information, Systems and Requirements," August 2000, for personnel preparing and estimating liabilities.

Revised and  
redirected

Recommendation 2 states that the Deputy Under Secretary of Defense (Environmental Security) should revise DoD Instruction 4715.10 "Environmental Education, Training and Career Development," April 24, 1996. Specifically, the instruction should:

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- a. Require training programs to specify documentation required and the need to support environmental liability estimates.
- b. Require all personnel responsible for generating, compiling, and reporting environmental liabilities attend the required training course.

We concur that better training is required. However, because the Services do things differently in restoration, training at the DoD level would have to be very general and might be ineffective. OSD should establish specific requirements (recommendation 2.a) and allow the Services to design training courses, approved at the DoD level, which respond to those requirements.

### Recommendation 3

Recommendation 3 states that the Assistant Secretary of the Army (Financial Management and Comptroller), Assistant Secretary of the Navy (Financial Management and Comptroller) and Assistant Secretary of the Air Force (Financial Management and Comptroller) identify, accrue, and report environmental liabilities related to the preservation

Revised,  
redirected, and  
renumbered as  
Recommendation 2.

and maintenance of active and inactive ranges as an environmental liability as required by DoD Regulation 7000.14-R, Volume 6B.

We do not concur in this recommendation. The Department of the Navy position continues to be that environmental liabilities, cleanup and closure, should be reported only for ranges that are closed, transferred, or transferring. At this time, we do not plan to close any active or inactive ranges. Our ranges, active and inactive, will be needed for the foreseeable future. There is no legal requirement to clean up the active and inactive ranges. Since most or all of the ranges will continue in use, any estimates of restoration costs would be highly speculative. As time passes and technology improves, restoration costs can be expected to change dramatically.

The Department of the Navy did report environmental liabilities for closed, transferred, and transferring ranges in FY 1999 and FY 2000. However, as stated on page 8 of the subject draft report, the guidance in DoD Regulation 7000.14-R did not clearly include instructions for recognizing a liability for active and inactive ranges. We recommend that the Regulation be revised to specify that environmental liabilities be reported only for closed, transferred, and transferring ranges.

Other

Some of the information contained in the report appears outdated, and as such, does not reflect the current situation. The report restated a GAO finding that "DoD does not have a complete inventory and has not used a consistent methodology to compute the costs." The Services are developing a standardized model for estimating costs of cleanup for unexploded ordnance (UXO). This model was used to calculate costs of cleanup for closed, transferred and transferring ranges for our UXO Report to Congress. We continue to work on further refinements to the model that will allow us to continue to improve these cost estimates. As part of this process, the Services have developed a complete inventory of all of our ranges, to include active and inactive ranges.



Duncan Holaday  
Deputy Assistant Secretary  
(Installations and Facilities)

## **Audit Team Members**

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