Audit Report

OFFICE OF THE INSPECTOR GENERAL

THE NATIONAL SECURITY EDUCATION TRUST FUND FINANCIAL STATEMENTS FOR FY 1994

Report No. 95-180

April 24, 1995

Department of Defense

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Acronyms

JFMIP	Joint Financial Management Improvement Plan
OMB	Office of Management and Budget

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Report No. 95-180 April 24, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR POLICY
UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF DEFENSE (STRATEGY AND REQUIREMENTS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, WASHINGTON HEADQUARTERS SERVICES
DIRECTOR, NATIONAL SECURITY EDUCATION PROGRAM

SUBJECT: Audit Opinion on the National Security Education Trust Fund Financial Statements for FY 1994 (Project No. 5RF-2005)

Introduction

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 (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General, DoD, to express an opinion on financial statements and to report on the adequacy of management controls and compliance with laws and regulations. This report contains our opinion on the National Security Education Trust Fund Financial Statements for FY 1994.

Audit Opinion

We based our opinion on the FY 1994 financial statements provided to us March 1, 1995, by the Chief Financial Officer of DoD. Public Law 103-178, "Intelligence Authorization Act for Fiscal Year 1994," December 3, 1993, directed reducing the National Security Education Trust Fund (Trust Fund) corpus from $150 million to $120 million, but allowed amounts already appropriated for expenditures. In our opinion, generally accepted accounting principles require that the reduction be reflected in the financial statements. The effect of management's failure to make the reduction has been to overstate the Trust Fund corpus by $18.3 million and to overstate the interest income that is available to support future expenditures.

In our opinion, except for the effects of not reducing the Trust Fund corpus, the FY 1994 financial statements present fairly, in all material respects, the financial position of the Trust Fund as of September 30, 1994, and the results of operations, cash flows, and budget and actual expenses for the years then ended, in accordance with DoD accounting policies and procedures and generally accepted accounting principles applicable to DoD financial statements.

Audit Objectives

The primary audit objective was to determine whether the Trust Fund's FY 1994 financial statements were presented fairly in accordance with generally accepted accounting principles or the other comprehensive basis of accounting described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We evaluated the management control structure established for the Trust Fund, and we assessed compliance with applicable laws and regulations that could have a material effect on the financial statements. In a memorandum issued on January 31, 1995, to the Director, National Security Education Program, we identified adjustments to the financial statements. The Director implemented action to adjust the statements, but did not reduce the Trust Fund to the authorized balance.

Scope and Methodology

We examined the financial statements of the Trust Fund for the year ended September 30, 1994. The statements included the Overview and Notes 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.

We examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements, including the accompanying overview and notes. Also, we assessed the accounting principles used and significant estimates made by management, as well as evaluated the overall presentation of the financial statements.

Scope of the Review of Management Controls. We updated our FY 1993 client profile for the Trust Fund, which discusses the management controls for Trust Fund financial operations, and reviewed controls over payment of Trust Fund expenditures. We believe that our audit provides a reasonable basis for our opinion. This financial statement audit was made during October 1994 through January 1995.

Scope of Review of Compliance With Laws and Regulations. To obtain reasonable assurance about whether the Principal Statements are free of material

misstatements, we tested compliance with laws and regulations that may directly affect the financial statements, and other laws and regulations designated by OMB and DoD for inclusion in financial statement audits. We identified the key provisions of those laws and regulations, and we reviewed transactions, documents, and other records to verify that they complied with the provisions of those laws and regulations.

Reliability of Computer-Processed Data. 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 Trust Fund's Accounting System, observing operations, conducting interviews, and verifying securities balances on U.S. Treasury reports. We performed limited reviews of the systems at Washington Headquarters Services and the Defense Finance and Accounting Service that generated the payment and accounting data we used. Further, we reviewed the financial information in management's Overview of the Fund. To the extent that we reviewed the data, we concluded that the data were sufficiently reliable to meet our audit objectives.

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, DoD, and OMB Bulletin No. 93-06, January 8, 1993, and the general provisions of the President's Council on Integrity and Efficiency, "Federal Financial Statement Audit Manual," January 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements. To assess the materiality of matters that affect the fair presentation of the financial statements and related management control weaknesses, we relied on the guidelines suggested by the General Accounting Office and our professional judgment.

Accounting Principles

Accounting principles for use in preparation of financial statements required by the Chief Financial Officers Act of 1990 remain under development. The Federal Accounting Standards Advisory Board was established to recommend the Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. Those officials are principals of the Joint Financial Management Improvement Program (JFMIP). The Director, OMB, and the Comptroller General of the United States issue specific standards agreed on by the JFMIP principals.

The Director, OMB, and the Comptroller General of the United States have not issued accounting principles that will govern all aspects of financial statement reporting and that will constitute "generally accepted accounting principles for the Federal Government." Until those principles are issued, agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01. The hierarchy constitutes the "other comprehensive basis of accounting" to be used for preparing financial statements of Federal agencies. A summary of the hierarchy defined and approved by the JFMIP principals follows:

- o statements agreed to and published by the JFMIP principals,
- o form and content requirements of the OMB,
- o accounting principles in agency guidance, and
- o accounting principles published by other authoritative sources.

To date, three accounting principles have been published by the JFMIP principals, so most accounting principles for the DoD "other comprehensive basis of accounting" are found in DoD accounting policy guidance. The DoD accounting guidance is primarily in the DoD Accounting Manual. The Office of the Under Secretary of Defense (Comptroller) has updated portions of the DoD Accounting Manual and has incorporated those sections into 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 principles or requirements of OMB, the policy in the DoD Accounting Manual or in the DoD Financial Regulation, as applicable, is the authoritative basis for preparing financial statements in accordance with the "other comprehensive basis of accounting."

Prior Audits and Other Reviews

The Office of the Inspector General, DoD, issued Audit Report No. 94-153, "Principal Financial Statements of the National Security Education Trust Fund - FY 1993," June 30, 1994. We expressed an unqualified opinion because the financial statements presented fairly the financial position of the Fund.

The Office of the Inspector General, DoD, issued Audit Report No. 93-143, "Principal Financial Statements of the National Security Education Trust

Fund - FY 1992," June 30, 1993. We expressed a qualified opinion because the financial statements presented fairly the financial position of the Fund with one exception. The exception was the nondisclosure of an accounting procedure that categorized program operational expenses of $418,487 for FY 1992 incurred in doing the business of the National Security Education Program as "nonoperational expenses."

Based on the financial statement audit, the Office of the Inspector General, DoD, issued Audit Report No. 94-007, "National Security Education Trust Fund Accounting Records," October 19, 1993. The report states that a system of controls to record obligations and liabilities in the Trust Fund accounting records had not been established. Management concurred with the recommendation to establish a system of controls. The Washington Headquarters Services agreed to establish an account for program operational expenses for the Trust Fund.

Background

Public Law 102-183, "Intelligence Authorization Act for Fiscal Year 1992," December 4, 1991, established the Trust Fund and authorized a corpus of $150 million. The Trust Fund was to provide resources to meet the national security education needs of the United States by increasing the quantity, quality, and diversity of teaching and learning in international fields critical to the Nation's interest.

Public Law 103-178, "Intelligence Authorization Act for Fiscal Year 1994," December 3, 1993, reduced the Trust Fund balance from $150 million to $120 million, but allowed amounts already appropriated for expenditures. As of the date of Public Law 103-178, $20 million had been appropriated by separate appropriations of $10 million each. Including the $120 million, the authorized Trust Fund balance is $140 million.

As of September 30, 1994, the Trust Fund's assets were $158.3 million. The Assistant Secretary of Defense (Strategy and Requirements), Office of the Under Secretary of Defense for Policy is the Trust Fund manager. The Principal Statements of the Trust Fund are the responsibility of the Assistant Secretary of Defense (Strategy and Requirements) and the Director, Defense Finance and Accounting Service.

Discussion

Management Controls. We reviewed the management control structure of the Trust Fund and obtained an understanding of the management control policies

and procedures. Also, we assessed the level of control risks relevant to all significant cycles, classes of transaction, and account balances. For the 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 and working as designed.

We identified no material management control weaknesses; however, we identified reportable conditions under standards established by OMB Bulletin No. 93-06. The management control issues will be discussed in a separate report.

Compliance With Laws and Regulations. We evaluated the Trust Fund for material instances of noncompliance with laws and regulations for the fiscal year ended September 30, 1994. Such tests are required by the Chief Financial Officers Act of 1990.

Trust Fund operations generally complied with applicable laws and regulations. One exception was that the Trust Fund corpus had not been reduced in accordance with Public Law 103-178. As a result, the Trust Fund balance was overstated by $18.3 million. An incorrect balance materially affects interest earned and the amount available for awards. Issues concerning compliance with laws and regulations will be discussed in a separate report.

The National Security Education Program provided the Legal Representation Letter that stated no claims are pending against the Trust Fund.

Management Comments and Audit Response

The Director, National Security Education Program, provided comments on a draft of this report. The full text of the comments is in Enclosure 2.

Director, National Security Education Program, Comments. The Director stated that actions are being taken to comply with Public Law 103-178, section 311, to reduce the amount in the Trust Fund. The Secretary of Defense has directed the Under Secretary of Defense (Comptroller) to implement changes mandated by Congress. The Under Secretary of Defense (Comptroller) has directed his staff to notify the Defense Finance and Accounting Service to correct the Trust Fund financial statements to reflect the reduced amount. The Director does not have the authority to take the action, but is tracking the action and will verify compliance. Also, the Legal Representation Letter, which shows that no claims are pending against the Trust Fund, has been sent to the Office of the Inspector General, DoD. Further, resources from the Trust Fund are available until expended and, therefore, are not tied to a fiscal year. Consequently, actual expenses do occur outside the fiscal year within which an obligation is made. Approximately $0.2 million in divestments were requested

at the end of September 1994, but did not appear as expenditures until October 1994. The Director will work to avoid bridging expenditures at the end of a fiscal year.

Audit Response. Actions described by the Director, when completed, should correct the Trust Fund balance. We revised the final report to show that the Legal Representation Letter was received. Also, although funds are available until expended, the National Security Education Program has a requirement to track and report expenditures by fiscal year. Congress requires the National Security Education Program to submit an annual report on the conduct of the Trust Fund. The annual report is an analysis of the results of the program for the previous fiscal year and must be submitted with the budget for the next fiscal year. Complete and accurate reporting of expenditures by fiscal year is a requirement and should be reflected in the annual financial statements.

We appreciate the courtesies shown to the audit staff. If you have questions on this audit, please contact Mr. Harrell D. Spoons, Audit Program Director, at (703) 604-9575 (DSN 664-9575) or Ms. Dianna J. Pearson, Audit Project Manager, at (703) 604-9576 (DSN 664-9576) or telefax (703) 604-9475. The distribution of this report is in Enclosure 1. Audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosures

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Director, National Security Education Program, Comments

POLICY

OFFICE OF THE SECRETARY OF DEFENSE
NATIONAL SECURITY EDUCATION PROGRAM
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March 31, 1995

MEMORANDUM FOR THE DIRECTOR, READINESS AND OPERATIONAL SUPPORT DIRECTORATE OF THE OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Response to draft audit report on the National Security Education Trust Fund (NSETF) Financial Statements for FY 1994 (Project No. 5RF-2005)

In response to your draft audit report, I would like to offer the following comments on the qualified audit opinion on the financial statements.

The opinion was qualified because:

1) "the Trust Fund balance was ... in excess of the authorized amount;"

Comment: Actions are being taken to comply with Public Law 103-178, Sec 311 to reduce the amounts in the NSETF. Secretary Perry has charged his Undersecretary of Defense (Comptroller) with responsibility for directing all fiscal changes mandated by Congress. Mr. Hamre has directed his staff to notify Defense Finance and Accounting Services (DFAS) to make a notation in the Financial Statements to correctly reflect the reduced trust fund amount. The draft audit report states that the Director National Security Education Program should transfer these amounts to the Treasury of the United States as miscellaneous receipts. The Director NSEP does not have the authority to take such an action. However, the Director NSEP is tracking such actions and will, to the best of her effort and ability, ensure that compliance is met.

2) "management did not provide the Legal Counsel Representation Letter;"

Comment: Director NSEP requested the Legal Counsel Representation Letter twice. Some delay in obtaining this letter occurred due to Congressional actions against the NSETF during February and March 1995 causing uncertainty. General Counsel (Fiscal) office has informed us that the formal response has now been sent and that there are no claims pending.

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3) "...discrepancies between expenditures reported on the financial statements and supporting documentation."

Comment: Because every expenditure for the Program must be paid from the NSETF and because these resources are identified as available until expended and therefore not tied to any fiscal year, actual expenditures will and do occur outside a fiscal year within which an obligation is made. There were expenditures of approximately $200,000 for which disinvestments were requested at the end of September 1994 but which did not show up as expenditures until early October 1994 and so bridged two fiscal years. Because audits are conducted on a particular fiscal year's financial statements, Director NSEP will, to the best of her effort and ability, work to avoid bridging expenditures at the close of a particular fiscal year. However, the best financial management of the earnings on the NSETF appears to the Director NSEP to be one of requesting disinvestments at the time of best realization of earnings for the monies to ensure that the best investments are continued. The Director NSEP will continue to work with the DFAS personnel who work with U.S. Treasury personnel to meet both objectives.

Should you have any questions or wish to discuss any of the above matters, please do not hesitate to contact me or the Deputy Director, Dr. Robert O. Slater.

R. Charlene King

R. Charlene King
Director

Audit Team Members

This report was produced by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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