Audit Report

OFFICE OF THE INSPECTOR GENERAL

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS FOR THE NATIONAL DEFENSE STOCKPILE TRANSACTION FUND FINANCIAL STATEMENTS FOR FY 1996

Report No. 97-176 June 25, 1997

Department of Defense

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Acronyms

CFO	Chief Financial Officer
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DNSC	Defense National Stockpile Center
FAR	Federal Acquisition Regulation
GSA	General Services Administration
JFMIP	Joint Financial Management Improvement Program
MIF	Master Inventory File
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

June 25, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY
ADMINISTRATOR, DEFENSE NATIONAL STOCKPILE CENTER

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Report No. 97-176)

We are providing this report for your review and comment. Financial statement audits are required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. On March 1, 1997, we issued a qualified opinion on the FY 1996 National Defense Stockpile Transaction Fund Financial Statements because we were unable to audit the prior-year statements and, therefore, had no valid basis for comparison of current balances with unaudited prior-year balances (Appendix E). We found internal control weaknesses that were not material to the financial statements for collecting accounts receivable and for collecting, recording, and reporting interest receivable. Reportable noncompliance issues related to the internal control findings and other financial statement disclosure inaccuracies are discussed in detail in Parts I.A. and I.B. Our review of compliance with laws and regulations did not disclose any material noncompliance affecting the financial statements.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We considered Defense Logistics Agency comments on the draft report in preparing the final report. The comments conformed to the requirements of DoD Directive 7650.3; therefore, additional Defense Logistics Agency comments are not required. The Director, Defense Finance and Accounting Service, did not comment on a draft of this report. We request that the Defense Finance and Accounting Service provide comments on Recommendations A.1., A.2., B. 1., and C.2. by August 25, 1997.

We appreciate the courtesies extended to the audit staff. If you have any questions, please contact Mr. David F. Vincent, Audit Program Director, at (703) 604-9110 (DSN-664-9110) or Mr. John A. Richards, Audit Project Manager, at (703) 604-9133 (DSN 664-9133). See Appendix F for report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-176 **June 25, 1997**
(Project No. 6FH-2028.01)

Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an annual audit of revolving funds such as the National Defense Stockpile Transaction Fund. The Chief Financial Officers Act prescribes the responsibility of management and auditors with respect to the financial statements, internal controls, and compliance with laws and regulations. Fund managers are responsible for establishing and maintaining an internal control structure and complying with laws and regulations applicable to that fund. Management is responsible for establishing a comprehensive management control system and monitoring and reporting on the system. The fund manager responsible for this fund is the Comptroller, Defense Logistics Agency. As of September 30, 1996, reported National Defense Stockpile Transaction Fund assets were $4.3 billion and liabilities were $69.1 million.

Audit Objectives. The primary audit objective was to determine whether the FY 1996 financial statements were presented fairly in accordance with the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. In addition, we reviewed the management control program and management's compliance with laws and regulations and followed up on corrective actions from previous audits. Our review provided a reasonable basis for determining the adequacy of the internal control structure and compliance with laws and regulations as they relate to the financial statements.

Qualified Opinion. On March 1, 1997, we issued a qualified opinion on the financial statements dated September 30, 1996. A qualified opinion was required because we were unable to compare FY 1996 financial statement balances to the FY 1995 financial statement balances. We could not make the necessary comparisons because we were unable to audit the financial statements of September 30, 1995. See Appendix E for the financial statements and qualified opinion.

Internal Controls. The internal control structure was effective in accounting for and managing resources, ensuring compliance with laws and regulations, and providing reasonable assurance that the financial statements are free of material misstatements. None of the accounts affected by management control weaknesses addressed in this report resulted in a material misstatement on the financial statements. Our review would not necessarily disclose all reportable conditions that might also be considered

material weaknesses. See Part I.A. for the management control weaknesses identified and Appendix A for the management controls assessed. Management continues to have management control program weaknesses as they relate to:

o collecting $15.5 million in delinquent accounts receivable and related interest charges (Finding A), and

o recording and reporting $1.5 million in interest revenue due the U.S. Treasury (Finding B).

Compliance With Laws and Regulations. Management generally complied with the selected provisions of laws and regulations pertaining to the accuracy of the financial statements. However, the Defense National Stockpile Center did not comply with guidance set forth in DoD 7000.14-R, "DoD Financial Management Regulation," volumes 1 and 4, on using appropriate U.S. Treasury interest receivable accounts, establishing appropriate allowances for uncollectible accounts, and accounting for fixed assets and accrued annual leave and pension liability. In addition, the financial statement preparation did not fully comply with Office of Management Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, and DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," November 8, 1996 (Finding C). Additional regulations that were not complied with as they relate to the internal control weaknesses are addressed in Part I.A. Compliance issues identified during our review did not have a material impact on the financial statements. The compliance issues regarding allowances for uncollectible accounts and preparation of financial statements, as well as those related to internal control weaknesses, were also identified in the audit report for the FY 1995 financial statements. See Part I.B. for the noncompliance issues identified. With respect to items not tested, we found nothing that caused us to believe management had not complied, in all material respects, with those provisions previously identified.

Summary of Recommendations. The Administrator, Defense National Stockpile Center, should turn over the function of collecting delinquent accounts receivable to the Defense Finance and Accounting Service Columbus Center and properly disclose interest revenue due the U.S. Treasury. The Director, Defense Finance and Accounting Service Columbus Center, should attempt to collect the $14.1 million in delinquent accounts receivable and $1.4 million in delinquent interest charges; write off uncollectible amounts; and establish accounts to record interest charges receivable and interest revenue, fixed assets and related depreciation, and accrued annual leave and pension liability.

Management Comments. The Defense Logistics Agency concurred with all recommendations. The comments were fully responsive; therefore, additional Defense Logistics Agency comments are not required. The Defense Finance and Accounting Service did not comment on a draft of this report. We request that the Director, Defense Finance and Accounting Service, provide comments on the final report by August 25, 1997. See Part I for discussion of management comments and Part III for complete text of management comments.

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Part I - Audit Results

Audit Background

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires annual audits of funds such as the National Defense Stockpile Transaction Fund (the Fund). Our responsibility under the CFO Act is to express an opinion on the Fund's FY 1996 financial statements based on our audit, determine whether internal controls are adequate, and determine whether the Fund managers complied with applicable laws and regulations. For background information on the audited entity, see Appendix E, which includes an Overview of the Principal Statements.

Qualified Opinion. We audited the FY 1996 National Defense Stockpile Transaction Fund Financial Statements dated September 30, 1996. The financial statements included the Statement of Financial Position, the Statement of Operations and Changes in Net Position, and the Statement of Cash Flows. Also included were the Footnotes and the Overview to the Principal Statements. We issued a qualified opinion on the financial statements on March 1, 1997. The reason for the qualified opinion was that we were unable to audit the prior-year financial statements and therefore had no basis for comparing current balances with unaudited prior-year balances in the Statement of Financial Position and Statement of Operations and Changes in Net Position. Comparative prior-year data were not available for the Statement of Cash Flows because that statement was not required for FY 1995. See Appendix E for the financial statements and audit opinion.

Accounting Functions. In June 1994, the Fund accounting functions performed by Defense Finance and Accounting Service (DFAS) located at Cameron Station, Virginia, were consolidated into the DFAS Columbus Center. Currently, the Defense National Stockpile Center (DNSC) and the DFAS Columbus Center jointly perform finance and accounting functions for the Fund. A Concept of Operations, dated July 16, 1994, specifies each entity's financial and accounting responsibilities. An amended Concept of Operations has been drafted but not yet approved. As of September 30, 1996, the Fund reported assets of $4.3 billion and liabilities of $69.1 million.

Audit Objectives

The primary audit objective was to determine whether the FY 1996 financial statements for the Fund were presented fairly in accordance with the other comprehensive basis of accounting described in the Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. In addition, we reviewed the management control program and compliance with laws and regulations and followed up on corrective actions taken resulting from previous audits of the Fund's prior-year financial statements. Part I.A. contains our report on internal controls.

Part I.B. contains our report on compliance with laws and regulations. Appendix A provides discussion on the scope, methodology, auditing standards, accounting principles, and management control program. Appendix B provides a summary of prior audit coverage.

Part I.A. - Review of Internal Control Structure

Introduction

Audit Responsibilities. Our audit objective was to determine whether controls over transactions supporting the accounts in the FY 1996 financial statements were adequate to provide reasonable assurance that the accounts were free of material misstatements. In planning and performing our audit of the Fund for the fiscal year that ended September 30, 1996, we evaluated the internal control structure, including implementation of the DoD Management Control Program. We performed this evaluation to:

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

o determine whether an internal control structure had been established.

DoD Directive 5010.38,* "Internal Management Control Program," April 14, 1987, implements title 31, United States Code, section 3512 (31 U.S.C. 3512), which requires management to establish and maintain a comprehensive management control system, including an internal control structure, and monitor and report on the system. The internal control structure consists of three elements.

o Control environment is the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures.

o Accounting and related systems are those methods and records established to identify, assemble, analyze, classify, record, and report on the entity's transactions and to maintain accountability for the related assets and liabilities.

o Control procedures are the policies and procedures in addition to the control environment and accounting and related systems that management has established to provide reasonable assurance that specific entity objectives will be achieved.

Management Responsibilities. Management is responsible for establishing and maintaining the internal control structure of the Fund. The responsibility requires management to make estimates and judgments to assess the expected

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that:

o transactions are properly recorded and accounted for in order to prepare reliable financial statements and to maintain accountability over assets;

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

o transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and are in compliance with any other laws and regulations that the OMB, entity management, or the Inspector General, DoD, have identified as being significant for objectively measuring and evaluating compliance.

Reportable Conditions

Our review of internal controls for the Fund identified conditions that we considered to be reportable under OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. However, the audit did not disclose any material weaknesses. Reportable conditions are matters coming to the auditors' attention relating to significant deficiencies in the design or operation of the internal control structure that, in their judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information for use in managing and evaluating operational performance. A material weakness is a reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors or irregularities would be in amounts that would be material to the statements being audited and not be detected within a timely period by employees in the normal course of performing their functions.

Our consideration of the internal control structure would not necessarily disclose all reportable conditions and would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Although our review of internal controls for the Fund did not disclose any material weaknesses, reportable conditions continue to exist that were addressed in last year's report. Specifically, management still needs to improve collecting accounts receivable and interest revenue and reporting interest revenue due the U.S. Treasury. See Appendix A for management controls assessed.

Finding A. Collection Procedures

The DNSC did not effectively pursue the collection of $15.5 million of delinquent accounts receivable and related interest charges. As of September 30, 1996, DNSC had $14.1 million in delinquent accounts receivable and $1.4 million of delinquent interest receivable. Of these amounts, $8.6 million of the accounts receivable and $1.3 million of the interest receivable were over 120 days old. These collection procedure deficiencies were also identified in FY 1995. Our FY 1995 audit report previously identified $9.5 million of the $15.5 million of delinquent receivables ($8.4 million of the accounts receivable and $1.1 million of the interest receivable). Ineffective collections continued because the DNSC has not formalized procedures for the collection of amounts due nor designated an office with primary responsibility for collection. Valid amounts due the Federal Government will continue to go uncollected unless these problems are corrected.

DNSC Collection Procedures

Collection Responsibility. DNSC is responsible for the collection of delinquent receivables. The 1994 Concept of Operations between DNSC and DFAS Columbus Center requires DFAS Columbus Center personnel to maintain the actual receivable records and provide the DNSC Office of Financial Management (DNSC finance) with monthly accounts receivable and interest age reports. A draft revised Concept of Operations does not indicate any change to this division of responsibility.

Previous Procedures. In our report, "Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995," June 28, 1996, we noted that DNSC did not have standard operating procedures for monitoring and collecting delinquent accounts receivable and related interest charges. We also noted that responsibility for collecting delinquent accounts was split between three DNSC offices--DNSC finance, the DNSC Directorate of Stockpile Contracts (DNSC contracting), and the DNSC Office of Counsel--and that the process was not well coordinated between these three offices.

Planned Revised Procedures. In the response to the FY 1995 audit report, the Defense Logistics Agency (DLA) stated that DNSC would develop detailed standard operating procedures for monitoring and collecting the receivables and designated DNSC finance as the office responsible for the collection of delinquent receivables. DLA also stated that DNSC would research and pursue collection of the existing delinquent receivables, write off any determined to be uncollectible, and refer remaining receivables valued at more than $600 and not considered uncollectible to the Debt Collection Division, DFAS Columbus Center, for collection. The planned completion date was September 30, 1996.

Revised Procedures. DNSC finance has informally revised its existing standard operating procedures on delinquent bill letters and has revised its standard solicitation for material sales contracts. The new delinquent bill letter procedures do not designate DNSC finance as having primary responsibility for collection of receivables, and the actions prescribed would not necessarily result in effective followup of delinquent receivables. The procedures state that DNSC finance should provide a designated person in DNSC contracting with copies of delinquent bills and with subsequent notification of nonpayment of those bills. The procedures also specify which demand letters DNSC finance and DNSC contracting should send, and when, based on the dollar amount of the receivables. As a final step, DNSC finance is to consult with DNSC contracting on receivables not collected after 90 days to determine whether the accounts should get further DNSC collection effort, be written off, or be referred to DFAS Columbus Center.

The revised solicitation allows DNSC to apply payments received from a contractor to the contractor's delinquent accounts and to withhold release of material until all of the contractor's delinquencies are paid, in addition to full payment for the material to be released. It also speeds up the charging of storage charges and interest for material not paid for and removed by the contract removal date. These new terms should be helpful but have not been effective so far, as noted in the next section.

Efforts to Resolve Delinquent Receivables

Write-off of Uncollectible Accounts. As of April 1997, DNSC and DFAS Columbus Center had only written off delinquent accounts receivable, valued at $120,614.97, for three closed contracts that we had specifically mentioned in the FY 1995 audit report. These accounts had existed since before the Stockpile was transferred from the General Services Administration (GSA) in 1988. The three contracts were unique in that they were identified in our FY 1995 audit report as the DNSC legal counsel's responsibility for determining collectibility.

Attempts to Write Off Uncollectible Accounts. DNSC had made two attempts to refer about $2.8 million in delinquent receivables for diamond contracts to DFAS Columbus Center to be written off. For the first attempt, on September 26, 1996, the DNSC Office of Counsel sent a list of applicable contracts to DNSC finance and attached the documentation requirements from DFAS Columbus Center. DNSC finance personnel stated that they later compiled the documentation for these contracts and sent it to DFAS Columbus Center. They further stated that they did not make a backup copy of the material and that they have been unable to locate a cover letter or any record of when they sent it. DFAS Columbus Center personnel stated that they received a copy of the list and attachment from DNSC Office of Counsel on September 30, 1996, but that they never received a complete documentation package.

In the second attempt, on March 20, 1997, DNSC finance sent DFAS Columbus Center another list of delinquent receivables for diamond contracts to

be written off. This list included the same contracts as in the first attempt plus a few small additional ones, still amounting to about $2.8 million. This list did not include any of the necessary documentation. DNSC finance personnel stated that the person who compiled this list was unaware of the documentation requirements. DFAS Columbus Center was not able to process this list without the documentation and pointed out that some of the balances on this list were incorrect.

Lack of Action on Closed Contracts. DNSC had not taken any action on the 21 closed contracts, valued at $206,366, listed in Appendix D of the FY 1995 audit report. The contracting officer stated that the customer had paid for the material with a letter of credit, which DFAS Columbus Center had failed to exercise before the expiration date. The customer had therefore received the material without paying for it (most customers pay in advance, and many of the outstanding receivables are for storage charges and various adjustments). The contracting officer stated that her last action was a letter to DFAS Columbus Center in 1992; she acknowledged the need to reopen the matter, but had not.

DNSC Contracting Efforts. DNSC contracting had designated one employee to address the receivable problem. However, that employee stated she had never seen an accounts receivable age report and was not aware of any old receivables other than the $2.8 million addressed to DFAS Columbus Center and the 21 closed contracts mentioned in the FY 1995 audit report. Meanwhile, DNSC finance personnel attributed the slowness of resolving old accounts to the slowness of contracting personnel in making determinations of collectibility.

Referral of Debts Considered Collectible to DFAS Columbus Center. As of April 1997, DFAS Columbus Center Debt Management Division had not received any accounts receivable from DNSC. Both DNSC finance and DNSC contracting personnel stated that they had not determined collectibility of accounts, other than the $2.8 million sent to DFAS Columbus Center.

Newly Delinquent Accounts. The DNSC contracting employee assigned to clear the accounts receivable has spent most of her time on this type of account. She receives printouts from both a DNSC contracting database and from DFAS Columbus Center. The printouts from the DNSC contracting database only go back to 1995 contracts, and the printouts from DFAS Columbus Center are on current contracts. They therefore do not bring the older accounts to the DNSC contracting employee's attention.

Even for the newly delinquent accounts, this procedure appears to have been ineffective. From September 1996 to February 1997, the number of delinquent receivables more than 60 days old increased from $14.1 million to $23.7 million. The contracting employee assigned to clear the receivables had no explanation for the increase.

Conclusion

The accounts receivable situation at DNSC has not improved. Our recommendations in the FY 1995 audit report, with which DLA concurred, were intended to assign clear responsibility for the handling of the receivables and to promptly resolve old accounts and refer delinquencies valued at more than $600 to DFAS Columbus Center for write-off or further collection effort. Very few of the old accounts from the prior audit have been resolved, the number of delinquent accounts is growing, and nothing has been referred to DFAS Columbus Center, except the $120,614.97 of accounts written off.

The collection responsibility needs to be at DFAS Columbus Center. DFAS Columbus Center performs the collection function for other agencies and already has the necessary procedures and experience. DNSC has not yet formalized collection procedures and has left the responsibility split between contracting and finance, with few positive results.

DNSC finance officials told us that they are better able to collect receivables because of being closer to DNSC contracting and are also better able to communicate questions of collectibility. We believe the DFAS Columbus Center employees who handle the accounts and interest receivable on a day-to-day basis will have the necessary information about the accounts as they become due, a better understanding of the documentation requirements, and easier access to the collection specialists in their Debt Management Division. The advantages should more than compensate for the distance between DFAS Columbus Center and DNSC contracting.

Recommendations and Management Comments

A.1. We recommend that the Administrator, Defense National Stockpile Center, and the Director, Defense Finance and Accounting Service Columbus Center:

a. Revise the Concept of Operations to assign primary collection responsibility to the Defense Finance and Accounting Service Columbus Center.

b. Agree and adhere to a schedule for getting the necessary documentation to the Defense Finance and Accounting Service Columbus Center Debt Management Division, both for long-standing delinquent receivables and for receivables becoming delinquent in the future.

Management Comments. The Defense Logistics Agency concurred with both recommendations, stating that the Defense National Stockpile Center would work with the Defense Finance and Accounting Service to revise the Concept of Operations and would coordinate a schedule for sending the necessary documentation from the Defense National Stockpile Center to Defense Finance and Accounting Service Columbus Center. The Defense Finance and Accounting Service did not comment on a draft of this report. We request that the Defense Finance and Accounting Service provide comments on the final report.

A.2. We recommend that the Director, Defense Finance and Accounting Service Columbus Center:

a. Research and actively pursue collection of the $14.1 million in delinquent accounts receivable, $1.4 million in delinquent interest charges, and any additional amounts that have become delinquent since September 30, 1996.

b. Initiate write-offs of receivables determined to be uncollectible.

c. Refer receivables valued at more than $600, and not considered uncollectible, to the Debt Management Division.

Management Comments. The Defense Finance and Accounting Service did not comment on a draft of this report. We request that the Defense Finance and Accounting Service provide comments on the final report.

Finding B. Reporting of Interest Charges

The DFAS Columbus Center and DNSC did not record or report $1.5 million in interest revenue due the U.S. Treasury in the FY 1996 financial statements. The DFAS Columbus Center did not use standard general ledger accounts for recording interest charges billed and collected on delinquent accounts receivable and subsequently did not report the interest revenue due the U.S. Treasury on the fiscal year-end trial balance. These issues were also identified in our FY 1995 audit report. In addition, as in FY 1995, even though DNSC had the interest revenue information, DNSC did not report it in the financial statements. As a result, the Fund's FY 1996 financial statements understated interest receivable owed to the Federal Government by $1.5 million.

Recording Interest Charges

Nature of Interest Charges. The DFAS Columbus Center is responsible for billing contractors interest charges on delinquent accounts receivable. The receivables are considered "non-entity assets" in that DNSC is charged with collecting them, but the proceeds are to be credited as miscellaneous receipts of the U.S. Treasury rather than to the DNSC account. Non-entity assets are to be reported separately on financial statements.

DFAS Columbus Center Procedures. In January 1995, DFAS Columbus Center developed a monthly interest age report and began using the report to monitor interest charges due on delinquent accounts receivable. DFAS Columbus Center sends these monthly reports to DNSC finance. DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993 (with a draft update issued in June 1995), and volume 4, "Accounting Policy and Procedures," January 1995, provide guidance on accounting for and reporting interest charges. See Appendix C for a discussion on DoD 7000.14-R guidance pertaining to interest charges.

Recording Interest Charges in the Accounting Records. According to the yearend interest age report dated September 1996, $1.5 million in uncollected interest charges had been billed on delinquent accounts receivable. However, because the DFAS Columbus Center had not incorporated standard general ledger accounts to record the interest charges billed and collected, the trial balance did not disclose the resulting $1.5 million in interest revenue due the U.S. Treasury.

Reasons for Not Recording Interest Charges. Our FY 1995 audit report recommended that DFAS Columbus Center begin to record the interest receivable. In the response from DFAS Columbus Center to DFAS headquarters, DFAS Columbus Center did not concur with the recommendation.

DFAS Columbus Center stated that recording the interest would overstate the DNSC position because the interest is owed to the U.S. Treasury in general, not DNSC. DFAS Columbus Center also stated that DFAS had not developed general procedures for recording interest receivable. However, in the official response to our report, DFAS headquarters concurred, stating that DFAS Columbus Center would begin to record the interest receivable. The staff at DFAS Columbus Center did not receive a copy of the final report and were not otherwise informed that DFAS headquarters expected the interest to be recorded.

Correct Procedures for Recording the Non-Entity Receivable. As noted above, procedures for recording the interest receivable existed in DoD 7000.14-R and have been improved in the June 1995 draft update to volume 1. Following these procedures, correct accrual of the interest would not overstate the Fund's position, because the procedures require that the receivables be offset with a corresponding liability to the U.S. Treasury and that the interest revenue be offset with a corresponding contra-revenue. As a result of our pointing out the DFAS headquarters response and the necessary procedures, the Chief, Fuel Accounting and Payments Division, DFAS Columbus Center, has already approved an appropriate method for recording interest receivable.

Reporting Interest Charges

In the FY 1996 financial statements, DNSC did not report the $1.5 million in interest charges due the U.S. Treasury. During FY 1996, DNSC also did not report interest charges due the U.S. Treasury in the "Federal Agencies' Centralized Trial Balance System." According to DNSC management, DNSC did not report the interest because personnel relied on the figures from the fiscal yearend trial balance to generate the financial statements. However, DNSC had the necessary information and could have reported the interest receivable even though it was not reflected on the trial balance.

Recommendations and Management Comments

B.1. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, implement standard operating procedures to record interest charges receivable and the interest revenue collected and deposited into a U.S. Treasury receipt account, as required by the applicable regulations, and include those amounts in the trial balance.

Management Comments. The Defense Finance and Accounting Service did not comment on a draft of this report. We request that the Defense Finance and Accounting Service provide comments on the final report.

B.2. We recommend that the Director, Defense Logistics Agency, disclose in future National Defense Stockpile Transaction Fund Financial Statements the total amount of interest revenue due the U.S. Treasury and the amount of interest revenue collected during the fiscal year and deposited into the U.S. Treasury receipt account.

Management Comments. The Defense Logistics Agency concurred, stating that the interest is reflected on the Trial Balance and will be included in the FY 97 financial statements.

Part I.B. - Review of Compliance With Laws and Regulations

Introduction

We reviewed compliance with applicable laws and regulations to obtain reasonable assurance that the financial statements were free of material misstatements, not to provide an opinion on the overall compliance with such provisions. As part of obtaining reasonable assurance that the financial statements were free of material misstatements, we reviewed compliance with laws and regulations directly affecting the financial statements and compliance with certain other laws and regulations designated by the OMB and the DoD. Compliance with laws and regulations applicable to the Fund is the responsibility of the Chief Financial Officer of the DoD; Director, DFAS; Director, DLA; Comptroller, DLA; and DNSC management. See Appendix D for applicable laws and regulations.

Reportable Conditions

Material instances of noncompliance are failures to follow requirements, laws, or regulations that would cause us to conclude that the aggregation of the misstatements resulting from those failures is either material to the financial statements or that the sensitivity of the matter would cause others to perceive it as significant. The results of our reviews indicate that management generally complied with the selected provision of laws and regulations as they pertain to the accuracy of the financial statements. The audit did not detect any material noncompliance issues. However, DNSC did not comply with guidance addressing the use of appropriate U.S. Treasury interest receivable accounts, allowances for uncollectible receivable accounts, fixed asset and depreciation accounts, and accrued annual leave and pension expense accounts. In addition, DNSC did not comply with guidance provided for the reconciliation of the Fund Balance with Treasury and for the preparation of financial statements, particularly in accounting for prior-period adjustments. The compliance issues regarding using appropriate U.S. Treasury interest receivable accounts and allowances for uncollectible accounts were previously identified in the FY 1995 audit report.

Additional regulations that were not complied with, as they relate to the internal control weaknesses addressed in Part I.A., include: Federal Acquisition Regulation (FAR) 32.6, "Contract Debts," April 1, 1984; Defense FAR Supplement 232.6, "Contract Debts," 1991 edition; DLA Manual 7000.1, "DLA Accounting and Finance Manual," August 1980; and DoD 7000.14-R, volumes 1 and 4. These compliance issues were previously identified in the FY 1995 audit report. Compliance issues identified during our review would not have had a material impact on the financial statements. With respect to the items not tested, we found nothing that caused us to believe that the Fund managers had not complied, in all material respects, with the provisions identified above.

Interest Charges. The DFAS Columbus Center and DNSC did not record or report $1.5 million in interest revenue due the U.S. Treasury. Therefore, DNSC and DFAS Columbus Center did not comply with DoD 7000.14-R, volumes 1 and 4. The noncompliance with DoD 7000.14-R and the facts relating to the DFAS and DNSC handling of interest charges are discussed in greater detail in Part I.A., Finding B. We also identified this issue in the FY 1995 audit report.

Allowance for Uncollectible Accounts. The DFAS Columbus Center had not been effectively using the allowance for uncollectible accounts because DNSC had not determined an estimated amount of uncollectible accounts. As of September 30, 1995, the DNSC accounting records contained an unsupportable allowance for uncollectible accounts. We reported this unsupportable balance in the FY 1995 audit report. As of September 30, 1996, DNSC had removed this unsupportable allowance but had not replaced it with a valid estimate. DFAS Columbus Center and DNSC current procedures do not comply with DoD 7000.14-R, volume 4, which requires DoD Components to ensure that their accounting systems provide for the establishment of allowances for uncollectible accounts. The noncompliance with DoD 7000.14-R is discussed in greater detail in Part I.B., Finding C.

Fixed Assets and Related Depreciation, Annual Leave Liability, and Pension Liability. As of April 1997, DFAS Columbus Center had not recorded any of these amounts in the accounting records as required by DoD 7000.14-R, volume 4. The noncompliance with DoD 7000.14-R, volume 4, is discussed in more detail in Part I.B., Finding C.

Preparation of Financial Statements and Prior-Period Adjustment. During FY 1996, DNSC made a prior-period adjustment of about $108.5 million as a result of a recommendation in the FY 1995 audit report. DNSC did not inform DFAS Columbus Center that it was a prior-period adjustment so that it could be posted as such, as required by DoD 7000.14-R, volume 4. DNSC did not comply with other aspects of the DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" (the DoD form and content Guidance), October 1996; however, these discrepancies were minor and were provided to management during our audit. The prior-period adjustment noncompliance is discussed in greater detail in Part I.B., Finding C.

Uncollectible Accounts Written Off. During FY 1996, DNSC wrote off $120,000 in accounts receivable even though $3.7 million of the $8.6 million in accounts receivable due more than 120 days had been delinquent since FYs 1991 through 1994. The FY 1995 audit report identified $4.5 million in delinquent accounts receivable for FYs 1991 through 1994. These procedures did not comply with DoD 7000.14-R, volume 4, which requires losses on receivables to be recognized when it is likely that the receivable will not be collected. Delinquent accounts receivable and other discrepancies are discussed in Part I.A., Finding A.

Reconciliation of Fund Balance With Treasury. DNSC had not reconciled the Fund Balance With Treasury account between DNSC's general ledger and the U.S. Treasury's records as required in DoD 7000.14-R, volume 4.

Additionally, DNSC has not referred the discrepancy to DFAS Columbus Center for resolution. The noncompliance with DoD 7000.14-R is fully discussed in Part I.B., Finding C.

Conclusion

The DNSC and DFAS Columbus Center need to implement the regulations, standards, and generally accepted accounting principles addressed in Parts I.A. and I.B. to resolve problems with interest charges, allowances for uncollectibles, fixed assets, accrued annual leave, pension liability, prior-period adjustments, uncollectible write-offs, and reconciliation of the Fund Balance With Treasury account. Except for the recommendations made for the financial statement preparation finding that follows, we have not made recommendations in this section for each compliance issue.

Finding C. FY 1996 Accounting Records and Financial Statements Compliance

The DNSC did not inform DFAS Columbus Center of $108.5 million in corrections made to prior-period adjustments and the cost of goods related to the FY 1995 financial statements. Specifically, DNSC had DFAS process $108.5 million as a current-year cost of goods sold that should have been processed against the prior years' sales. Additionally, the DNSC did not provide DFAS Columbus Center with information to accrue an allowance for doubtful accounts, and DNSC also did not reconcile the general ledger Fund Balance With Treasury account with the U.S. Treasury records and did not refer the existing discrepancy to DFAS Columbus Center for resolution. Finally, the accounting records and financial statements did not reflect fixed assets and accrued annual leave and pension liability. These problems occurred because DNSC and DFAS Columbus Center Personnel were unaware of certain accounting requirements, and DNSC and DLA management did not review the statements. As a result, the accounting records and financial statements understated assets, liabilities, and expenses. In addition, the Fund Balance With Treasury account on the financial statements may reflect transactions that do not properly belong to DNSC. The FY 1995 audit report had a similar finding on financial statement compliance but dealt with different specific conditions.

Prior-Period Adjustment

In the FY 1995 audit report, we noted that DNSC had the DFAS Columbus Center post the sale of material and the related accounts receivable at the time of the sale, but did not have DFAS post the reduction of inventory and cost of goods sold until the material was shipped. This condition led to a mismatch of sales revenue to the related expense.

During FY 1996, as a result of the FY 1995 audit report, DNSC processed the reduction of inventory and the cost of goods sold at the time of the sale. During FY 1996, DNSC made adjustments of $108.5 million to the current cost of goods for sales made prior to FY 1996. However, the $108.5 million adjustment should have been processed against prior-year sales as a prior-period adjustment. DNSC did not inform DFAS Columbus Center that this was a prior-period adjustment and should be posted as such. As a result, had DNSC not corrected the financial statements when we brought the matter to their attention, the cost of goods sold would be overstated, giving the impression that the excess of revenues over expenses declined sharply during FY 1996.

Allowance for Doubtful Accounts

As of September 30, 1995, DNSC had a recorded allowance for doubtful accounts on the accounting records and the financial statements. This allowance had existed for years, and no one could explain the basis for the amount. DNSC properly removed this allowance during FY 1996. However, DNSC did not create a new allowance as required by DoD 7000.14-R, volume 4. DNSC personnel stated that DFAS Columbus Center had told them they could not establish an allowance without identifying specific accounts, which DNSC finance had been unable to do. DFAS Columbus Center said that a former employee might have told them to identify specific accounts but that it was probably a misunderstanding.

Without an allowance for doubtful accounts, net accounts receivable and capital are overstated by an estimated percentage representing the dollar amount of accounts considered doubtful but not yet written off. In the case of DNSC, this overstatement would be in addition to any overstatement from accounts receivable that should have been written off (Finding A).

Fund Balance With Treasury

As of September 30, 1995, the DNSC Fund Balance With Treasury general ledger account was $290,775,958 while the U.S. Treasury records showed $290,711,582 or $64,376 less. DNSC used the lower U.S. Treasury figure in the financial statements.

DoD 7000.14-R, volume 4, requires that discrepancies between Fund Balance with Treasury general ledger account and U.S. Treasury records be reconciled. If the discrepancies result from errors rather than timing differences, the errors are to be corrected.

Part of the $64,376 discrepancy, $18,431, occurred during FY 1996. This $18,431 discrepancy occurred because of disbursement transactions that involved the U.S. Treasury records about which DFAS Columbus Center had no knowledge. DNSC finance personnel stated that in such cases, they simply have to wait for documentation to come through, which sometimes takes years, before booking such transactions to the accounting records. They further stated that they had not asked DFAS Columbus Center for assistance. Personnel at DFAS Columbus Center said that they had never seen the U.S. Treasury reports and that they could get documentation of the unknown transactions promptly if they had access to those reports. The remainder of the discrepancy, $45,945, occurred before FY 1996; no documentation was available to determine the cause of that discrepancy.

Without the supporting documentation, DNSC has no way of knowing whether the unknown transactions were correct or whether they properly belong to

DNSC. DNSC also does not know to which account the offsets for the disbursements should be posted. If the transactions do not belong to DNSC, the accounts of some other entity are also misstated.

Fixed Assets and Depreciation

As of April 1997, DNSC did not have fixed assets and depreciation posted to the accounting records as required by DoD 7000.14-R, volume 4. Personnel at DFAS Columbus Center did not have the necessary data to post the amounts to the September 30, 1996, post-closing trial balance. Although DNSC received the necessary data ($4,805,819 in equipment net of accumulated depreciation of $4,362,562) and forwarded it to DFAS Columbus Center shortly thereafter, personnel were not aware of the requirement to post it to the accounting records.

The financial statements disclosed the amounts in a footnote, but not in the main body of the statements. DNSC finance personnel said that they had not received the information from DLA in time to get it to DFAS Columbus Center to be posted in the trial balance as of September 30, 1996, and therefore could not include it in the main body of the statements. However, DNSC could have adjusted the financial statements without updating the trial balance as they did with the $108.5 million adjustment to the cost of goods sold and prior-period adjustments account.

Annual Leave and Pension Liability

DoD 7000.14-R, volume 4, requires the annual leave liability and the DoD contribution to civilian retirement benefits to be accrued in the accounting records and, therefore, reflected in the financial statements. Personnel at both DFAS Columbus Center and DNSC said they were unfamiliar with this requirement and did not know where to obtain the information. The employee in the office of the DLA Comptroller who reviewed the DNSC statements said that the information is readily available from the Defense Business Management System at the DFAS Columbus Center. Personnel at the Defense Business Management System confirmed that this information was available.

Reasons for Lack of Compliance

As noted, both DNSC and DFAS Columbus Center personnel were unaware of some requirements. Additionally, the DNSC finance employee responsible for preparing the statements had been detailed to areas other than DNSC for about

6 months and had to find time during one of those details to prepare the financial statements. This person did receive training in financial statement preparation as recommended in our prior audit report.

In response to our FY 1995 audit, DLA agreed to establish procedures to ensure that the DNSC financial statements were adequately reconciled and reviewed before submission. A staff member in the DLA Comptroller's Office did review the financial statements. Based on the number of errors and the failure to notice the prior-period adjustment, we conclude that this review was cursory. However, because the FY 1997 financial statements will be prepared at DFAS Indianapolis Center, we have no recommendations on financial statement preparation.

Recommendations and Management Comments

C.1. We recommend that the Director, Defense Logistics Agency, determine and provide all necessary information to the Defense Finance and Accounting Service Columbus Center so that all required entries can be posted, including information on prior-period adjustments, allowances for doubtful accounts, Fund Balance With Treasury, fixed assets and depreciation, accrued annual leave, and pension liability.

Management Comments. The Defense Logistics Agency concurred, stating that the Defense National Stockpile Center would provide Defense Finance and Accounting Service Columbus Center the information necessary for all required entries to be posted. The estimated completion date for this action is September 30, 1997.

C.2. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, establish local procedures to ensure that all accounting entries required by DoD 7000.14-R for the Defense National Stockpile Center are made.

Management Comments. The Defense Finance and Accounting Service did not comment on a draft of this report. We request that the Defense Finance and Accounting Service provide comments on the final report.

Part II - Additional Information

Appendix A. Audit Process

Scope

Statements Reviewed. We audited the FY 1996 National Defense Stockpile Transaction Fund (the Fund) Financial Statements. The financial statements included the Statement of Financial Position, the Statement of Operations and Changes in Net Position, and the Statement of Cash Flows. Also included were the Footnotes and the Overview to the Principal Statements. The financial statements upon which our opinion is based were dated September 30, 1996, and received on February 20, 1997.

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

Accounting Principles. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the principles of the Joint Financial Management Improvement Program (JFMIP), who are the Director, OMB; the Secretary of the Treasury; and the Comptroller General. Specific standards agreed on by those officials are issued by the Director, OMB, and the Comptroller General. Financial statement reporting is governed by accounting standards approved by the JFMIP.

To date, seven accounting standards and two accounting concepts have been published in final form, and three accounting standards have been published in draft form. One other accounting standard (No. 8) has been approved by the Federal Accounting Standards Advisory Board, but it must undergo a congressional review before it is promulgated by OMB. OMB Form and Content incorporates these standards and concepts and should be used by Federal agencies to prepare financial statements.

Statements of Federal Financial Accounting Standards and Concepts

Number	Title	Status	Effective Date
Standard No. 1	Accounting for Selected Assets and Liabilities, March 30, 1993	Final	FY 1994
Standard No. 2	Accounting for Direct Loans and Loan Guarantees, August 23, 1993	Final	FY 1994
Standard No. 3	Accounting for Inventory and Related Property, October 27, 1993	Final	FY 1994
Standard No. 4	Managerial Cost Accounting Concepts and Standards for the Federal Government, July 31, 1995	Final	FY 1997
Standard No. 5	Accounting for Liabilities of the Federal Government, September 1995	Final	FY 1997
Standard No. 6	Accounting for Property, Plant and Equipment, November 30, 1995	Final	FY 1998
Standard No. 7	Accounting for Revenue and Other Financing Sources, May 10, 1996	Final	FY 1998
Standard No. 8	Supplementary Stewardship Reporting	Approved	
Concept No. 1	Objectives of Federal Financial Reporting, September 2, 1993	Final	
Concept No. 2	Entity and Display, June 6, 1995	Final	

Through FY 1996, agencies were required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. A summary of the FY 1996 hierarchy follows:

o standards agreed to and published by the JFMIP Principals;

o form and content requirements of OMB Bulletin No. 94-01;

o accounting standards contained in agency accounting policy guidance as of March 29, 1991; and

o accounting principles published by other authoritative sources.

Beginning in FY 1997, agencies are required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. A summary of the FY 1997 hierarchy follows:

- standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller General;
- interpretations on the standards issued by OMB;
- requirements of the effective OMB form and content bulletin; and
- accounting principles published by other authoritative sources.

Because only three accounting standards and two accounting concepts were effective in FY 1996, most accounting standards for the "other comprehensive basis of accounting" used by DoD came from DoD accounting guidance. Previously, DoD Manual 7220.9-M, the "DoD Accounting Manual," was the primary DoD accounting guidance. Since FY 1992, the USD(C) has updated sections of the "DoD Accounting Manual," and has incorporated those sections into new volumes of the "DoD Financial Management Regulation." The USD(C) had issued 14 completed volumes as of April 1997 and plans to issue 1 additional volume. The "DoD Financial Management Regulation," when completed, will be the single DoD-wide regulation that all DoD Components will use for accounting, budgeting, finance, and education and training for financial management. However, after FY 1996, neither the policy in the "DoD Accounting Manual" nor in the "DoD Financial Management Regulation" will be the authoritative basis for preparing financial statements.

Scope of Review of Internal Controls. Our consideration of the internal control structure included obtaining an understanding of significant internal control structure policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances. For those significant control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed. For areas where internal controls were determined to be weak, we attempted to perform tests to determine the level of assurance that could be placed on those controls.

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

Scope of Review of Compliance with Laws and Regulations. As part of obtaining reasonable assurance about whether the Fund's financial statements were free of material misstatements, we reviewed compliance with laws and regulations that may directly affect the financial statements and other laws and regulations designated by the OMB and the DoD. See Appendix D for a complete list of laws and regulations that we reviewed.

Audit Period. We conducted this audit from May 1996 through April 1997 at the DNSC and its storage locations and at the Defense Finance and Accounting Service Columbus Center.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Computer-Processed Data. To achieve the overall audit objective, we initially relied upon computer-processed data obtained from the DNSC Master Inventory File (MIF). We assessed the reliability of the MIF data by reviewing the general controls at DNSC, by comparing the MIF records to local site records, and by testing inventories of the stockpile materials. To perform the inventory of stockpile materials, we used both statistical and judgment samples. At audit inventory locations, comparisons were made among our physical inventory results, MIF information, and local records. At all locations where local inventory records are kept, we compared local records to MIF information whether or not we performed any physical inventory. The information provided by the MIF was found to be generally reliable, and the discrepancies identified were not material to the financial statements.

Statistical Sampling Methodology

The Quantitative Methods Division, Inspector General, DoD, developed the statistical sampling plan for this audit. That work included statistically selecting the locations and the inventory line items at each location. In addition, the Army Corps of Engineers provided assistance with the measurement of sample selections of materials in bulk storage, as these materials were not readily countable.

Audit Universe. The audit universe consisted of all stockpile materials included in the inventory as of September 30, 1996. The reported value of the ending inventory shown on the FY 1996 financial statements was about $3.7 billion. The sample selections were chosen from the MIF data base as of June 30, 1996, consisting of 35,680 records or line items representing commodities at 82 DNSC storage locations.

Sampling Plan. A multistage cluster random sample was employed for this audit. Factors in the sample selection process were: (1) the estimated auditing (travel) costs, (2) the relative values, as reflected in the MIF, of all of the inventory materials located within geographic clusters, and (3) the relative values of specific materials within a given cluster. The sample was selected to minimize the dollar values in factor 1 and to maximize the dollar values in factors 2 and 3. Asbestos, a hazardous material, was the only item excluded from possible sample selection. The sample selection consisted of 41 line items from 9 DNSC storage locations.

Judgment Sample. At each site chosen through statistical sampling, a judgment sample selection was made from the inventory of site materials after excluding statistical sample selections. Inventory results from the judgment sample were compared to local records and to the MIF records.

Sample Results. The inventory of sample selections was conducted from October through December of 1996. We were able to determine that on-hand quantities were generally accurate.

Management Control Program

DoD Directive 5010.38,* "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DNSC management controls as they relate to the Fund's financial statements. Specifically, we reviewed DNSC management controls over recording, accounting, and reporting financial information resulting from DNSC operations during FY 1996. Because we did not identify a material weakness as they relate to the financial statements, we did not assess management's self-evaluation.

Adequacy of Management Controls. The DNSC management controls we reviewed were adequate; we identified no material management control weaknesses as they relate to the financial statements.

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

Appendix B. Summary of Prior Coverage

During the last 5 years, the following reports relating to the Fund's financial statements and DNSC accounting policies and practices were issued:

General Accounting Office Letter Report No. NSIAD-97-30, "Disposal of Excess Zinc," November 7, 1996 (OSD Case 1200). This audit was performed pursuant to a Congressional request arising from a dispute between the American Zinc Association and the Federal Government. The dispute concerned the Government's basis for its interpretation of the statutory phrase "usual markets" as applied to the zinc sales program and DoD efforts not to unduly disrupt the zinc market. The General Accounting Office found that the statute does not define the "usual markets" and agreed with DNSC's interpretation that it means the total U.S. market for all grades of zinc, not just the grades being sold by DNSC. The report also states that DNSC has policies and procedures for selling zinc without unduly disrupting the zinc market.

Inspector General, DoD, Report No. 96-190, "Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1995," June 28, 1996. We issued a disclaimer of opinion on the financial statements because documentation that supported the inventory account value was not available. The audit did not disclose any material internal control weaknesses or lack of compliance with laws and regulations. However, the audit disclosed reportable internal control conditions in the accuracy of the stockpile materials financial statement inventory balance, in the collection of accounts receivable and related interest receivable, and in recording and reporting interest due to the U.S. Treasury. The audit also disclosed a reportable condition in compliance with form and content guidance for the financial statements. Management concurred with all recommendations but has taken effective action only in the area of the stockpile materials financial statement inventory balance. Therefore, all other conditions are cited in this report.

General Accounting Office Report No. AIMD-95-35R (OSD Case 9842), "Stockpile Fund," December 16, 1994. This report states that the audit reviewed accounting policies and practices involved with cash and noncash transactions. The report states that cash and noncash transactions were not separately identified in the Fund's FY 1993 financial statements and annual Strategic and Critical Materials Report to the Congress for FY 1993. Also, the Fund's FY 1993 financial statements did not separately disclose all of the amounts comprising the Fund's net position, as prescribed by OMB. Additionally, the report states DNSC was not in compliance with Section 518 of Public Law 100-440 because the Fund used part of the estimated $215.8 million appropriated to the Fund before January 1, 1985, on contracts involving in-kind exchanges that did not meet the requirements of Section 518. The Fund was required to use all funds authorized and appropriated to evaluate, test, relocate, upgrade, or purchase stockpile materials before January 1, 1988.

Inspector General, DoD, Report No. 93-139, "National Defense Stockpile Transaction Fund Financial Statements for FY 1992," June 30, 1993. We disclaimed an opinion on the financial statements because the DLA could not provide documentation to support the inventory valued on the financial statements, and management did not provide the necessary management and legal representation letters. The audit did not disclose any reportable or material internal control weaknesses. The report states that the DNSC complied in all material respects with policies, laws, and regulations. The report did not contain any recommendations. However, management concurred with all of the facts presented in the audit report.

Inspector General, DoD Report No. 92-141, "National Defense Stockpile Transaction Fund," September 30, 1992. This report states that the financial status of the Fund, as reported to Congress for FYs 1989 and 1990, was inaccurate. However, the audit identified no material internal control weaknesses related to procedures for reporting the financial status of the Fund to Congress. The audit recommended revising the reporting format for the Strategic and Critical Materials Report to Congress, correcting the balances reported to Congress for FYs 1989 and 1990, and establishing procedures for preparing the Strategic and Critical Materials Report to Congress that use accounting system data reported in the Report on Budget Execution. Management concurred with these recommendations and took corrective actions to revise the reporting format and reporting procedures to conform with audit recommendations.

Appendix C. Accounts Receivable and Interest Charges Criteria

Accounts Receivable Criteria

FAR 32.6, "Contract Debts," April 1, 1984, prescribes policies and procedures for the Government's actions in ascertaining and collecting contract debts, charging interest on the debts, deferring collection, and compromising and terminating certain debts. Specifically, sections 2 through 16 provide procedures for assigning responsible officials to follow up on amounts due the Federal Government, debt determination, collection procedures to include documentation retention requirements, and compromise actions for debts less than $100,000 that are deemed uncollectible. According to the FAR, the primary responsible official is the contracting officer or other official designated under agency procedures to administer the collection of contract debts and applicable interest.

Defense FAR Supplement 232.6, "Contract Debts," December 31, 1991, provides additional guidance for debt determination and collection when the functions are performed by the disbursing officers, in coordination with the contract finance office and the contracting officer.

DLA Manual 7000.1, "DLA Accounting and Finance Manual," chapter 12, "Debt Claims," August 1980, provides guidance for the processing of debt claims of the United States which arise as a result of operations of, or are referred to, the DLA. The regulation requires that claims against business entities will be ascertained and documented promptly, and settlement or collection action will be initiated immediately and pursued aggressively until disposition. The guidance also includes procedures for handling claims that cannot be resolved through collection or offset. This regulation was incorporated into DoD 7000.14-R, volume 10, "Contract Payment Policy and Procedures," February 1996.

Title 28, United States Code, section 2415, "Time for Commencing Action," and title 31, United States Code, section 3716, "Administrative Offset," advise that because of the statute of limitations, agencies are barred after 6 years from pursuing collection actions other than administrative offsets. An offset can be made for up to 10 years. Public Law 104-304, Chapter 10, Section 31001, "Debt Collection Improvement Act of 1996," April 25, 1996, provides various new procedures designed to maximize collections of delinquent debt and reduce losses from debt management activities.

Interest Charges Criteria

DoD 7000.14-R, volume 4, "Accounting Policy and Procedures," chapter 1, "Financial Control of Assets," January 1995, provides guidance for the reporting of receivables that are not due the collecting entity. This Regulation states that receivables should be distinguished between entity receivables and non-entity receivables. Non-entity receivables are amounts that the entity collects on behalf of the U.S. Government or other entities but is not authorized to spend. Receivables not available to an entity should be reported separately from receivables available to the entity.

DoD 7000.14-R, volume 4, chapter 3, "Receivables," January 1995, provides specific guidance on accounting for interest charges. This Regulation states that accounting for receivables shall include provisions for accruing interest on delinquent accounts from the public in accordance with title 31, United States Code, section 3717. Additionally, this Regulation requires accounting systems to be designed to accumulate and record such charges for all debts owed the U.S. Government.

DoD 7000.14-R, volume 1, "General Financial Management Information, Systems, and Requirements," chapter 7, "DoD Standard General Ledger," May 1993, provides standard general ledger accounts that can be used for recording amounts owed the U.S. Treasury. The June 1995 draft update provides different standard general ledger accounts and more specificity on how they can be used.

Appendix D. Laws and Regulations

Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982," September 8, 1982

Public Law 97-365, "Debt Collection Act of 1982," October 25, 1982

Public Law 100-496, "Prompt Payment Act of 1988," October 17, 1988

Public Law 101-576, "Chief Financial Officers Act of 1990," November 15, 1990

Public Law 103-335, "DoD Appropriations Act for FY 1995," September 30, 1994

Public Law 103-337, "National Defense Authorization Act for 1995," October 5, 1994

Public Law 104-304, "Debt Collection Improvement Act of 1996," April 25, 1996

Title 28, U.S.C., section 2415, "Time for Commencing Action"

Title 31, U.S.C., section 3716, "Administrative Offset"

OMB Circular No. A-127, "Financial Management Systems," December 19, 1984

OMB Circular No. A-123 Revised, "Internal Control Systems," June 21, 1995

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

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

OMB Statements of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," October 27, 1993

FAR 32.6, "Contract Debts," April 1, 1984

"DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," November 8, 1996

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

DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993

DoD 7000.14-R, "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 1995

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

Defense FAR Supplement 232.6, "Contract Debts," December 31, 1991

DLA Manual 7000.1, "DLA Accounting and Finance Manual," August 1980

Appendix E. Financial Statements and Auditor Opinion

National Defense Stockpile Transaction Fund

Chief Financial Officer Annual Financial Statement FY 1996

March 1, 1997

DEFENSE NATIONAL STOCKPILE

TRANSACTION FUND

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DEFENSE NATIONAL STOCKPILE TRANSACTION FUND

OVERVIEW

Overview

2

Overview

Executive Summary and Highlights

The Defense National Stockpile Center (DNSC) is a unique Department of Defense activity, in that our mission is to maintain, acquire and sell raw materials (commodities) that are strategic and critical to the Defense industry in the event of a national emergency. As a field activity of the Defense Logistics Agency, DNSC is responsible for oversight and maintenance of 91 commodities that are stored in 82 different locations throughout the Continental United States. The market value of DNSC inventory as of September 30, 1996, was $6.1 billion. DNSC operations are governed by the Strategic and Critical Stock Piling Act (50 U.S.C. 98 *et seq.*).

Overall mission success depends on special blending of:

- Marketing research for customer awareness and feedback, price determinations, and strategic planning;
- Contracting for acquisition of new commodities, purchase of operational needs, and sale of excess commodities;
- Depot operations to ensure the quality of material, the timely shipment and receipt of material, and that no loss of material occurs.

DNSC has had a long held successful tradition of serving its customers as well as obtaining the best return on investment for the government. Whether DNSC is selling a commodity, redrumming a commodity for long-term storage, or receiving an upgraded commodity into storage, the work is accomplished through the variety of talent found within the core cadre of the Center.

For example, when Congress authorizes the sale of a commodity that is no longer required for national security needs, there are many actions necessary to successfully offer it in the market place. Our marketing research directorate performs research into markets and prices to determine what can be effectively sold at a market value price without affecting international commodity markets. They prepare an Annual Materials Plan (AMP) which must be approved by a legislatively mandated Market Impact Committee, the Office of the Secretary of Defense, and eventually Congress. Once the AMP is approved, the contracting and strategic materials directorate determine a sales strategy which considers operational requirements, when to offer the commodities, what amounts to offer, chemical analysis of the commodities, which contracting instrument to use, etc. Once the sales strategy is defined, the contract is prepared and reviewed by our legal department. When the sales contract is awarded, the strategic materials directorate orchestrates shipments and prepares the appropriate inventory documents. Inventory adjustments and invoice information are handled by our administrative staff.

Overview

During FY 1996, a number of significant management initiatives and program achievements were accomplished:

⇒ Sold $390.8 million in excess commodities.

Transferred $150 million to the Military Services -- $50 million each to the Army, Navy, and Air Force operation and maintenance accounts.

⇒ Collected $321.7 million from current and prior year sales contracts.

⇒ Privatized the William Langer Jewel Bearing Plant.

⇒ Reorganized the DNSC operational configuration which reduced personnel strength and streamlined the organization. The regional level of management was eliminated and mission critical positions were moved to the DNSC Ft. Belvoir office. Twenty positions were abolished and now there is direct management authority between our depot activities and DNSC headquarters.

⇒ Delegated the use of the International Merchant Purchase Authorization Card down to the depot level.

⇒ Eliminated Imprest Funds throughout DNSC.

⇒ Standardized administrative procedures DNSC-wide.

⇒ Delegated limited micropurchase authority to the depot level.

⇒ Performed a complete reconciliation of Master Inventory File records with inventory cards at the DNSC depots and cleared all discrepancies of greater than 2 percent.

History and Profile

Although the United States has considerable mineral resources, it is far from self-sufficient, particularly in times of war. During World War II, shortages and disruptions in the supply of rubber, tin, tungsten, copper, and other essential materials dramatically brought to the attention of the US government and the American public the need for a cache of materials that could be drawn upon in an emergency.

The Stock Piling Act of 1946 was enacted on July 23, 1946. It authorized the Secretary of War, Navy, and Interior "to...determine, from time to time, which materials are strategic and critical...and to determine, from time to time, the quality and quantities of such material which shall be stockpiled." Responsibility for performing the functions of the Stock Piling Act was originally given to the Army-Navy Munitions Board and then to the National Security Resources Board. Later the responsibility shifted to the Treasury Department. A few years later, the

functions were merged with the newly created General Services Administration (GSA). The Act also contained a provision to prevent undue disruption of usual markets of producers, processors, and consumers by preventing Stockpile materials from being released indiscriminately.

The next step was to determine what commodities were needed in what quantities and for whom. A factoring system was developed in 1950 to determine the estimated value of wartime supplies. The system took into account the possible military accessibility to critical materials, political dependability of potential foreign suppliers, concentration of supplies of needed materials, and other miscellaneous factors, such as vulnerability to sabotage. Most commodities were purchased through foreign sources primarily because two-thirds of the commodities to be stockpiled were not produced in the U.S. It was determined that only high purity, raw materials would be stockpiled.

The Korean War caused the need for expanded production of materials quickly. This lead to the passage of the Defense Production Act of 1950 (50 U.S.C. 2061, as amended). The policy set forth in the Defense Production Act is as follows:

> In view of the present international situation and in order to provide for the national defense and national security, our mobilization effort continues to require some diversion of certain materials and facilities from civilian use to military and related purposes. It also requires the development of preparedness programs and the expansion of productive capacity and supply beyond the levels needed to meet the civilian demand, in order to reduce the time required for full mobilization in the event of an attack on the United States.

A later amendment, approved June 30, 1953, allowed the President to transfer to the existing National Stockpile those materials that had been accumulated under the Defense Production Act. This Act also gave rise to the Barter Program. Under the Act, the Commodity Credit Corporation (CCC) was permitted to barter agricultural commodities that it owned for strategic materials.

The Defense Production Act accelerated the Stockpile effort tremendously. Between 1939 and 1950, Congress had appropriated $1.5 billion for stockpiling. Between 1950 and 1951, Congress authorized an additional $3.5 billion for stockpiling purposes. By 1955, major appropriations for Stockpile procurement had ended. However, some Stockpile objectives remained unfilled.

Within that same time period, the expansion of the nuclear age, with its completely different theories and strategies of warfare, changed the philosophy of stockpiling materials. An advisory committee was established to review Stockpile policy. Their report prompted the following changes to Stockpile policy:

- Strategic Stockpile objectives should be reduced from a five to a three-year global war scenario.

Overview

- Disposals of excesses should be made only if they do not disrupt US domestic markets or US international relations.

The Stockpile initiative had shifted from a time of shortage to a time of surplus. Disposal of excess commodities were problematic. In 1959, a restriction was placed on sales by adding a requirement for review of any proposed disposals of excess materials by the Department of Interior, Commerce, State, Agriculture, and Defense, as well as any other concerned Federal agencies. This slowed down the sales process and/or halted it altogether.

From 1962 to 1976, many changes occurred in both stockpile policy and management. In 1976, the President issued guidance requiring a stockpile that could support US defense requirements:

- During a major war over a three-year period.
- Assuming large-scale industrial mobilization and increased materials demand.
- Providing for a wide range of basic civilian economic needs to ensure a healthy wartime economy.
- Planning should include:
  - Maintaining current data and planning factors,
  - Developing an "Annual Materials Plan," that will respond to changes in national security, budgetary considerations, domestic markets, and international events.

This new policy became effective August 23, 1976 and new goals were announced on October 1, 1976.

In 1979, President Carter signed the Strategic and Critical Materials Stockpiling Revision Act. The most significant provisions of this Act are as follows:

- ◊ Transferred the Stockpile policy functions from GSA's Federal Preparedness Agency to the newly created Federal Emergency Management Agency (FEMA). Management functions remained with GSA.
- ◊ Established the National Defense Stockpile Transaction Fund (T-Fund). Proceeds from disposals of commodities were to be deposited into the T-Fund and used to purchase commodities that were short of goal.
- ◊ Encouraged use of barter to acquire and dispose of Stockpile material.

Overview

In March of 1981, President Reagan announced a new major purchase program for the National Defense Stockpile. He stated that, "It is now widely recognized that our nation is vulnerable to sudden shortages in basic raw materials that are necessary to our defense production base." At that time, of the 61 family groups and individual materials, 37 were less than goal. To fill these gaps, Congress apportioned $100 million out of Transaction Fund to purchase urgently needed, high defense commodities. That same year, the President signed the Omnibus Budget Reconciliation Act (P.L.97-35) that authorized disposals of 16 commodities to be sold over a three-year period.

P.L. 97-35 also required that the AMP be submitted each year with the President's budget. The AMP would include a plan for sales and acquisition of material for the next fiscal year plus assumptions for the succeeding four years. The AMP fell under the purview of the Federal Emergency Management Agency. The AMP was developed in a way as to avoid undue market disruption and to conform to budget limitations. Once developed, through a combined effort of Federal Agencies and Congressional Committees, the AMP was then submitted to the House and Senate Armed Services Committees.

In FY 1982, President Reagan issued a directive stating that, over a 10-year period, chromite and manganese ores in the Stockpile were to be upgraded into high-carbon ferrochromium and ferromanganese. The intent of the directive was to help sustain the processing capability necessary for national defense, reducing the time needed to convert Stockpile materials to ferroalloys in case of a national emergency.

The National Defense Authorization Act of 1987 (P.L. 99-661) allowed the Transaction Fund to be used to pay for: transportation of commodities; storage; development of specifications; upgrading expenses; testing and quality studies of Stockpile materials; material and mobilization studies; and other reasonable requirements for management of the Stockpile. It also legislatively mandated the ferroalloy upgrade program mentioned above.

In FY 1988, the President issued Executive Order 12626, designating the Secretary of Defense as the National Defense Stockpile Manager (in accordance with Section 6A of the National Defense Stock Piling Act). The Stockpile Manager, who's office was responsible for the development of Stockpile policy, had previously resided in FEMA. Those positions were transferred to the Assistant Secretary of Defense (Production & Logistics). Administrative and managerial functions were transferred from GSA to the Director, Defense Logistics Agency (DLA).

With the end of the cold war and the fall of the Soviet Block, there came a need to relook at our Nation's war scenario. It became apparent that the threat of global warfare was no longer a valid assumption. The need to adjust Stockpile goals also came into question. The Stockpile acquisition program was put on-hold, and only minor upgrade programs were being performed. Additional commodities were authorized as excess through the Defense Authorization process. The Department of Defense revised their war scenario to include two, simultaneous, regional conflicts. Excess cash was accruing into the Transaction Fund.

Overview

In order to put the excess proceeds to use, it was determined that DNSC operations should be financed via the Transaction fund vice an appropriation as had been the historic source of funds. As a result, a number of pieces of legislation were passed. In FY 93, P.L. 102-484, the National Defense Authorization Act authorized the use of Transaction Fund monies to pay for improvement or rehabilitation of facilities, structures, and infrastructure needed to maintain the integrity of stockpile materials. In FY 94, the Authorization Act (P.L. 103-160) authorized the payment of salaries and other expenditures out of the Transaction Fund. DNSC was now a self-financing activity.

In addition, the National Defense Appropriations Act of 1993 (P.L. 102-396) authorized the Secretary of Defense to transfer funds up to $400 million from the Transaction Fund. The Act made available $200 million of those funds for the minor construction and repair of real property for the military services and Defense Agencies. In FY 93, $200 million was transferred to the Services. P.L. 103-160, FY 94's Appropriations Act, signed November 3, 1993, authorized the transfer of not more than $500 million from the Transaction Fund to the Military Service operations and maintenance accounts ($150M each to the Army and Navy; $200M to the Air Force). Transfers in FY 94 resulted in $400 million being provided to the Military Services. In FY 95 and FY 96 Congress authorized the transfer of $150 million to the Military Services operation and maintenance account ($50M each). DNSC accomplished these transferred those amounts each year.

In June of FY 95, the biannual requirements report that is prepared by the Stockpile policy office, the Assistant Secretary of Defense (IA&I)(formerly P&L), was provided to Congress for approval and subsequent authorization. It reduced Stockpile requirements from $3.2 billion to $22 million. Due to the lateness of the report (due no later than January 15) and Congressional concerns, no action was taken by Congress to approve the report in its entirety. However, it did give rise to new legislation that proposed that DNSC sales proceeds be used to offset losses in other Defense-related areas. On September 27, 1996, the National Defense Authorization Act of 1997, authorized the sale of 11 commodities specifically to offset governmental losses incurred during Foreign Military Sales Research and Development. Sale of these commodities are expected to generate $612 million worth of proceeds over a ten year period. Proceeds would be deposited into the General Fund of the Treasury.

Organizational Profile

In July 1996, DNSC completed a reorganization which was intended to streamline our organization and reduce personnel strength. This action was necessary due to DoD-mandated end strength goals for 1996 and later years and was also driven by a general thrust throughout the Department of Defense to operate more efficiently and effectively in the post-Cold War era as the strategic mission of the Department changes.

We eliminated the DNSC field management level and created sufficient additional structure at the Ft. Belvoir office to continue to carry out the mission of the Center. Prior to the reorganization, there existed three DNSC Zone offices, located in New York City, NY;

Overview

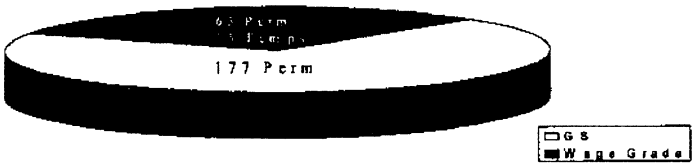
Hammond, IN; and Ft. Worth, TX. At one time, these three offices contained 39 employees who managed the DNSC depots within their geographical areas. Our Activity Based Costing analysis led us to a flatter, leaner organization with direct management between the operating headquarters and the depots. This eliminates added functions that were identified as unnecessary, resulting in a more efficient and productive organization. We determined that 19 Zone positions were mission critical and transferred their functions to Ft. Belvoir.

As of September 30, 1996, there were 255 personnel on-board working within the following organizational structure:

- **DNSC Headquarters**, Ft. Belvoir, VA, develops administrative policies and programs in accordance with applicable laws and regulations. Performs all contracting and marketing research functions DNSC-wide. Manages, oversees, and performs operations required to maintain facilities and acquire/dispose/maintain commodities. Oversee and provides guidance to DNSC quality assurance program. Maintains DNSC Master Inventory File. Administers financial and personnel liaison, develops and executes budgets, and administers Stockpile Automated Data Processing requirements DNSC-wide.

- **DNSC Depots Operations**, located at 82 sites across the US, maintains and repairs depot facilities and DNSC inventories, Prepares commodities for shipment. Receives commodities. Perform sampling and qualitative analysis and oversees shipment of commodities by contractor personnel. Ensures that security is adequate to protect commodities from theft. Maintains inventory records. Maintains material handling equipment. Prepares shipping records and other related reports.

DNSC Staffing
September 30, 1996
End Strength 255
FTE 264



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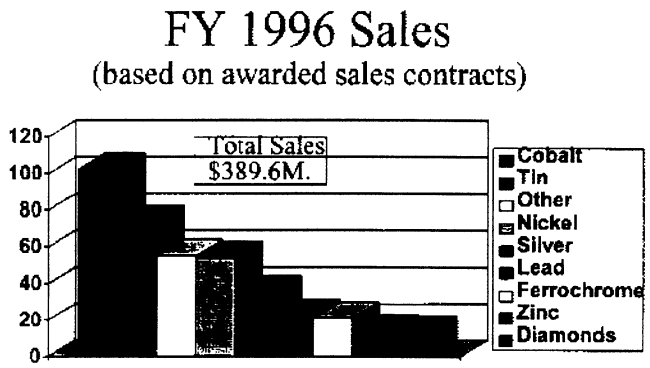
Overview

FUNDING

Sources of Funds

DNSC finances its operational expenditures through the proceeds that are generated by the sale of excess commodities. The Stockpile awarded sales contracts that totaled $390.8 million during Fiscal Year 1996. Total reimbursements earned in FY 96 were $374.1 million. This amount not only includes income earned through sales contracts but also includes contract modifications, refunds, and credits received.



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Overview

Uses of Funds

DNSC incurred obligations of $45.6 million in FY 96. Of that amount:

⇒ $14.5 million (32%) was obligated for employee salaries and benefits,

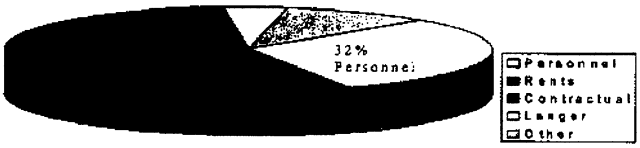
⇒ $14.6 million (32%) was obligated for rental space,

⇒ $10.6 million (23%) was obligated for contractual services (primarily real property maintenance, material handling, and environmental projects and depot operations support),

⇒ $2.0 million (4%) was obligated for William Langer Jewel Bearing Plant excessing costs.

The remaining 3.9 million (9%) was obligated for day to day program operational costs such as travel, transportation, supplies, and equipment.

DNSC FY 96
Operations Obligations



Annual Materials Plan

The Annual Materials Plan (AMP) includes the materials and their maximum quantities DoD proposes to acquire or sell during a given fiscal year. Before any materials can be sold, the Congress must enact specific enabling legislation. After the Congress authorizes the sale, DoD develops the AMP, which is submitted to the Congress by February 15th each year. Prior to submission, the AMP is coordinated with the Market Impact Committee, an interagency committee that advises DoD on the projected domestic and foreign economic effects of the proposed Stockpile transactions. The AMP is effective on the first day of the next fiscal year. If DoD proposes significant changes to the AMP during the fiscal year, a revised AMP is submitted to the Congress, but the revisions may not be implemented until 45 calendar days have elapsed.

Overview

REVISED ANNUAL MATERIALS PLAN (AMP)
FISCAL YEAR 1996

Material	Unit	Quantity
Potential Sales		
Aluminum Oxide, Abrasive Grain	ST	6,000
Aluminum Oxide, Fused Crude	ST	30,000
Analgesics (Morphine Sulfate)	AMA LB	2,500
Antimony	ST	3,000
Asbestos (all types)	ST	20,000
Bauxite, Metallurgical Grade, Jamaica	LDT	600,000
Bauxite, Metallurgical Grade, Surinam	LDT	300,000
Bauxite, Refractory Grade	LCT	80,000
Beryl Ore	ST	2,000
Bismuth	LB	300,000
Cadmium	LB	975,000
Celestite	SDT	3,600
Chromite, Chemical Grade	SDT	100,000
Chromite, Metallurgical Grade	SDT	550,000
Chromite, Refractory Grade	SDT	100,000
Cobalt	LB Co	4,000,000
Diamond, Industrial Crushing Boart	CT	1,000,000
Diamond, Industrial Stone	CT	2,000,000
Fluorspar, Acid Grade	SDT	130,000
Fluorspar, Metallurgical Grade	SDT	150,000
Graphite, Natural, Malagasy	ST	1,220
Iodine	LB	450,000
Jewel Bearings	PC	51,778,337
Lead	ST	60,000
Manganese Dioxide Ore, Natural Battery Grade	SDT	60,000
Manganese Dioxide, Synthetic	ST	3,011
Manganese Ore, Chemical Grade	SDT	40,000
Manganese Ore, Metallurgical Grade	SDT	400,000
Manganese Metal, Electrolytic	ST	2,000
Manganese, Ferro	ST	50,000
Mercury	FL	20,000
Mica, All Types	LB	2,260,000
Nickel	ST	10,000
Quartz Crystals	LB	300,000

REVISED ANNUAL MATERIALS PLAN (AMP) (continued)
FISCAL YEAR 1996

Material	Unit	Quantity
Quinidine	Av Oz	200,000
Quinine	Av Oz	200,000
Sapphire & Ruby	CT	10,000,000
Sebacic Acid	LB	4,500,000
Silicon Carbide	ST	4,500
Silver (for coinage programs)	Tr Oz	9,000,000
Talc	ST	1,200
Thorium Nitrate 1/	LB	1,000,000
Tin	MT	12,000
Vanadium Pentoxide	ST V	465
Vegetable Tannin Extract, Chestnut	LT	5,000
Vegetable Tannin Extract, Quebracho	LT	5,000
Vegetable Tannin Extract, Wattle	LT	5,000
Zinc	ST	50,000

1/ Thorium Nitrate, Mercury, and Asbestos presents special environmental problems that may preclude a revenue producing sale.

Planned Expenditures

Expense Category	Obligation Authority
William Langer Jewel Bearing Plant Excessing Costs	2,000,000
Mobilization Studies	2,000,000
Operating Costs	47,600,000
Total Planned Expenditures	**$51,600,000**

Overview

Inventory

Inventory values are based on September 30, 1996, prices at which comparable materials are being traded. In the absence of current trading data, market values are estimated. The market values are not necessarily the amount that would be realized if the materials were sold.

Stockpile Goals

The Stockpile goals reflect requirements currently in law. For materials or groups with authorized disposal authority, the goals are derived by subtracting new legislative disposal authority from the requirement in effect prior to enactment of the disposal authority.

The value of the NDS goals recommended by DoD, as explained in the *1995 Report to the Congress on NDS Requirements*, is lower than the value of the goals currently in law.

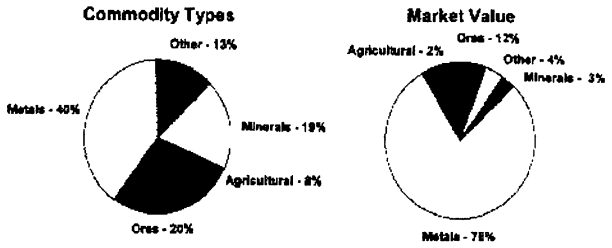
Family Groupings of Materials

For many materials, the Stockpile contains more than one form of a primary material with a goal. In these cases, the goal may be stated in pounds of the primary material, while the inventory consists of the different forms of the material. For example, the goal for tantalum is stated in pounds of tantalum, but the inventory consists of metal, metal powder, carbide powder, oxide, and minerals, none of which has a separate goal. A conversion factor is used to convert the tantalum content of the different forms of tantalum in the inventory (the family group) into equivalent pounds of tantalum. Therefore, the stockpile goal for a family group of materials consists of the equivalent content of the primary material as represented by the different forms of the material.

Overview

NATIONAL DEFENSE STOCKPILE INVENTORY

91 MATERIALS VALUED AT $6.1 BILLION
as of September 30, 1996



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Overview

STOCKPILE GOALS AND INVENTORY STATUS *
as of September 30, 1996
(Millions of Dollars)

Material	Unit	Goal	Inventory Level Quantity	Inventory Level Value	Inventory Status Excess	Inventory Status Deficit
1. Aluminum Group						
Aluminum Metal	ST	0	62,881	$ 67,288	62,881	
Bauxite, Metal Grade, Group	LDT	0	15,228,652	196,659	15,228,652	
Bauxite, Metal Grade, Jamaica Type	LDT		10,330,516	107,954	10,330,516	
Bauxite, Metal Grade, Surinam Type	LDT		4,898,136	88,705	4,898,136	
2. Aluminum Oxide						
Aluminum Oxide, Abrasive Grain	ST	0	33,258	15,842	33,258	
Aluminum Oxide, Fused, Crude	ST	0	186,289	33,532	186,289	
3. Antimony	ST	0	27,305	68,263	27,305	
4. Asbestos						
Amosite	ST	0	34,006	0	34,006	
Chrysotile	ST	0	10,766	0	10,766	
5. Bauxite, Refractory	LCT	69,000	151,006	10,570	82,006	
6. Beryllium Metal						
Beryl Ore (11% BeO)	ST	0	15,023	10,245	15,023	
Beryllium Copper Master Alloy	ST	7,387	7,387	85,911	0	
Beryllium Metal	ST	400	400	209,385	0	
7. Bismuth	LB	0	504,357	1,578	504,357	
8. Cadmium	LB	0	4,452,585	8,593	4,452,585	
9. Chromite, Refractory Grade	SDT	159,000	254,895	5,353	95,895	
10. Chromium Group						
Chromite, Chem. & Met. Group	SDT	34,000	616,528	28,664	582,528	
Chromite, Chemical Grade	SDT		193,123	2,233	159,123	
Chromite, Metallurgical Grade	SDT		423,405	26,431	423,405	
Chromium, Ferro Group	ST	621,204	1,136,309	940,420	515,105	
Chromium, Ferro, High Carbon	ST		766,571	389,238	515,105	
Chromium, Ferro, Low Carbon	ST		311,662	434,824	0	
Chromium, Ferro, Silicon	ST		58,076	116,358	0	
Chromium Metal	ST	26,835	8,511	39,491		18,324
11. Cobalt	LB Co	14,446,597	40,335,631	872,137	25,889,034	
12. Columbium Group	LB Cb	2,165,344	3,096,255	27,438	0	
Columbium Carbide Powder	LB Cb		21,372	,676	0	
Columbium Concentrates	LB Cb		1,733,454	5,554	0	
Columbium, Ferro	LB Cb		1,380,306	16,052	930,911	
Columbium, Metal	LB Cb		161,123	5,156	0	
13. Diamond, Industrial						
Diamond Dies	ct	0	25,473	0,917	25,473	
Diamond, Industrial, Crushing Boart	ct	0	815,652	4,453	815,652	
Diamond, Industrial, Stones	ct	3,000,000	4,654,877	78,272	1,654,877	
14. Fluorspar						
Acid Grade	SDT	0	454,988	44,589	454,988	
Metallurgical Grade	SDT	0	272,793	10,994	272,793	

* Note: Goals are those currently authorized in law including some goals that were affected by the sales authority in the National Defense Authorization Act for Fiscal Year 1997. DoD recommended goals in the *1995 Report to the Congress on NDS Requirements* are lower.

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STOCKPILE GOALS AND INVENTORY STATUS *
as of September 30, 1996

Material	Unit	Goal	Inventory Level Quantity	Inventory Level Value	Inventory Status Excess	Inventory Status Deficit
15. Germanium	KG	28,198	68,207	$ 18.761	40,009	
16. Graphite						
Ceylon Amorphous (Lump)	ST	13,477	5,492	2.591		7,985
Malagasy (Crystalline)	ST	0	15,847	2.218	15,847	
Other than Ceylon & Malagasy	ST	0	1,119	.104	1,119	
17. Indium	Tr Oz	15,205	50,205	.394	35,000	
18. Iodine	LB	0	5,207,831	24.164	5,207,831	
19. Jewel Bearings						
Jewel Bearings	PC	84,000,000	30,273,221	50.617	0	53,726,779
Jewel Bearings - NSG	PC		51,778,337	0	51,778,337	
Sapphire and Ruby	ct	0	0	0		
20. Lead	ST	0	431,345	330.631	431,345	
21. Manganese Dioxide Battery Grade						
Manganese Dioxide, Bat. Grade, Natural	SDT	0	145,046	10.370	145,046	
Manganese Dioxide, Bat. Grade, Synthetic	SDT	0	3,011	5.725	3,011	
22. Manganese, Group						
Manganese Ore Group	SDT	0	1,438,109	54.156	1,438,109	
Manganese Ore, Chemical Grade	SDT		164,753	12.851	164,753	
Manganese Ore, Metallurgical Grade	SDT		1,273,356	41.305	1,273,356	
Manganese, Ferro Group	ST	209,074	1,086,391	373.093	877,317	
Manganese, Ferro, High Carbon	ST		1,066,707	358.596	857,633	
Manganese, Ferro, Medium Carbon	ST		19,482	14.435	0	
Manganese, Ferro, Silicon	ST		202	.062	0	
Manganese Metal (Electrolytic)	ST	0	10,809	20.343	10,809	
23. Mercury	FL	0	127,857	10.740	127,857	
24. Mica						
Muscovite Block, Stained & Better	LB	301,000	3,086,658	18.431	2,785,658	
Muscovite Film, 1st & 2nd Qualities	LB	0	254,563	.169	254,563	
Muscovite Splittings	LB	0	13,232,166	52.929	13,232,166	
Phlogopite Block	LB	316,518	130,745	.523		185,773
Phlogopite Splittings	LB	0	676,659	5.645	1,203,181	
25. Morphine Sulfate (Refined)	AMA LB	0	41,047	16.179	41,047	
26. Nickel	ST	0	11,328	74.155	11,328	
27. Platinum Group Metals						
Iridium	Tr Oz	86,000	29,590	1.420		56,410
Palladium	Tr Oz	1,249,601	1,264,601	122.161	15,000	
Platinum	Tr Oz	421,761	431,761	134.192	10,000	
28. Quartz Crystals	LB	240,000	236,236	1.027		3,764
29. Quinidine	Av Oz	0	2,472,951	7.518	2,472,951	
30. Quinine	Av Oz	0	3,096,041	1.579	3,096,041	

* Note: Goals are those currently authorized in law including some goals that were affected by the sales authority in the National Defense Authorization Act for Fiscal Year 1997. DoD recommended goals in the *1995 Report to the Congress on NDS Requirements* are lower.

Overview

STOCKPILE GOALS AND INVENTORY STATUS *
as of September 30, 1996

Material	Unit	Goal	Inventory Level Quantity	Inventory Level Value	Inventory Status Excess	Inventory Status Deficit
31. Ricinoleic/Sebacic Acid Products	LB	0	3,757,897	$ 6.809	3,757,897	
32. Rubber, Natural	LT	0	123,003	74.778	123,003	
33. Rutile	SDT	0	0	0		
34. Silicon Carbide	ST	0	22,986	10.344	22,986	
35. Silver	Tr Oz	0	46,667,014	157.875	46,667,014	
36. Talc, Steatite Block & Lump	ST	0	1,074	.644	1,074	
37. Tantalum Group	LB Ta	2,303,957	3,099,957	127.591	0	
Tantalum Carbide Powder	LB Ta		28,688	3.731	6,000	
Tantalum Metal Powder	LB Ta		160,986	28.324	0	
Tantalum Metal	LB Ta		245,228	23.542	0	
Tantalum Minerals	LB Ta		2,501,364	67.804	750,000	
Tantalum Oxide	LB Ta		163,691	4.190	40,000	
38. Thorium Nitrate	LB	600,000	7,095,691	0	6,495,691	
39. Tin	MT	0	115,879	712.145	115,879	
40. Titanium Sponge	ST	53,315	36,690	249.490		16,625
41. Tungsten Group	LB W	70,900,000	82,314,619	323.420	11,414,381	
Tungsten Carbide Powder	LB W		2,032,958	21.328		
Tungsten, Ferro	LB W		2,024,143	5.474		
Tungsten Metal Powder	LB W		1,899,283	19.281		
Tungsten Ores & Concentrates	LB W		76,358,235	277.333		
42. Vanadium Pentoxide	ST V	0	410	2.558	410	
43. Vegetable Tannin Extract						
Chestnut	LT	0	6,865	2.153	6,865	
Quebracho	LT	0	109,733	29.492	109,733	
Wattle	LT	0	8,921	2.180	8,921	
44. Zinc	ST	0	285,717	272.455	285,717	

TOTALS: STRATEGIC AND CRITICAL MATERIALS	$ 6,072.359
NON-STRATEGIC AND CRITICAL MATERIALS 1/	.093
OTHER INVENTORIES 1/	.368
TOTAL INVENTORY VALUE	**$6,072.820**

* Note: Goals are those currently authorized in law including some goals that were affected by the sales authority in the National Defense Authorization Act for Fiscal Year 1997. DoD recommended goals in the *1995 Report to the Congress on NDS Requirements* are lower.

1/ **In addition to the materials listed in this Table, the NDS inventory also contains asbestos (crocidolite), celestite, kyanite, mica (muscovite block, stained and lower), talc (ground), and zirconium valued at $.093 million; these materials have not been determined to be strategic and critical and, consequently, do not have NDS goals. The NDS also holds other inventories of mercury and vanadium pentoxide, valued at $0.368 million.**

Program Discussion and Analysis

New Commodities Authorized

As DNSC enters into its fifth year of an aggressive sales program, the focus of the use of proceeds from sale of excess commodities is starting to shift. Instead of using the funding as supplemental income to the Military Operations and Maintenance account, proceeds from the sale of excess commodities are being used to offset losses in other DoD program areas. At the end of FY 96, the National Defense Authorization Act -- P.L. 104-201, Section 3303 -- authorized the sale of additional quantities of certain materials in the Stockpile to offset governmental losses incurred during Foreign Military Sales Research and Development. Sales proceeds are to be deposited in the general fund of the U.S. Treasury. Further, $81 million in sales receipts from these materials is to be deposited in Fiscal Year 1997, and a total of $612 million is to be deposited during the ten-fiscal year period ending September 30, 2006.

The materials and the maximum quantities to be sold under this prevision are:

Aluminum	62,881	ST
Cobalt	26,000,000	LBS
Columbium, Ferro	930,911	LB-Cb
Germanium	40,000	KG
Indium	35,000	TR OZ
Palladium	15,000	TR OZ
Platinum	10,000	TR OZ
Rubber, Natural	125,138	LT
Tantalum, Carbide Powder	6,000	LB-Ta
Tantalum, Minerals	750,000	LB-Ta
Tantalum, Oxide	40,000	LB-Ta

It appears that this piece of legislation is just the start. As of November, 1996, there are two pieces of pending legislation that propose using Stockpile sales proceeds to offset revenue lost as a result of Government Furnished Equipment rentals and Defense Reutilization and Marketing operations.

Titanium Transfer to the US Army

In accordance with section 3305 of P.L. 104-106, 250 tons of titanium sponge valued at $943,000 were transferred to the Army's Tank and Automotive Command for use in the weight reduction portion of the main battle tank upgrade program. These transfers of up to 250 tons annually will continue through Fiscal Year 2003. This material is being provided from the Stockpile to the Army without reimbursement except for transportation and handling costs.

Overview

Additionally, there is language in P.L. 104-208, Section 524 of the FY 97 Treasury and Postal Appropriations bill that proposes that the US Mint be allowed to use approximately 400 thousand troy ounces of DNSC platinum as working inventory. This transfer is currently under discussion between the DoD and the Treasury.

Marketing Initiatives

As Congress and DoD move toward authorizing additional material for sale, we have a growing number of markets in which we will enter for the first time. We are making concerted effort to better understand the specific business needs of our customers. For example, after trying some "negotiated bid" sales and finding that they boost revenue and provide greater satisfaction for customers, we have begun to make large-scale moves toward the process and away from the traditional "sealed bid" approach. We have begun taking Visa and Master Card and will soon also accept Discover as a payment mechanism. We are investigating innovative and non-traditional markets in which to advertise the use of our materials. These are just a few of our efforts to achieve acceptance in a wide variety of highly volatile markets with industries that are accustomed to highly specialized services.

It is DNSC's intention to be open and responsive to concerns of industry. When we make administrative policy changes, we issue press releases and otherwise publish our intentions. We specifically invite comment on the proposed change and are willing to alter our course should the need arise in the future. We discuss our intended sales plan and procedures with an industry advisory committee and use their feedback to ensure that our policies are in line with industry expectations.

Streamlining Purchasing and Administrative Procedures

We took an in-depth look at the Zone purchasing and administrative procedures so that they could be re-engineered to function effectively and efficiently in direct support of geographical remote operaations. From the time the reorganization was announced, we worked very closely with Zone and depot personnel by holding meetings, field trips, and training sessions.

During our reviews, we determined that there were many procedures that could be streamlined and some that could be eliminated. For instance, the Zone contracting personnel prepared numerous purchase orders, many of which were under $2,500. Before our review, the use of the Rocky Mountain I.M.P.A.C. credit card had been limited to only our Ft. Belvoir office. We decided that the I.M.P.A.C. card purchase authority needed to be delegated down to the depot level, with oversight by review teams, resulting in fewer purchase orders. Our administrator also delegated limited micro-purchase authority to the depot managers, allowing them to certify that invoices and receiving reports were correct and proper for payment.

Overview

Standard operating procedures were developed to document and streamline the flow of administrative actions DNSC-wide. These procedures include receiving reports, travel, travel vouchers, training, certified invoices, penalty stamps, postage meters, GSA vehicles, reimbursable work authorizations, inter-service support agreements, etc.

Additionally, prior to the reorganization, the depot managers had all maintained imprest funds for small and emergency purchases. Now that they have the credit card, there is no longer a need for the imprest fund. This should reduce administrative paperwork. As a side benefit, it has made it easier for us to comply with recent DoD policy that eliminates imprest fund usage for all Continental US DoD activities by the end of this fiscal year. All our imprest funds were eliminated on June 30, 1996.

Privatization of the William Langer Jewel Bearing Plant

After more than 40 years as a government-owned contractor operated (GOCO) facility, the William Langer Jewel Bearing Plant in Rolla, North Dakota was privatized at the end of September 1996. Under the provision of section 2852 of P.L. 104-201, the National Defense Authorization Act for 1997, the plant and equipment located on 9 acres were transferred to the Rolla Job Development Authority and will operate as Microlap Technologies. The facility, which had been determined excess to defense requirements, will continue to employ approximately 80 people focusing on the commercial marketplace and producing such products as fiber optic connectors and other items requiring high-precision or close tolerance manufacturing. Management will also continue the capability to maintain the industrial base skills such as those used to produce critical components for defense programs. In recent years this has included production to support programs such as the F-15 and F-18 fighters, the Abrams tank and the Tomahawk missile.

Audit of Stockpile Financial Controls and Statements

In Report number 96-190, the Department of Defense Inspector General (DoD IG) found that the DNSC's internal controls regarding Transaction Fund financial statements are effective in accounting for and managing resources, ensuring compliance with laws and regulations, and providing reasonable assurance that the financial statements are free of misstatements. However, the IG did find internal control weaknesses over inventory accountability, debt collection techniques, interest revenue disclosures, and financial statement preparation. A disclaimer was issued primarily due to incomplete documentation supporting inventory account values.

As a result of the FY 95 audit, two Business Process Review Teams were established to rectify the inventory reconciliation process and clear up aged accounts receivable. The Inventory Reconciliation Team, comprised of members of the Directorate of Strategic Materials Management and the Office of Management and Systems Support, reconciled all inventory records the DNSC Master Inventory File with a discrepancy greater than 2 percent before the end of the fiscal year. Additionally they revised standard operating procedures to permanently

avoid similar discrepancies in the future. The Accounts Receivable Team was comprised of members of the Directorate of Contracts, the Office of Finance, and the Office of General Council. They worked on determining the status of delinquent contracts. DNSC is still in the process of compiling appropriate records and documentation to transfer the majority of the delinquent diamond contracts to DFAS Columbus for further collection.

In May 1996, the Office of Management and Budget (OMB), DoD Inspector General (IG), General Accounting Office (GAO), and Defense Logistics Agency (DLA) coordinated an agreement that would enable DNSC to obtain an opinion on their financial statements. Due to lack of source documents, the DoD IG cannot currently prove that the value of DNSC inventory is accurate. However, an audit of GSA was performed by the GAO in FY 87. In the report, there was a section that applied to the Stockpile. In it, there were no footnotes stating that any of the inventory acquisition records were missing. In FY 96, the auditors will perform an audit of the balances carried over from GSA during the FY 88 transition. If it can be proven that the GSA and DNSC inventory values match, then an opinion can be given.

Financial Performance

The National Defense Stockpile Transaction Fund (T-Fund) is a revolving fund that accounts for resources necessary to procure and dispose of strategic commodities. These financial statements have been prepared to report on the financial position and the results of operations of the DNSC T-Fund, pursuant to the requirements of the Chief Financial Officers Act of 1990. While the financial statements have been prepared from the books and records of the T-Fund in accordance with the formats prescribed by the OMB, these statements are different from the financial reports and statements (that are also prepared from the same books and records) used to monitor and control budgetary resources.

The following definitions of the financial performance measures stem from DoD guidance. We have provided them here to clarify the graphs on the following page.

Definitions:

- Net Operating Costs - The total expenses minus the total revenue.
- Current Ratio - An indicator of financial condition, it is calculated by dividing current assets by current liabilities.
- Operating Results - The total revenues minus the total expenses.
- Financial Obligations - The total of current and long-term liabilities.
- Ending Fund Balance - The Fund balance with the Treasury.

Overview

The Net Operating Cost in FY 96 was -$97,933 thousand compared to -$262,940 thousand in FY 95. Conversely, the Operating Result was $97,933 thousand for FY 96 compared to $262,940 thousand for FY 95. Please note that all revenue and expenses are not necessarily cash transactions because revenues are sometimes realized and expenditure are sometimes made through barter transactions including exchange of material and payment-in-kind.

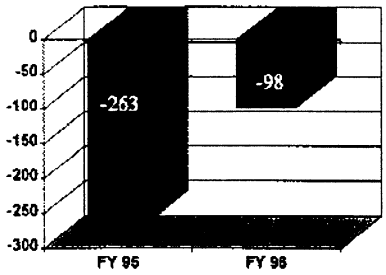
The decrease in operating result is primarily the result of a change in inventory accounting implemented in FY 96. Although not an official recommendation in the FY 95 CFO audit, the IG believed that our previous method of recording revenue and inventory was causing a double counting of assets. We were recording our revenue at the time the contract was signed, but did not reduce our inventory by the amount of commodity that was sold. The audit's solution was to record the sale at the time of shipment and leave the inventory the way it was. DNSC's position was that legally and managerially, it is necessary to continue to record sales in the current manner. Therefore, in order to fix this problem, we altered the way our inventory is being reported in the financial statements. We have created a separate class in the MIF called Class 21, Cost of Goods Sold, which equals the acquisition cost of current year sales contracts. This reduces inventory by the amount that is sold, and eliminates the double counting. We spoke to the DoD IG who said that this solution was acceptable to them.

The current ratio was 8.3 for FY 96 compared to 5.3 in FY 95. The Financial obligations (current and long term liabilities) were $69,052 in FY 96 compared to $77,418 in FY 95. The Ending Fund Balance was $290,712 thousand in FY 96 compared to $168,613 thousand in FY 95.

Net Operating Costs

Total Expense - Total Revenue

In Millions of Dollars



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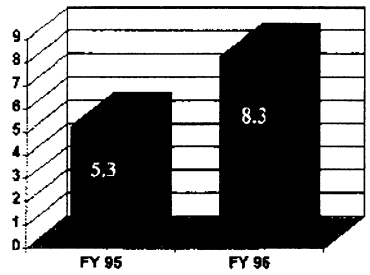
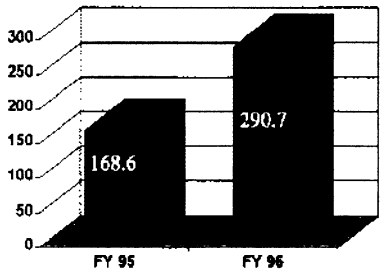
Overview

Current Ratio
Current Assets/Current Liabilities



Ending Fund Balance
In Millions of Dollars



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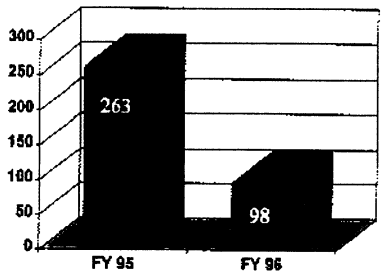
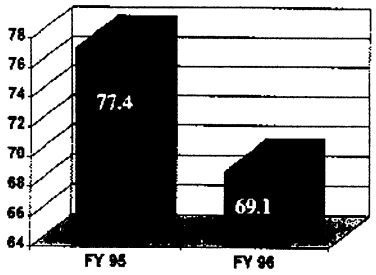
Overview

Operating Result
Total Revenue - Total Expense
In Millions of Dollars



Financial Obligations
Current & Long-Term Liabilities
In Millions of Dollars



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Overview

DEFENSE NATIONAL STOCKPILE TRANSACTION FUND

PRINCIPAL STATEMENTS

Principal Statements

Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Financial Position
As of September 30, 1996
(Thousands)

ASSETS	1996	1995
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$290,712	$168,613
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	35	5,816
(4) Interest Receivable	0	0
(5) Advances and Prepayments	(749)	13,473
(6) Other Federal (Intragovernmental) (Note 6)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	0
(2) Accounts Receivable, Net (Note 5)	285,021	222,864
(3) Credit Program Receivables' Related Foreclosed Property, Net (Note 7)	0	0
(4) Interest Receivable, Net	0	0
(5) Advances and Prepayments	0	0
(6) Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	0	0
e. Work in Process (Note 9)	0	0
f. Operating Materials/Supplies, Net (Note 10)	0	0
g. Stockpile Materials, Net (Note 11)	3,696,491	3,937,343
h. Seized Property (Note 12)	0	0
i. Forfeited Property, Net (Note 13)	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0
k. Property, Plant and Equipment, Net (Note 15)	0	0
l. Other Entity Assets	0	0
m. Total Entity Assets	$4,271,510	$4,348,109
2. Non-Entity Assets:		
a. Transactions With Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$0	$0
(2) Accounts Receivable, Net (Note 5)	0	0
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	0	0

The accompanying notes are an integral part of these statements.

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Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Financial Position
As of September 30, 1996
(Thousands)

ASSETS, Continued	1996	1995
2. **Non-Entity Assets:**		
b. Transactions With Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	$0	$0
(2) Interest Receivable, Net	0	0
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Other Non-Entity Assets	0	0
e. **Total Non-Entity Assets**	$0	$0
3. **Total Assets**	$4,271,510	$4,348,109
LIABILITIES		
4. **Liabilities Covered by Budgetary Resources:**		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$59,515	$73,801
(2) Interest Payable	0	0
(3) Debt (Note 16)	0	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	7,979	3,086
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	0	0
(b) Annual Accrued Leave	0	0
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	0	0
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	1,558	531
c. **Total Liabilities Covered by Budgetary Resources:**	$69,052	$77,418

The accompanying notes are an integral part of these statements.

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Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Financial Position
As of September 30, 1996
(Thousands)

LIABILITIES, Continued	1996	1995
5. Liabilities Not Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$0	$0
(2) Debt (Note 16)	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. **Total Liabilities Not Covered By Budgetary Resources**	$0	$0
6. Total Liabilities	$69,052	$77,418
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$0	$347,710
b. Invested Capital	3,536,106	3,602,186
c. Cumulative Results of Operations	666,352	320,795
d. Other	0	0
e. Future Funding Requirements	0	0
f. **Total Net Position**	$4,202,458	$4,270,691
8. Total Liabilities and Net Position	$4,271,510	$4,348,109

The accompanying notes are an integral part of these statements.

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Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1996
(Thousands)

	1996	1995
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used	$0	$0
2. Revenues from Sales of Goods and Services		
a. To the Public	365,982	420,314
b. Intragovernmental	54,267	43,145
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	1,442	3,591
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0	0
8. **Total Revenues and Financing Sources**	$421,691	$467,050
EXPENSES		
9. Program or Operating Expenses (Note 23)	$59,360	$52,753
10. Cost of Goods Sold (Note 24)		
a. To the Public	141,543	141,725
b. Intragovernmental	14,222	9,632
11. Depreciation and Amortization	0	0
12. Bad Debts and Writeoffs	120	0
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	0	0
14. Other Expenses (Note 25)	0	0
15. **Total Expenses**	$215,245	$204,110
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	$206,446	$262,940
17. Plus (Minus) Extraordinary Items (Note 26)	0	0
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	$206,446	$262,940

The accompanying notes are an integral part of these statements.

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Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1996
(Thousands)

EXPENSES, Continued	1996	1995
19. **Net Position, Beginning Balance, as Previously Stated**	$4,270,691	$4,181,565
20. Adjustments (Note 27)	(123,784)	(23,814)
21. Net Position, Beginning Balance, as Restated	$4,146,907	$4,157,751
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	206,446	262,940
23. Plus (Minus) Non Operating Changes (Note 28)	(150,895)	(150,000)
24. **Net Position, Ending Balance**	$4,202,458	$4,270,691

The accompanying notes are an integral part of these statements.

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Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Cash Flows
For the Period Ended September 30, 1996
(Thousands)

	1996	1995**
CASH FLOWS FROM OPERATING ACTIVITIES		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	$206,446	$0
Adjustments affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	(56,376)	0
4. Decrease (Increase) in Other Assets	254,179	0
5. Increase (Decrease) in Accounts Payable	(9,393)	0
6. Increase (Decrease) in Other Liabilities	1,027	0
7. Depreciation and Amortization	0	0
8. Other Unfunded Expenses	0	0
9. Other Adjustments	(123,784)	0
10. Total Adjustments	$65,653	$0
11. Net Cash Provided (Used) by Operating Activities	$272,099	$0
CASH FLOWS FROM INVESTING ACTIVITIES		
12. Sale of Property, Plant and Equipment	$0	$0
13. Purchase of Property, Plant and Equipment	0	0
14. Sale of Securities	0	0
15. Purchase of Securities	0	0
16. Collection of Loans Receivable	0	0
17. Creation of Loans Receivable	0	0
18. Other Investing Cash Provided (Used)	0	0
19. Net Cash Provided (Used) by Investing Activities	$0	$0
CASH FLOWS FROM FINANCING ACTIVITIES		
20. Appropriations (Current Warrants)	$0	$0
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	0	0
22. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	150,000	0
23. Net Appropriations	($150,000)	$0

The accompanying notes are an integral part of these statements.

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Principal Statements

Department of Defense
Defense National Stockpile Transaction Fund
Statement of Cash Flows
For the Period Ended September 30, 1996
(Thousands)

CASH FLOWS FROM FINANCING ACTIVITIES, Continued	1996	1995**
24. Borrowing from the Public	$0	$0
25. Repayments on Loans to the Public	0	0
26. Borrowing from the Treasury and the Federal Financing Bank	0	0
27. Repayments on Loans from the Treasury and the Federal Financing Bank	0	0
28. Other Borrowings and Repayments	0	0
29. Net Cash Provided (Used) by Financing Activities	($150,000)	$0
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	$122,099	$0
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	168,613	0
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	$290,712	$0

Supplemental Disclosure of Cash Flow Information:	1996	1995**
33. Total Interest Paid	$0	$0

Supplemental Schedule of Financing and Investing Activity:	1996	1995**
34. Property and Equipment Acquired Under Capital Lease Obligations	$0	$0
35. Property Acquired Under Long-Term Financing Arrangements	$0	$0
36. Other Exchanges of Non-cash Assets or Liabilities	$0	$0

** No Cash Flow Statement was prepared in Fiscal Year 1995

The accompanying notes are an integral part of these statements.

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Principal Statements

The accompanying notes are an integral part of these statements.

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DEFENSE NATIONAL STOCKPILE TRANSACTION FUND

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Footnotes

Footnotes

DEFENSE NATIONAL STOCKPILE TRANSACTION FUND
FINANCIAL OPERATIONS
NOTES TO THE PRINCIPAL STATEMENTS
AS OF SEPTEMBER 30, 1996

Note 1. Significant Accounting Policies

A. Basis of Presentation:

These financial statements have been prepared to report the financial position and results of operations of the Defense Logistics Agency (DLA) National Defense Stockpile Transaction Fund, (the T-Fund) as required by the Chief Financial Officers (CFO) Act of 1990. They have been prepared from the accounting records of the Fund in accordance with the hierarchy of accounting standards as prescribed by the Federal Accounting Standards Advisory Board (FASAB), OMB Bulletin 94-01 and supplemental DoD guidance. The accounting standards prescribed by the FASAB, in the DoD Accounting Manual (DoD 7220.9-M) and in the Financial Management Regulation (DoD 7000.14-R) were followed, as appropriate. To the extent that guidance is not provided by one of these standards, the T-Fund accounts for transactions in accordance with guidance promulgated by the GAO, OMB, Department of Treasury, and commercial Generally Accepted Accounting Principles. These statements differ from the T-Fund financial reports prepared to monitor and control the use of budgetary resources.

B. Reporting Entity:

The Defense Logistics Agency (DLA) is a combat support agency responsible for worldwide logistics support throughout the Department of Defense. The primary focus of DLA is to support the war fighter, and to provide relief efforts during times of national emergency. The DLA Defense National Stockpile Center (DNSQ administers the acquisition, storage, management, and disposal of the nation s strategic and critical inventory of materials essential to the Military and industrial requirements of the United States. The T-Fund is a revolving fund that accounts for sources necessary to procure and dispose strategic commodities. The appropriation symbol is 97X4555.5145.

The CFO Act requires the T-Fund as a revolving fund to provide audited financial statements. Fiscal year 1996 represents the forth year that the T-Fund has prepared financial statements as required by the CFO Act.

Footnotes

C. Budgets and Budgetary Accounting:

The T-Fund receives an apportionment from the Office of Management and Budget for the operation and acquisition programs.

D. Basis of Accounting:

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

E. Revenues and Other Financing Sources:

Revenues and financing sources for the T-Fund consists of cash proceeds from the disposal of excess commodities and exchanges of commodities for the payment of obligations.

F. Accounting for Intra-governmental Activities:

DLA, as an agency of the Federal government, interacts with, and is dependent upon, other financial activities of the government as a whole. As a result, these financial statements do not reflect the results of all financial decisions applicable to DLA as though the agency were a stand alone entity.

For example, DLA's proportionate share of the public debt and related expenses of the Federal Government are not included in these financial statements because debt and related interest costs are not apportioned to Federal agencies. Financing for the construction of DoD facilities is obtained through appropriations from the Congress. To the extent that this financing may have been ultimately obtained through the issuance of public debt, interest costs have not been capitalized since the Treasury Department does not allocate interest costs to the benefiting agencies.

Finally, the T-Fund's civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS). The T-Fund does not disclose the assets or actuarial data on the accumulated plan benefits or unfunded pension liabilities of its employees. Reporting such amounts is the responsibility of the Office of Personnel Management for CSRS and FERS.

Footnotes

G. Funds with the U.S. Treasury and Cash:

The funds with the U.S. Treasury represent the balances as of 30 September 1996. Cash receipts and disbursements affect the available balances.

H. Foreign Currency:

Not applicable

I. Accounts Receivable:

Allowances for uncollectible accounts are established currently the balance is $0. Sales and disposals are recorded as receivable at the time sales agreement is issued and the material is removed from Inventory. Storage charges are assessed and billed if the purchaser does not pickup the material within the agreed upon time frame.

During fiscal year 1996, DNSC recognized a prior period adjustment of approximately $15 million to correct prior year's defaulted and other incorrect revenue posted in accounts receivable.

Advances and prepayment reflect a credit balance of $749 due to a overpayment of silver used in the Treasury's commemorative coinage program. This problem should be corrected in fiscal year 1997.

J. Loans Receivable:

Not applicable

K. Inventories:

The financial inventory balance for the stockpile materials is maintained on a laid in cost basis, that is, acquisition cost plus any fees, such as testing, upgrading, and transportation expenses. It is reported as Stockpile materials.

When the mission of the Stockpile was transferred to the DoD from GSA in 1988, the DoDIG audited the physical inventory records and quantities to be carried were established. The establishment of historical costs was determined by using the 1987 GAO audit of GSA, which reflected no adverse statements of the Stockpile' inventory value at that time. The original records of some of the purchases dated back to the 1950's and are no longer available. The market value of the material as of 30 September 1996 is estimated to be $6.1 billion.

Footnotes

L. Investments in U.S. Government Securities:

Not applicable

M. Property and Equipment:

National Stockpile Transaction Fund was unable to extract the 1996 equipment or depreciation expenses. I was provided the information on the depreciation expense for 1996 in November 1996 and was unable to include tha amounts in the closing trial balance. I have supplied the information in Note 15. The accumulated depreciation expense and equipment value will be included in FY 1997 statements.

N. Prepaid and Deferred Charges:

Not applicable

O. Leases:

The T-Fund is committed to operating leases and rental agreements. Generally, these leases and agreements are for the rental of equipment, space and operating facilities. Payments under these operating leases are expensed as incurred.

P. Contingencies:

The T-Fund may be party to various legal and administrative claims and actions. In management's opinion, the resolution of these actions will not materially affect the T-Fund operations or financial position. Therefore, no contingent liabilities have been recognized in the Statement of Financial Position.

Q. Accrued Leave:

Civilian annual leave is accrued as earned, and accrued hours are reduced as leave is taken. Sick leave and other types of nonvested leave are expensed as taken.

Footnotes

R. Equity:

Equity consists of invested capital, and cumulative result of operations. Invested capital, as presented in the Statement of Financial Position, represents the value of the DNSC's capital assets as reported at historical or actual costs. Increases to invested capital are recorded when capital assets are acquired. Decreases occur as capital assets are depreciated or transferred.

Cumulative results of operations for working capital funds represents the excess of revenues over expenses, less refunds to customers.

S. Aircraft/Ship Crashes:

Not applicable

T. Treaties for Use of Foreign Bases:

Not applicable

U. Comparative Data

The financial statements present fiscal year 1995 and 1996 amounts. For fiscal year 1995, the financial statements were audited. Since a discalimer of opinion was issued based the lack of original inventory source documents, management cautions the reader.

V. Restatement of Prior Year Principal Statements

Not applicable.

W. Unpaid Obligations and Undelivered Orders

The T-Fund is obligated for goods and services that have been ordered but not yet received. Total undelivered orders amounted to $20,179,503 consisting of $12,151,291 in cash obligations and $7,998,212 in barter obligations as of September 30, 1996.

Footnotes

X. Non Cash (Barter) Transactions

Line 1.b.(2) includes -$1,685,283 in non cash accounts receivable
Line 4.b.(1) includes -$313,650 in non cash accounts payable
Line 7.c includes $9,378,992 in net non cash sales

DFAS-CO is researching these negative balances for processing problems.

Note 2. Fund Balances with Treasury (in thousands)

A. Business Operations Fund (USD(C)) and All Other Funds and Accounts:

	Entity Assets				
	Trust Funds	Revolving Funds	Appropriated Funds	Other Fund Types	Total
Unobligated Balance Available:					
Available	$0	$526,431	$0	$0	$526,431
Restricted	0	0	0	0	0
Reserve For Anticipated Resources	(0)	(0)	(0)	(0)	(0)
Obligated (but not expensed)	0	(235,719)	0	0	(235,719)
Unfunded Contract Authority	(0)	(0)	(0)	(0)	(0)
Unused Borrowing Authority	(0)	(0)	(0)	(0)	(0)
Treasury Balance	$0	$290,712	$0	$0	$290,712

C. All Funds and Accounts: (in thousands)

	Entity Assets	
	Funds Collected	Funds Disbursed
Beginning Balance	$168,613	$0
Transfers of Cash to Others	0	150,000
Transfers of Cash from Others	0	0
Funds Collected	336,602	0
Funds Disbursed	(0)	64,503
Ending Balance	$505,215	$214,503

D. Other Information: Funds Collected includes $14,872M in non cash (barter) collections and Funds Disbursed includes an equal amount in non cash (barter) disbursements for a net of zero. Fund Collected is understated by $959 thousand and Funds Disbursed is understated by an equal amount due to a processing error which will be corrected in October 1996.

Footnotes

Note 5. Accounts Receivable, Net (in thousands)

	(1) Allowance Amount Due	(2) Allowance For Estimated Uncollectible $	(3) Method Used	(4) Amount Due
A. Entity Receivables:				
Intragovernmental	$35	$0		$35
Governmental	285,021	0		285,021
B. Non-Entity Receivables:				
Intragovernmental	$0	$0		$0
Governmental	0	0		0

C. Other Information: Governmental receivables include -$313,650 in non cash over collections against sales contracts issued as exchange/payment-in-kind payments. Research is being done by DFAS-CO for processing problems. An allowance account was established, however, it was erroneously deleted. A letter will be sent to DFAS-CO to re-establish this account in fiscal year 1997.

Note 11. Stockpile Materials Net (in thousands)

	(1) Stockpile Materials Amount	(2) Allowance For Losses	(3) Stockpile Materials Net	(4) Valuation Method
A. Stockpile Material:				
(1) Held for Sale	$0	$0	$0	
(2) Held in Reserve for Future Sale	3,696,491	0	3,696,491	Historic
Total	$3,696,491	$ 0	$3,696,491	

B. Restrictions on Stockpile Materials and Supplies: There are several restrictions on the use of the material. The quantities to be stockpiled are required to be sufficient to sustain the U. S. for a period of not less than three years during a national emergency (including a sustained conventional global war of indefinite duration). The required stockpile levels can only be changed by law through a Presidential proposal in the annual material plan submitted to the Congress.

Footnotes

Except for disposals made under the following situations, disposals cannot be made from the stockpile:

- Necessary upgrading, refining or processing
- Necessary rotation to prevent deterioration
- Determination as excess and of potential financial loss if not disposed
- By order of the President and/or authorized by law

C. Other Information: The estimated market value of the total inventory as of 30 September 1996 is $6.1 billion. The financial statements report the recorded historical cost in accordance with the lower of cost or market principal.

Note 15. Property, Plant, and Equipment, Net

Classes of Fixed Assets	(1) Depreciation Method	(2) Service Life	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
A. Land			$0	$0	$0
B. Structures, Facilities, & Leasehold Improvements			0	0	0
C. Military Equipment			0	0	0
D. ADP Software			0	0	0
E. Equipment			0	0	0
F. Assets Under Capital Lease			0	0	0
G. Other			0	0	0
H. Natural Resources			0	0	0
I. Construction-in-Progress			0	0	0
Total			$0	$0	$0

*Keys:

Depreciation Methods	Range of Service Life	
SL - Straight Line	1-5	1 to 5 years
DD - Double-Declining Balance	6-10	6 to 10 years
SY - Sum of the Years' Digits	11-20	11 to 20 years
IN - Interest (sinking fund)	>20	Over 20 years
PR - Production (activity or use method)		
OT - Other (describe)		

Footnotes

Due to interface problems at DFAS-CO, DNSC was unable to get the value of equipment and accumulated depreciation in the accounting records at the end of fiscal year 1996. We now have access to the 1996 figures and will be able to add them to the accounting records for 1997 as shown below.

Acquisition Value	FY 96 Depreciation	Accumulated Depreciation
$4,805,819	$185,119	$4,362,562

Note 20. Net Position (in thousands)

	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended Appropriations:				
(1)Unobligated,				
a. Available	$0	$0	$0	$0
b. Unavailable	0	0	0	0
(2)Undelivered Orders	0	0	0	0
B. Invested Capital	3,536,106	0	0	3,536,106
C. Cumulative Results of Operations	666,352	0	0	666,352
D. Other	0	0	0	0
E. Future Funding Requirements	(0)	(0)	(0)	(0)
F. Total	$4,202,458	$0	$0	$4,202,458

G. Other Information: FY 1995 and FY 1996 invested capital balances include the following amounts for unobligated appropriations and cash and noncash undelivered orders.

	FY 1996	FY 1995
Unobligated Appropriations	$552.7 million	$379.4 million
Cash and Noncash Undelivered Orders	20.2 million	47.9 million
Overstatement of Net Position	$572.9 million	$427.3 million

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Footnotes

Note 22. Other Revenues and Financing Sources (in thousands)

	1996/7	1995/6
A. Other Revenues and Financing Sources:	$0	$0
(1)Refunds_from Contractors	968	198
(2)Storage charges	166	247
(3)Administrative Charges	308	3,146
Total	$1,442	$3,591

B. Other Information:

Note 23. Program or Operating Expenses (in thousands)

	1996/7	1995/6
A. Operating Expenses by Object Classification:		
(1) Personal Services and Benefits	$15,810	$13,436
(2) Travel and Transportation	1,259	1,096
(3) Rental, Communication and Utilities	18,249	12,803
(4) Printing and Reproduction	5	6
(5) Contractual Services	14,408	6,096
(6) Supplies and Materials	885	1,142
(7) Equipment not Capitalized	265	162
(8) Grants, Subsidies and Contributions	8,470	18,011
(9) Insurance Claims and Indemnities	0	0
(10) Other (describe):		
(a) County Taxes	9	1
(11) Total Expenses by Object Class	$59,360	$52,753

C. Other Information: Total expensesinclude $4.937 incurred in fy95 not recorded as an expense until fy96. Total expenses are are over stated by $959 thousand due to a processing error. Will be corrected in October 1996.

Footnotes

Note 24. Cost of Goods Sold **Do A, B, or C as appropriate.**

C. Cost of Goods Sold from Inventory (using Historical Cost):

(1) Beginning Inventory	$3,937,343
(a) Plus: Purchases at Cost	23,426
(b) Plus: Inventory Gains	0
(c) Minus: Inventory Losses	0
(2) Less: Ending Inventory	3,696,491
Cost of Goods Sold	$264,278

Due to a change in accounting methods the total includes 108,513 in fy95 material sold but unshipped as of 30 Sep 95.

Note 27. Prior Period Adjustments

A. Prior Period Adjustments:

(1)Defaulted Contracts/Other PY Cont. Adj.	$15,271
(2)Material sold in fy95 not shipped or recorded as cost of goods sold until fy96	108,513
Total	$123,784

B. Other Information:

Note 28. Non-Operating Changes - (Transfers and Donations)

	1996/7	1995/6
B. Decreases:		
(1) Transfers-Out:		
(a)U.S Army	$50,000	$50,000
(b)U.S. Air Force	50,000	50,000
(c)U. S. Navy	50,000	50,000
(2) Donations	0	0
(3) Other Decreases	895	0
(4) Total Decreases	0	0
C. Net Non-Operating Changes (Transfers):	$150,895	$150,000

D. Other Information: We transferred 250 Short tons of Titanium to the U.S. Army without reimbursement, per P.L 104-106. Inventory value of the material was $985 thousand.

Footnotes

APPENDIX A

STRATEGIC AND CRITICAL MATERIALS STOCK PILING ACT
(50 U.S.C. 98 *et seq.*)
As amended by:
the National Defense Authorization Act for Fiscal Year 1996
(P.L. 104-106); and
the National Defense Authorization Act for Fiscal Year 1997
(P.L. 104-201)

SEC. 1. This Act may be cited as the "Strategic and Critical Materials Stock Piling Act."

FINDINGS AND PURPOSE

SEC. 2. (a) The Congress finds that the natural resources of the United States in certain strategic and critical materials are deficient or insufficiently developed to supply the military, industrial, and essential civilian needs of the United States for national defense.

(b) It is the purpose of this Act to provide for the acquisition and retention of stocks of certain strategic and critical materials and to encourage the conservation and development of sources of such materials within the United States and thereby to decrease and to preclude, when possible, a dangerous and costly dependence by the United States upon foreign sources for supplies of such materials in times of national emergency.

(c) The purpose of the National Defense Stockpile is to serve the interest of national defense only. The National Defense Stockpile is not to be used for economic or budgetary purposes.

MATERIALS TO BE ACQUIRED: PRESIDENTIAL AUTHORITY AND GUIDELINES

SEC. 3. (a) Subject to subsection (c), the President shall determine from time to time (1) which materials are strategic and critical materials for the purposes of this Act, and (2) the quality and quantity of each such material to be acquired for the purposes of this Act and the form in which each such material shall be acquired and stored. Such materials when acquired, together with the other materials described in section 4 of this Act, shall constitute and be collectively known as the National Defense Stockpile (hereinafter in this Act referred to as the "stockpile").

(b) The President shall make the determinations required to be made under subsection (a) on the basis of the principles stated in section 2(c).

(c)(1) The quantity of any material to be stockpiled under this Act, as in effect on September 30, 1987, may be changed only as provided in this subsection or as otherwise provided by law enacted after December 4, 1987.

(2) The President shall notify Congress in writing of any change proposed to be made in the quantity of any material to be stockpiled. The President may make the change after the end of the 45-day period beginning on the date of the notification. The President shall include a full explanation and justification for the proposed change with the notification.

MATERIALS CONSTITUTING THE NATIONAL DEFENSE STOCKPILE

SEC. 4. (a) The stockpile consists of the following materials:

(1) Materials acquired under this Act and contained in the national stockpile on July 29, 1979.

(2) Materials acquired under this Act after July 29, 1979.

(3) Materials in the supplemental stockpile established by section 104(b) of the Agricultural Trade Development and Assistance Act of 1954 (as in effect from September 21, 1959, through December 31, 1966) on July 29, 1979.

(4) Materials acquired by the United States under the provisions of section 303 of the Defense Production Act of 1950 (50 U.S.C. App. 2093) and

transferred to the stockpile by the President pursuant to subsection (f) of such section.

(5) Materials transferred to the United States under section 663 of the Foreign Assistance Act of 1961 (22 U.S.C. 2423) that have been determined to be strategic and critical materials for the purposes of this Act and that are allocated by the President under subsection (b) of such section for stockpiling in the stockpile.

(6) Materials acquired by the Commodity Credit Corporation and transferred to the stockpile under section 4(h) of the Commodity Credit Corporation Charter Act (15 U.S.C. 714b(h)).

(7) Materials acquired by the Commodity Credit Corporation under paragraph (2) of section 103(a) of the Act entitled "An Act to provide for greater stability in agriculture; to augment the marketing and disposal of agricultural products; and for other purposes," approved August 28, 1954 (7 U.S.C. 1743(a)), and transferred to the stockpile under the third sentence of such section.

(8) Materials transferred to the stockpile by the President under paragraph (4) of section 103(a) of such Act of August 28, 1954.

(9) Materials transferred to the stockpile under subsection (b).

(10) Materials transferred to the stockpile under subsection (c).

(b) Notwithstanding any other provision of law, any material that (1) is under the control of any department or agency of the United States, (2) is determined by the head of such department or agency to be excess to its needs and responsibilities, and (3) is required for the stockpile shall be transferred to the stockpile. Any such transfer shall be made without reimbursement to such department or agency, but all costs required to effect such transfer shall be paid or reimbursed from funds appropriated to carry out this Act.

(c)(1) The Secretary of Energy, in consultation with the Secretary of Defense, shall transfer to the stockpile for disposal in accordance with this Act uncontaminated materials that are in the Department of Energy inventory of materials for the production of defense-related items, are excess to the requirements of the Department for that purpose, and are suitable for transfer to the stockpile and disposal through the stockpile.

(2) The Secretary of Defense shall determine whether materials are suitable for transfer to the stockpile under this subsection, are suitable for disposal through the stockpile, and are uncontaminated.

AUTHORITY FOR STOCKPILE OPERATIONS

SEC. 5. (a)(1) Except for acquisitions made under the authority of paragraph (3) or (4) of section 6(a), no funds may be obligated or appropriated for acquisition of any material under this Act unless funds for such acquisition have been authorized by law. Funds appropriated for such acquisition (and for transportation and other incidental expenses related to such acquisition) shall remain available until expended, unless otherwise provided in appropriation Acts.

(2) If for any fiscal year the President proposes certain stockpile transactions in the annual materials plan submitted to Congress for that year under section 11(b) and after that plan is submitted the President proposes (or Congress requires) a significant change in any such transaction, or a significant transaction not included in such plan, no amount may be obligated or expended for such transaction during such year until the President has submitted a full statement of the proposed transaction to the appropriate committees of Congress and a period of 45 days has passed from the date of the receipt of such statement by such committees.

(b) Except for disposals made under the authority of paragraph (3), (4) or (5) of section 6(a) or under section 7(a), no disposal may be made from the stockpile unless such disposal, including the quantity of the material to be disposed of, has been specifically authorized by law.

(c) There is authorized to be appropriated such sums as may be necessary to provide for the transportation, processing, refining, storage, security, maintenance, rotation, and disposal of materials contained in or acquired for the stockpile. Funds appropriated for such purposes shall remain available to carry out the purposes for which appropriated for a period of two fiscal years, if so provided in appropriation Acts.

STOCKPILE MANAGEMENT

SEC. 6. (a) The President shall —

(1) acquire the materials determined under section 3(a) to be strategic and critical materials;

(2) provide for the proper storage, security, and maintenance of materials in the stockpile;

(3) provide for the upgrading, refining or processing of any material in the stockpile (notwithstanding any intermediate stockpile quantity established for such material) when necessary to convert such material into a form more suitable for

storage, subsequent disposition, and immediate use in a national emergency;

(4) provide for the rotation of any material in the stockpile when necessary to prevent deterioration or technological obsolescence of such material by replacement of such material with an equivalent quantity of substantially the same material or better material;

(5) subject to the notification required by subsection (d)(2), provide for the timely disposal of materials in the stockpile that (A) are excess to stockpile requirements, and (B) may cause a loss to the Government if allowed to deteriorate; and

(6) subject to the provisions of section 5(b), dispose of materials in the stockpile the disposal of which is specifically authorized by law.

(b) Except as provided in subsections (c) and (d), acquisition of strategic and critical materials under this Act shall be made in accordance with established Federal procurement practices, and, except as provided in subsections (c) and (d) and in section 7(a), disposal of materials from the stockpile shall be made by formal advertising or competitive negotiation procedures. To the maximum extent feasible —

(1) competitive procedures shall be used in the acquisition and disposal of such materials; and

(2) efforts shall be made in the acquisition and disposal of such materials to avoid undue disruption of the usual markets of producers, processors, and consumers of such materials and to protect the United States against avoidable loss.

(c)(1) The President shall encourage the use of barter in the acquisition under subsection (a)(1) of strategic and critical materials for, and the disposal under subsection (a)(5) or (a)(6) of materials from, the stockpile when acquisition or disposal by barter is authorized by law and is practical and in the best interest of the United States.

(2) Materials in the stockpile (the disposition of which is authorized by paragraph (3) to finance the upgrading, refining, or processing of a material in the stockpile, or is otherwise authorized by law) shall be available for transfer at fair market value as payment for expenses (including transportation and other incidental expenses) of acquisition of materials, or of upgrading, refining, processing, or rotating materials, under this Act.

(3) Notwithstanding section 3(c) or any other provision of law, whenever the President provides under subsection (a)(3) for the upgrading, refining, or processing of a material in the stockpile to convert that material into a form more suitable for storage, subsequent disposition, and immediate use in a national emergency, the President may barter a portion of the same material (or any other material in the stockpile that is authorized for disposal) to finance that upgrading, refining, or processing.

(4) To the extent otherwise authorized by law, property owned by the United States may be bartered for materials needed for the stockpile.

(d)(1) The President may waive the applicability of any provision of the first sentence of subsection (b) to any acquisition of material for, or disposal of material from, the stockpile. Whenever the President waives any such provision with respect to any such acquisition or disposal, or whenever the President determines that the application of paragraph (1) or (2) of such subsection to a particular acquisition or disposal is not feasible, the President shall notify the Committee on Armed Services of the Senate and the Committee on National Security of the House of Representatives in writing of the proposed acquisition or disposal at least thirty days before any obligation of the United States is incurred in connection with such acquisition or disposal and shall include in such notification the reasons for not complying with any provision of such subsection.

(2) Materials in the stockpile may be disposed of under subsection (a)(5) only if such congressional committees are notified in writing of the proposed disposal at least 45 days before any obligation of the United States is incurred in connection with such disposal.

(3) The President may acquire leasehold interests in property, for periods not in excess of twenty years, for storage, security, and maintenance of materials in the stockpile.

SPECIAL DISPOSAL AUTHORITY OF THE PRESIDENT

SEC. 7. (a) Materials in the stockpile may be released for use, sale, or other disposition —

(1) on the order of the President, at any time the President determines the release of such materials is required for purposes of the national defense; and

(2) in time of war declared by the Congress or during a national emergency, on the order of any officer or employee of the United States designated by the President to have authority to issue disposal orders under this subsection, if such officer or employee determines that the release of such materials is required for purposes of the national defense.

(b) Any order issued under subsection (a) shall be promptly reported by the President, or by the officer or employee issuing such order, in writing, to the Committee on Armed Services of the Senate and the

Committee on National Security of the House of Representatives.

MATERIALS DEVELOPMENT AND RESEARCH

SEC. 8. (a)(1) The President shall make scientific, technologic, and economic investigations concerning the development, mining, preparation, treatment, and utilization of ores and other mineral substances that (A) are found in the United States, or in its territories or possessions, (B) are essential to the national defense, industrial, and essential civilian needs of the United States, and (C) are found in known domestic sources in inadequate quantities or grades.

(2) Such investigations shall be carried out in order to —

(A) determine and develop new domestic sources of supply of such ores and mineral substances;

(B) devise new methods for the treatment and utilization of lower grade reserves of such ores and mineral substances; and

(C) develop substitutes for such essential ores and mineral products.

(3) Investigations under paragraph (1) may be carried out on public lands and, with the consent of the owner, on privately owned lands for the purpose of exploring and determining the extent and quality of deposits of such minerals, the most suitable methods of mining and beneficiating such minerals, and the cost at which the minerals or metals may be produced.

(b) The President shall make scientific, technologic, and economic investigations of the feasibility of developing domestic sources of supplies of any agricultural material or for using agricultural commodities for the manufacture of any material determined pursuant to section 3(a) of this Act to be a strategic and critical material or substitutes therefore.

(c) The President shall make scientific, technologic, and economic investigations concerning the feasibility of —

(1) developing domestic sources of supply of materials (other than materials referred to in subsections (a) and (b)) determined pursuant to section 3(a) to be strategic and critical materials; and

(2) developing or using alternative methods for the refining or processing of a material in the stockpile so as to convert such material into a form more suitable for use during an emergency or for storage.

(d) The President shall encourage the conservation of domestic sources of any material determined pursuant to section 3(a) to be a strategic and critical material by making grants or awarding contracts for research regarding the development of:

(1) substitutes for such material; or

(2) more efficient methods of production or use of such material.

NATIONAL DEFENSE STOCKPILE TRANSACTION FUND

SEC. 9. (a) There is established in the Treasury of the United States a separate fund to be known as the National Defense Stockpile Transaction Fund (hereinafter in this section referred to as the "fund").

(b)(1) All moneys received from the sale of materials in the stockpile under paragraphs (5) and (6) of section 6(a) shall be covered into the fund.

(2) Subject to section 5(a)(1), moneys covered into the fund under paragraph (1) are hereby made available (subject to such limitations as may be provided in appropriations Acts) for the following purposes:

(A) The acquisition, maintenance, and disposal of strategic and critical materials under section 6(a).

(B) Transportation, storage, and other incidental expenses related to such acquisition, maintenance, and disposal.

(C) Development of current specifications of stockpile materials and the upgrading of existing stockpile materials to meet current specifications (including transportation, when economical, related to such upgrading).

(D) Testing and quality studies of stockpile materials.

(E) Studying future material and mobilization requirements for the stockpile.

(F) Activities authorized under section 15.

(G) Contracting under competitive procedures for materials development and research to —

(i) improve the quality and availability of materials stockpiled from time to time in the stockpile; and

(ii) develop new materials for the stockpile.

(H) Improvement or rehabilitation of facilities, structures, and infrastructure needed to maintain the integrity of stockpile materials.

(I) Disposal of hazardous materials that are stored in the stockpile and authorized for disposal by law.

(J) Pay of employees of the National Defense Stockpile program.

(K) Other expenses of the National Defense Stockpile program.

(3) Moneys in the fund shall remain available until expended.

(c) All moneys received from the sale of materials being rotated under the provisions of section 6(a)(4) or disposed of under section 7(a) shall be covered into the fund and shall be available only for the acquisition of replacement materials.

(d) If, during a fiscal year, the National Defense Stockpile Manager barters materials in the stockpile for the purpose of acquiring, upgrading, refining, or processing other materials (or for services directly related to that purpose), the contract value of the materials so bartered shall —

(1) be applied toward the total value of materials that are authorized to be disposed of from the stockpile during that fiscal year;

(2) be treated as an acquisition for purposes of satisfying any requirement imposed on the National Defense Stockpile Manager to enter into obligations during that fiscal year under subsection (b)(2); and

(3) not increase or decrease the balance in the fund.

ADVISORY COMMITTEES

SEC. 10. (a) The President may appoint advisory committees composed of individuals with expertise relating to materials in the stockpile or with expertise in stockpile management to advise the President with respect to the acquisition, transportation, processing, refining, storage, security, maintenance, rotation, and disposal of such materials under this Act.

(b) Each member of an advisory committee established under subsection (a) while serving on the business of the advisory committee away from such member's home or regular place of business shall be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 5703 of title 5, United States Code, for persons intermittently employed in the Government service.

(c)(1) The President shall appoint a Market Impact Committee composed of representatives from the Department of Agriculture, the Department of Commerce, the Department of Defense, the Department of Energy, the Department of the Interior, the Department of State, the Department of the Treasury, and the Federal Emergency Management Agency, and such other persons as the President considers appropriate. The representatives from the Department of Commerce and the Department of State shall be Cochairmen of the Committee.

(2) The Committee shall advise the National Defense Stockpile Manager on the projected domestic and foreign economic effects of all acquisitions and disposals of materials from the stockpile that are proposed to be included in the annual materials plan submitted to Congress under section 11(b), or in any revision of such plan, and shall submit to the manager the Committee's recommendations regarding those acquisitions and disposals.

(3) The annual materials plan or the revision of such plan, as the case may be, shall contain—

(A) the views of the Committee on the projected domestic and foreign economic effects of all acquisitions and disposals of materials from the stockpile;

(B) the recommendations submitted by the Committee under paragraph (2); and

(C) for each acquisition or disposal provided for in the plan or revision that is inconsistent with a recommendation of the Committee, a justification for the acquisition or disposal.

(4) In developing recommendations for the National Defense Stockpile Manager under paragraph (2), the Committee shall consult from time to time with representatives of producers, processors, and consumers of the types of materials stored in the stockpile.

REPORTS TO CONGRESS

SEC. 11. (a) Not later than January 15 of each year, the President shall submit to the Congress an annual written report detailing operations under this Act. Each such report shall include —

(1) information with respect to foreign and domestic purchases of materials during the preceding fiscal year;

(2) information with respect to the acquisition and disposal of materials under this Act by barter, as provided for in section 6(c) of this Act, during such fiscal year;

(3) information with respect to the activities by the Stockpile Manager to encourage the conservation, substitution, and development of strategic and critical materials within the United States;

(4) information with respect to the research and development activities conducted under sections 2 and 8;

(5) a statement and explanation of the financial status of the National Defense Stockpile Transaction Fund and the anticipated appropriations to be made to the fund, and obligations to be made from the fund, during the current fiscal year; and

(6) such other pertinent information on the administration of this Act as will enable the Congress to evaluate the effectiveness of the program provided for under this Act and to determine the need for additional legislation.

(b)(1) Not later than February 15 of each year, the President shall submit to the appropriate committees of the Congress a report containing an annual materials plan for the operation of the stockpile during the next fiscal year and the succeeding four fiscal years.

(2) Each such report shall include details of all planned expenditures from the National Defense Stockpile Transaction Fund during such period (including expenditures to be made from appropriations from the general fund of the Treasury) and of anticipated receipts from proposed disposals of stockpile materials during such period. Each such report shall also contain details regarding the materials development and research projects to be conducted under section 9(b)(2)(G) during the fiscal years covered by the report. With respect to each development and research project, the report shall specify the amount planned to be expended from the fund, the material intended to be developed, the potential military or defense industrial applications for that material, and the development and research methodologies to be used.

(3) Any proposed expenditure or disposal detailed in the annual materials plan for any such fiscal year, and any expenditure or disposal proposed in connection with any transaction submitted for such fiscal year to the appropriate committees of Congress pursuant to section 5(a)(2), that is not obligated or executed in that fiscal year may not be obligated or executed until such proposed expenditure or disposal is resubmitted in a subsequent annual materials plan or is resubmitted to the appropriate committees of Congress in accordance with section 5(a)(2), as appropriate.

DEFINITIONS

SEC. 12. For the purposes of this Act:

(1) The term "strategic and critical materials" means materials that (A) would be needed to supply the military, industrial, and essential civilian needs of the United States during a national emergency, and (B) are not found or produced in the United States in sufficient quantities to meet such need.

(2) the term "national emergency" means a general declaration of emergency with respect to the national defense made by the President or by the Congress.

IMPORTATION OF STRATEGIC AND CRITICAL MATERIALS

SEC. 13. The President may not prohibit or regulate the importation into the United States of any material determined to be strategic and critical pursuant to the provisions of this Act, if such material is the product of any foreign country or area not listed in general headnote 3(d) of the Harmonized Tariff Schedule of the United States (19 U.S.C. 1202), for so long as the importation into the United States of material of that kind which is the product of a country or area listed in such general note is not prohibited by any provision of law.

BIENNIAL REPORT ON STOCKPILE REQUIREMENTS

SEC. 14. (a) Not later than January 15 of every other year, the Secretary of Defense shall submit to Congress a report on stockpile requirements. Each such report shall include —

(1) the Secretary's recommendations with respect to stockpile requirements; and

(2) the matters required under subsection (b).

(b) Each report under this section shall set forth the national emergency planning assumptions used by the Secretary in making the Secretary's recommendations under subsection (a)(1) with respect to stockpile requirements. The Secretary shall base the national emergency planning assumptions on a military conflict scenario consistent with the scenario used by the Secretary in budgeting and defense planning purposes. The assumptions to be set forth include assumptions relating to each of the following:

(1) The length and intensity of the assumed military conflict.

(2) The military force structure to be mobilized.

(3) The losses anticipated from enemy action.

(4) The military, industrial, and essential civilian requirements to support the national emergency.

(5) The availability of supplies of strategic and critical materials from foreign sources during the mobilization period, the military conflict, and the subsequent period of replenishment, taking into consideration possible shipping losses.

(6) The domestic production of strategic and critical materials during the mobilization period, the military conflict, and the subsequent period of replenishment, taking into consideration possible shipping losses.

(7) Civilian austerity measures required during the mobilization period and military conflict.

(c) The stockpile requirements shall be based on those strategic and critical materials necessary for the United States to replenish or replace, within three years of the end of the military conflict scenario required under subsection (b), all munitions, combat support items, and weapons systems that would be required after such a military conflict.

(d) The Secretary shall also include in each report under this section an examination of the effect that alternative mobilization periods under the military conflict scenario required under subsection (b), as well as a range of other military conflict scenarios addressing potentially more serious threats to national security, would have on the Secretary's recommendations under subsection (a)(1) with respect to stockpile requirements.

(e) The President shall submit with each report under this section a statement of the plans of the President for meeting the recommendations of the Secretary set forth in the report.

DEVELOPMENT OF DOMESTIC SOURCES

SEC. 15. (a) Subject to subsection (c) and to the extent the President determines such action is required for the national defense, the President shall encourage the development of domestic sources for materials determined pursuant to section 3(a) to be strategic and critical materials —

(1) by purchasing, or making a commitment to purchase, strategic and critical materials of domestic origin when such materials are needed for the stockpile; and

(2) by contracting with domestic facilities, or making a commitment to contract with domestic facilities, for the processing or refining of strategic and critical materials in the stockpile when processing or refining is necessary to convert such materials into a form more suitable for storage and subsequent disposition.

(b) A contract or commitment made under subsection (a) may not exceed five years from the date of the contract or commitment. Such purchases and commitments to purchase may be made for such quantities and on such terms and conditions, including advance payments, as the President considers to be necessary.

(c)(1) Descriptions of proposed transactions under subsection (a) shall be included in the appropriate annual materials plan submitted to Congress under section 11(b). Changes to any such transaction or the addition of a transaction not included in such plan, shall be made in the manner provided by section 5(a)(2).

(2) The authority of the President to enter into obligations under this section is effective for any fiscal year only to the extent that funds in the National Defense Stockpile Transaction Fund are adequate to meet such obligations. Payments required to be as a result of obligations incurred under this section shall be made from amounts in the fund.

(d) The authority of the President under subsection (a) includes the authority to pay —

(1) the expenses of transporting materials, and

(2) other incidental expenses related to carrying out such subsection.

(e) The President shall include in the reports required under section 11(a) information with respect to activities conducted under this section.

NATIONAL DEFENSE STOCKPILE MANAGER

SEC. 16. (a) The President shall designate a single Federal office to have responsibility for performing the functions of the President under this Act, other than under sections 7 and 13. The office designated shall be one to which appointment is made by the President, by and with the advice and consent of the Senate.

(b) The individual holding the office designated by the President under subsection (a) shall be known for purposes of functions under this Act as the "National Defense Stockpile Manager."

(c) The President may delegate functions of the President under this Act (other than under sections 7 and 13) only to the National Defense Stockpile Manager. Any such delegation made by the President shall remain in effect until specifically revoked by law or Executive order. The President may not delegate functions of the President under sections 7 and 13.

United States Code Citations

Section 2	-	50 U.S.C. 98a	Section 9	-	50 U.S.C. 98h
Section 3	-	50 U.S.C. 98b	Section 10	-	50 U.S.C. 98h-1
Section 4	-	50 U.S.C. 98c	Section 11	-	50 U.S.C. 98h-2
Section 5	-	50 U.S.C. 98d	Section 12	-	50 U.S.C. 98h-3
Section 6	-	50 U.S.C. 98e	Section 13	-	50 U.S.C. 98h-4
Section 7	-	50 U.S.C. 98f	Section 14	-	50 U.S.C. 98h-5
Section 8	-	50 U.S.C. 98g	Section 15	-	50 U.S.C. 98h-6
			Section 16	-	50 U.S.C. 98h-7

APPENDIX B

ABBREVIATIONS USED IN THIS REPORT

AMA LB	Anhydrous Morphine Alkaloid Pound
AMP	Annual Materials Plan
Av Oz	Avoirdupois Ounce (28.350 Grams)
DLA	Defense Logistics Agency
DNSC	Defense National Stockpile Center
FL	Flask (76 Pounds)
KG	Kilogram
ct	Carat
LB	Pound
LB Cb	Pounds of Contained Columbium
LB Co	Pounds of Contained Cobalt
LB Ta	Pounds of Contained Tantalum
LB Ta_2O_5	Pounds of Contained Tantalum Oxide
LB W	Pounds of Contained Tungsten
LCT	Long Calcined Ton
LDT	Long Dry Ton
LT	Long Ton
MT	Metric Ton
NDS	National Defense Stockpile
NSG	Non-Stockpile Grade
PC	Piece
S&CM	Strategic and Critical Materials
SDT	Short Dry Ton
ST	Short Ton
ST Be	Short tons of Contained Beryllium
ST Cr	Short tons of Contained Chromium
ST Mn	Short tons of Contained Manganese
ST V	Short tons of Contained Vanadium
Tr Oz	Troy Ounce

APPENDIX C

DNSC-L

MEMORANDUM FOR DEPUTY DIRECTOR (MATERIEL MANAGEMENT)

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

As Administrator of the Defense National Stockpile Center (DNSC), I recognize the importance of internal controls. I have taken the necessary measures to ensure that the evaluation of the system of internal control of DNSC has been conducted in a conscientious and thorough manner. The results indicate that the system of internal accounting and administrative control, along with other mechanisms of DNSC in effect during the fiscal year ending September 30, 1996, taken as a whole provides reasonable assurance that the objectives of the FMFIA were achieved within the limits described in Tab A. This section also provides information on how the evaluation was conducted and cities any deficiencies in the process.

RICHARD J. CONNELLY
Administrator

ATTACHMENT

60

DESCRIPTIONS OF THE CONCEPT OF REASONABLE ASSURANCE AND HOW THE EVALUATION WAS CONDUCTED
TAB A

The system of internal accounting and administrative control, of the Defense National Stockpile Center (DNSC) in effect during the fiscal year ending September 30, 1996, was evaluated in accordance with the Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government. These guidelines were issued by the Director of the Office of Management and Budget, in consultation with the Comptroller General, as required by the Federal Managers' Financial Integrity Act of 1982. Included is an evaluation of whether the system of internal accounting and administrative control of DNSC is in compliance with standards prescribed by the Comptroller General.

The objectives of the system of internal accounting and administrative control of DNSC are to provide reasonable assurance that:

-- obligations and costs are in compliance with applicable law;

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

-- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. The expected benefits and related costs of control procedures should be addressed using estimates and managerial judgment. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. Finally, projection of any evaluation of the system to future periods is subject to risk that procedures may be inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate. Therefore, statements of reasonable assurance are provided within the limits of the preceding.

DNSC continued to implement the Internal Control Program during FY 96. All of the DLAR 5010.4 requirements and any updated regulations associated with the program are disseminated throughout DNSC and have the full support of the Administrator and all levels of management. Emphasis is given to training on the importance of internal controls and the need to conduct periodic reviews in order to increase the effectiveness of preventing and detecting waste, fraud,

or mismanagement. The Administrator ensured that all DNSC employees involved in this review process are updated on new regulations or guidelines related to the IMC program.

During FY 96, an evaluation was performed in accordance with the guidelines identified above and other information provided from the following sources:

FY 95 audit conducted on Financial Statements for the National Defense Stockpile transaction fund which began in July 1995 (Project No. 5FH-2022) resulted in a report number 96-190 dated June 23, 1996, from the Department of Defense Inspector General (DoD IG). The audit was entitled "Internal Controls and compliance with laws and regulations for the National Defense Stockpile transaction fund financial statements for FY 1995". The report stated that DNSC's internal control structure was effective in accounting for and managing resources, ensuring compliance with laws and regulations, and providing reasonable assurance that financial statements are free of misstatements.

Recommendations from the audit were to correct internal control weaknesses over inventory accountability, debt collection techniques, interest revenue disclosures, and financial statement preparation. None of the above recommendations were considered material weaknesses to the financial statements.

The inventory division has implemented recommendations from the IG by updating Standard Operating Procedures (SOP's) for the Master Inventory File (MIF) procedures, reconciliation of DNSC inventories, and preparation of outbound storage reports and provided guidance has been given to the DNSC organizations that are involved.

The Financial Management Division reviewed recommendations made as a result of the DoD IG FY 95 Audit and are in the process of implementing the following:
a. revised delinquent bill letter to conform with DoD Financial Management Regulation.
b. establish control records in accordance with the FAR for each contract debt and provide detailed sop's to DNSC organizations involved.
c. develop detailed Standard Operating Procedures for monitoring collections on delinquent accounts receivable and interest charges
d. forward to Defense Finance and Accounting Service Columbus Center Debt Management Division all debts, deemed collectible in excess of $600 when no response to second debt collection letter is received.

During February 5-16, 1996, a Procurement Management Review (PMR) was performed on DNSC's directorate of stockpile contracts and three areas were noted as needing immediate attention (actions taken so far on these recommendations are also shown):

--Basic written policy and procedures for processing procurements and sales needed to be implemented.
Action taken: DNSC-P realizes the importance of compliance with regard to developing and issuing written formal policies and procedures. A senior contracting officer has been reassigned to write these policies and procedures and another mid-level employee experienced in writing regulations has been hired to assist in the effort.

-- DNSC-P needs to maintain oversight over the use of the Rocky Mountain Bank Card Program in the 14 depots.
Action taken: Controls and oversight have been put in place for this program. SOP's have been issued for Ft. Belvoir and Depot employees involved in the program. RMBC training has been given and DNSC-P will conduct periodic reviews to assure compliance.

--Fundamental changes need to be created in the sales program in order to enhance safeguards.
Action taken: As a result of consolidation at the field activities, oversight in sales programs by DNSC-P has been improved. DNSC will generate a sales strategy and revisions in Annual Sales Plans for all commodities regarding quantities, sales methodology, pricing benchmarks, historical corporate sales and a review of the mail list will be prepared.

Also noted by the PMR team was DNSC's commendable job in providing its contracting workforce education, training and work experience required by the Defense Acquisition Workforce Improvement Act (DAWIA). Contracting workforce that occupied critical acquisition positions had Level III DAWIA certifications and were members of the Acquisition Corp. Most other contracting career path employees met DAWIA requirements for the level at which they were working.

DNSC also conducted mandatory training on how to perform risk assessments and internal management control reviews for all of its managers GS-13 and higher as recommended in the Administrator's FY 95 Annual Statement of Assurance.

In response to the DoD IG Audit performed in May 1995 on all small purchases made within Defense Logistics Agency (DLA) activities (project no. 5CH-0051). Upon recommendations from the auditiors, DNSC has increased its use of the Rocky Mountain Bankcard Program. The expansion of the I.M.P.A.C. credit card program at DNSC has resulted in fewer purchase orders and eliminating the imprest fund on June 30, 1996 which reduces administrative paperwork. The I.M.P.A.C. credit card program at DNSC now has 3 cardholders at Ft. Belvoir and 41 cardholders at the depots to allow for necessary small purchase requirements under $2500 for supplies and services. DNSC provided in FY 96 on-site training for all cardholders and approving officials, provided government supply catalogs, updated and distributed standard operating procedures to all those involved in the program, and established a centralized database where all purchases are recorded so that managers can monitor and oversee purchases. DNSC-L and DNSC-P will also perform annual internal audits on all cardholders records to ensure proper controls over purchases.

During July 1996, DNSC completed a streamlining of its organization and reduced personnel strength. This action was necessary due to DoD-mandated end strength goals for 1996 and later years. DNSC reorganization eliminated the DNSC field management level and created sufficient additional structure at Ft. Belvoir to continue to carry out the mission of the Stockpile. Due to the reorganization and closure of zone offices, DNSC updated administrative standard operating procedures to ensure a smooth and efficient transition for depots and Ft. Belvoir offices. Standard Operating Procedures for areas such as receiving reports, travel, travel vouchers, training, purchase card usage, inter-service agreements, reimbursable work authorizations, penalty stamps, postage meters, etc. have been disseminated throughout the DNSC-wide organization.

During FY 96 all directorates performed risk assessments, a total of 18 in their various assessable units. The Financial Management Division and Contracting Directorate performed 2 Internal Management Control Reviews. The overall program evaluation of control techniques revealed no material weaknesses and it appears that Internal Management Controls are adequate. Each Director has provided the Administrator with their FY 96 Annual Statement of Assurance required under the Federal Managers' Financial Integrity Act based on independent review of the individual evaluations.

The results of the aforementioned audits and analyses and the day to day administrative controls indicate that the system in effect during the fiscal year that ended September 30, 1996, taken as a whole, complies with the requirement to provide reasonable assurance that the above mentioned objectives were achieved. The reasonable assurance is within the limits described in the preceding paragraphs.

DEFENSE NATIONAL STOCKPILE TRANSACTION FUND

AUDIT OPINION

Audit Opinion _____

Audit Opinion

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

March 1, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Opinion on the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028)

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors with respect to the financial statements, internal controls, and compliance with laws and regulations. Fund managers are responsible for establishing and maintaining an internal control structure and complying with laws and regulations applicable to the National Defense Stockpile Transaction Fund (the Fund). Our responsibility is to express an opinion on the financial statements based on our audit, to determine whether internal controls are adequate, and to determine whether the Fund complied with applicable laws and regulations.

Qualified Audit Opinion. Except as explained in the following paragraphs, we conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

We were unable to audit the prior-year financial statements because documentation supporting the acquisition of the pre-1988 inventory assets was not available. Therefore, we had no basis for comparing current balances with prior-year balances shown in the Statement of Financial Position and the Statement of Operations (and Changes in Net Position). Comparative prior-year data were not available for the Statement of Cash Flows because the prior-year statement was not required to be provided.

In our opinion, except for the effects of any adjustments that might have been necessary for comparisons with the unaudited or unavailable prior-year balances, the FY 1996 financial statements present fairly, in all material respects, the financial position of the Fund as of September 30, 1996, and the results of operations and cash flows for the year then ended, in conformity with accounting principles described below.

Accounting Principles. Accounting principles and standards for the Federal Government remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Comptroller General, who establish accounting standards for the Federal Government. Until financial statement reporting is governed by accounting standards that will constitute generally accepted accounting principles for the Federal Government, agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993.

Audit Opinion

Scope. We have audited the Principal Statements and Notes to the Principal Statements of the National Defense Stockpile Transaction Fund as of September 30, 1996. The Principal Statements include the Statement of Financial Position, the Statement of Operations (and Changes in Net Position), and the Statement of Cash Flows.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statement. We believe that our audit provided a reasonable basis for our opinion.

Our audit would not necessarily disclose all internal control and compliance reportable conditions that might also be considered material weaknesses. Reportable internal control and compliance conditions are summarized below and will be further addressed in our report on internal controls and compliance with laws and regulations to be published at a later date.

Internal Controls. We reviewed the internal control structure of the Fund and obtained an understanding of the internal control policies and procedures. In addition, we reviewed the implementation of the management control program by the Fund managers. We performed applicable tests of the internal control structure to determine whether the controls were effective and working as designed.

The internal control structure was effective in accounting for and managing resources, ensuring compliance with laws and regulations, and ensuring that the financial statements are free of material misstatements. However, management needs to improve the internal controls over interest due to the U.S. Treasury. The annual statements of assurance of the Defense National Stockpile Center and of the Defense Finance and Accounting Service, Columbus Center, did not identify any material weaknesses related to the Fund's activities.

Compliance With Laws and Regulations. We reviewed compliance with selected provisions of laws and regulations as they pertain to the accuracy of the financial statements. Management generally complied with the provisions. None of the compliance issues identified during our review would have a material impact on the financial statements. An example of such issues was the failure to report interest receivable, which is contrary to guidance in the OMB Bulletin No. 94-01.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller) and Chief Financial Officer
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
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 Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Logistics Agency
  Administrator, Defense National Stockpile Center
Director, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
  Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
  House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
  House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform and Oversight
  House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

IN REPLY REFER TO DDAI

JUN 04 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

This is in response to the May 16, 1997 request. If you have any questions, please contact Mrs. LaVaeda Coulter, (703) 767-6261.

Encl

JEFFREY GOLDSTEIN
Chief (Acting), Internal Review

Federal Recycling Program Printed on Recycled Paper

SUBJECT: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

Finding A: Collection Procedures. The DNSC did not effectively pursue the collection of $15.5 million of delinquent accounts receivable and related interest charges. As of September 30, 1996, DNSC had $14.1 million in delinquent accounts receivable and $1.4 million of delinquent interest receivable. Of these amounts, $8.6 million of the accounts receivable and $1.3 million of the interest receivable were over 120 days old. These collection procedure deficiencies were also identified in FY 1995. Our FY 1995 audit report previously identified $9.5 million of the $15.5 million of delinquent receivables ($8.4 million of the accounts receivable and $1.1 million of the interest receivable). Ineffective collections continued because the DNSC has not formalized procedures for the collection of amounts due nor designated an office with primary responsibility for collection. Valid amounts due the Federal Government will continue to go uncollected unless these problems are corrected.

DLA Comments: Concur.

Action Officer: Frank Taylor, DNSC-DF, 767-6530
Review/Approval: Richard J. Connelly, DNSC
Coordination: LaVaeda Coulter, DDAI, 767-6261

Olin Coleman 30 May 97

DLA Approval

RAY E. McCOY
Major General, USA
Principal Deputy Director

SUBJECT: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

Recommendation No. A.1. We recommend that the Administrator, Defense National Stockpile Center, and the Director, Defense Finance and Accounting Service Columbus Center:

a. Revise the Concept of Operations to assign primary collection responsibility to the Defense Finance and Accounting Service Columbus Center.

b. Agree and adhere to a schedule for getting the necessary documentation to the Defense Finance and Accounting Service Columbus Center Debt Management Division, both for long-standing delinquent receivables and for receivables becoming delinquent in the future.

DLA Comments: Concur. DNSC will work with DFAS to revise the Concept of Operations to assign collection responsibility once a contract indebtedness has been reduced to a fixed sum and the contract has been terminated for default or initial efforts have failed. DNSC will coordinate a schedule for getting the necessary documentation to DFAS Columbus Center for the long standing delinquent receivables and for receivables becoming delinquent in the future.

Disposition: Action is Ongoing. ECD: 31 July 1997

Action Officer: Frank Taylor, DNSC-DF, 767-6530
Review/Approval: Richard J.Connelly, DNSC
Coordination: LaVaeda Coulter, DDAI, 767-6261

30 MAY 97

DLA Approval

RAY E. McCOY
Major General, USA
Principal Deputy Director

SUBJECT: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

Finding B. The DFAS Columbus Center and DNSC did not record or report $1.5 million in interest revenue due the U.S. Treasury in the FY 1996 financial statements. The DFAS Columbus Center did not use standard general ledger accounts for recording interest charges billed and collected on delinquent accounts receivable and subsequently did not report the interest revenue due the U.S. Treasury on the fiscal year-end trial balance. These issues were also identified in our FY 1995 audit report. In addition, as in FY 1995, even though DNSC had the interest revenue information, DNSC did not report it in the financial statements. As a result, the Fund's FY 1996 financial statements understated interest receivable owed the Federal Government by $1.5 million.

DLA Comments: Concur.

Action Officer: Dixie England, DNSC-DF, 767-5513
Review/Approval: Richard J.Connelly, DNSC
Coordination: LaVaeda Coulter, DDAI, 767-6261

30 MAY 97

DLA Approval:

RAY E. McCOY
Major General, USA
Principal Deputy Director

SUBJECT: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

Recommendation No. B.2. We recommend that the Director, Defense Logistics Agency disclose in the future National Defense Stockpile Transaction Fund Financial Statements the total amount of interest revenue due to the U.S. Treasury and the amount of interest revenue collected during the fiscal year and deposited into the U.S. Treasury receipt account.

DLA Comments: Concur. Interest is now reflected on the Trial Balance and will be included in the FY 1997 Statements.

Disposition Action is ongoing. ECD: 1 March 1998

Action Officer: Dixie England, DNSC-DF, 767-5513
Review/Approval: Richard J. Connelly, DNSC
Coordination: LaVaeda Coulter, DDAI, 767-6261

DLA Approval Olivia Calemma 30 MAY 97

RAY E. McCOY
Major General, USA
Principal Deputy Director

SUBJECT: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

Finding C. The DNSC did not inform DFAS Columbus Center of $108.5 million in corrections made to prior-period adjustments and the cost of goods related to the FY 1995 financial statements. Specifically, DNSC had DFAS process $108.5 million as a current-year cost of goods sold that should have been processed against the prior years' sales. Additionally, the DNSC did not provide DFAS Columbus Center with information to accrue an allowance for doubtful accounts, and DNSC also did not reconcile the general ledger Fund Balance With Treasury account with the U.S. Treasury records and did not refer the existing discrepancy to DFAS Columbus Center for resolution. Finally, the Accounting records and financial statements did not reflect fixed assets and accrued annual leave and pension liability. These problems occurred because DNSC and DFAS Columbus Center Personnel were unaware of certain accounting requirements, and DNSC and DLA management did not review the statements. As a result, the accounting records and financial statements understated assets, liabilities, and expenses. In addition, the Fund Balance With Treasury account on the financial statements may reflect transactions that do not properly belong to DNSC. The FY 1995 audit report had a similar finding on financial statement compliance but dealt with different specific conditions.

DLA Comments: Concur.

Action Officer: Dixie England, DNSC-DF, 767-5513
Review/Approval: Richard J.Connelly, DNSC
Coordination: LaVaeda Coulter, DDAI, 767-6261

Olive Coleman 30 MAY 97

DLA Approval

RAY E. McCOY
Major General, USA
Principal Deputy Director

SUBJECT: Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996 (Project No. 6FH-2028.01)

Recommendation No. C.1. We recommend that the Director, Defense Logistics Agency, determine and provide all necessary information to the Defense Finance and Accounting Service Columbus Center so that all required entries can be posted, including information on prior period adjustments, allowance for doubtful accounts, Fund Balance with Treasury, fixed assets and depreciation, accrued annual leave and pension liability.

DLA Comments: Concur. DNSC will determine all necessary information and provide it to DFAS, Columbus so that all required entries can be posted.

Disposition: Action is Ongoing. ECD: 30 September 1997

Action Officer: Dixie England, DNSC-DF, 767-5513
Review/Approval: Richard J. Connelly, DNSC
Coordination: LaVaeda Coulter, DDAI, 767-6261

Olen Coleman 30 MAY 97

DLA Approval

RAY E. McCOY
Major General, USA
Principal Deputy Director

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

F. Jay Lane
Raymond D. Kidd
David F. Vincent
John A. Richards
Ronald L. Smith
Livingston M. Johnson
Tyler C. Apffel
George B. West
Jermaine D. Lassiter
Jennifer L. Stephens
Francis M. Ponti
Frank C. Sonsini
Lusk Penn
Deborah Curry
Traci Sadler
Angela Clayton