

Audit



Report

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE
ARMY AUDIT AGENCY AUDIT OF THE ARMY GENERAL FUND
FINANCIAL STATEMENTS FOR FYs 1997 AND 1996

Report Number 98-102

April 7, 1998

Office of the Inspector General
Department of Defense

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Acronyms

AAA	Army Audit Agency
GAO	General Accounting Office
IG	Inspector General



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

April 7, 1998

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

SUBJECT: Inspector General, DoD, Oversight of the Army Audit Agency
Audit of the Army General Fund Financial Statements for FYs 1997
and 1996 (Report No. 98-102)

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Army Audit Agency (AAA) disclaimer of opinion on the Army General Fund Financial Statements for FYs 1997 and 1996, along with the AAA report, "Army's Principal Financial Statements for Fiscal Years 1997 and 1996: Auditor's Report." An audit of the Army General Fund Financial Statements is required by the "Chief Financial Officers Act of 1990," as amended by the "Federal Financial Management Act of 1994." Since this report contains no findings or recommendations, written comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-9145 (DSN 664-9145, e-mail rbird@dodig.osd.mil), or Mr. John J. Vietor, Audit Project Manager, at (317) 510-3855 (DSN 699-3855, e-mail jvietor@dodig.osd.mil). See Appendix D for the 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. 98-102
(Project No. 7FI-2031.01)

April 7, 1998

Inspector General, DoD, Oversight of the Army Audit Agency Audit of the Army General Fund Financial Statements for FYs 1997 and 1996

Executive Summary

Introduction. An audit of the Army General Fund financial statements is required by Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. We delegated the audit of the Army General Fund Financial Statements for FYs 1997 and 1996 to the Army Audit Agency. This report provides our endorsement of the Army Audit Agency disclaimer of opinion on the Army General Fund Financial Statements for FYs 1997 and 1996, along with the Army Audit Agency report, "Army's Principal Financial Statements for Fiscal Years 1997 and 1996: Auditor's Report."

Audit Objective. Our objective was to determine the accuracy and completeness of the Army Audit Agency audit of the Army General Fund Financial Statements for FYs 1997 and 1996. See Appendix C for a discussion of the audit process.

Audit Results. The Army Audit Agency report, "Army's Principal Financial Statements for Fiscal Years 1997 and 1996: Auditor's Report," February 13, 1998, stated that the Army Audit Agency was unable to express an opinion on the reliability of the Army General Fund Financial Statements for FYs 1997 and 1996. We concur with the Army Audit Agency disclaimer of opinion; our endorsement of that disclaimer is at Appendix A. The Army Audit Agency report is at Appendix B.

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**Appendix A. Inspector General, DoD,
Endorsement Memorandum**



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

February 27, 1998

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

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1997 Army General Fund Financial Statements (Project No. 7FI-2031)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Army Audit Agency (AAA) the audit of the FYs 1997 and 1996 Army General Fund financial statements. Summarized below are the AAA disclaimer of opinion on the FYs 1997 and 1996 Army General Fund financial statements and the results of our review of the AAA audit. We endorse the disclaimer of opinion expressed by the AAA (see the Enclosure).

Disclaimer of Opinion. The AAA disclaimer of opinion on the FYs 1997 and 1996 Army General Fund financial statements, dated February 13, 1998, states that the AAA was unable to express an opinion on the financial statements. We concur with the AAA disclaimer of opinion for the reasons summarized below.

- o Accounting and related systems were not designed for financial statement reporting and consequently could not produce reliable and auditable financial statement data.

- o The processes used to compute and report the amounts for material lines on the financial statements did not produce reliable and auditable numbers.

Inadequate accounting systems resulted in disclaimers of opinion for the FYs 1991 through 1996 Army principal financial statements. Inadequate accounting systems continued to exist in relation to the FY 1997 financial statements.

Internal Controls. Internal controls did not ensure that the FYs 1997 and 1996 Army General Fund financial statements contained no material misstatements. The Army and the Defense Finance and Accounting Service have recognized many of the financial reporting weaknesses and reported them in their FY 1997 Annual Statements of Assurance. Details on these matters and on compliance with laws and regulations will be discussed in a separate report.

Compliance With Laws and Regulations. The AAA also identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements for Federal Financial Statements," January 16, 1998, the AAA work disclosed that financial management systems did not comply with Federal financial management system requirements; applicable Federal accounting standards; and the United States Government Standard General Ledger at the transaction level.

Review of Army Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent work conducted by the AAA, we reviewed the approach and planning, and monitored the progress at the key points. We also performed other procedures deemed necessary to determine the fairness and accuracy of the approach and conclusions.

We conducted our review of the AAA work on the Army General Fund financial statements from August 27, 1997, to February 27, 1998, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the AAA disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosure

Appendix B. Army Audit Agency Report



**Army's Principal
Financial Statements
for Fiscal Years
1997 and 1996**

Auditor's Report

**13 February 1998
Audit Report: AA 98-104**

U.S. Army Audit Agency





DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of the Auditor General
3101 Park Center Drive
Alexandria, VA 22302-1596

13 February 1998

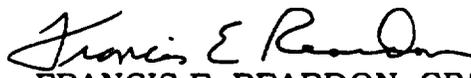
Acting Secretary of the Army

This is the auditor's report which summarizes the results of our efforts to audit the Army's Principal Financial Statements for the fiscal years ended 30 September 1997 and 1996. We performed our work pursuant to the Chief Financial Officers Act of 1990 as expanded by the Government Management Reform Act of 1994.

We were unable to express an opinion on the financial statements primarily because of inadequate accounting systems and incomplete or unauditible supporting records. We were unable to apply other auditing procedures in these areas to satisfy ourselves as to the fairness of the data presented.

Brief discussions of our results and conclusions are in the main part of this report. We will present more detailed discussions in several supporting audit reports to be published separately (see Annex C).

I appreciate the courtesies and cooperation extended to us during the audit.


FRANCIS E. REARDON, CPA
The Auditor General

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AUDITOR'S REPORT





DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of the Auditor General
3101 Park Center Drive
Alexandria, VA 22302-1596

Acting Secretary of the Army

As delegated by, and in coordination with, the Inspector General, DOD, we were engaged to audit the Army's Statements of Financial Position as of 30 September 1997 and 1996, and the related Statements of Operations and Changes in Net Position for the fiscal years then ended. Pursuant to the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, the Army prepared these financial statements and is responsible for them.

We were unable to express an opinion on these financial statements. Inadequate accounting systems, insufficient audit trails, and procedural problems resulted in the lack of reliable amounts reported for several types of assets, liabilities, and expenses. These conditions prevented us from using any practical methodology to conduct audit work of sufficient scope to enable us to express an opinion on these financial statements. Financial data in the Overview and the Supplemental Financial and Management Information sections of the Army's FY 97 Annual Financial Report was derived from the same sources as the financial statements and also may not be reliable.

Internal controls weren't fully effective to ensure there were no material misstatements in the financial statements. The Army and the Defense Finance and Accounting Service have recognized many of the associated financial reporting weaknesses and reported them in their FY 97 annual assurance statements.

Our limited audit work didn't identify any instances of unreported failures to comply with laws and regulations related to the Army's financial statements. However, the financial management systems that support the Army's financial statements for fiscal years 1997 and 1996 did not meet the requirements of the Federal Financial Management Improvement Act of 1996. Specifically, these systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

In this report, we describe the reasons for our disclaimer plus other reporting problems. We also cite some progress areas. We will issue a separate report on internal controls and compliance with laws and regulations.

Although there were significant limitations to the scope of our audit work, we performed our work to the extent possible in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 93-06 (Audit Requirements for Federal Financial Statements) as amended.

Reasons for Disclaimer

Our audit work showed that the Army continues to experience major financial reporting problems which prevented us from rendering an opinion on its financial statements. Specific reasons for our disclaimer were inadequate accounting systems and audit trails, and unreliable amounts for several material lines in the financial statements. The Army and the Defense Accounting Service are working on these problems, but complete solutions aren't likely for several years.

Building on prior year audit results, we performed audit work on major portions of the reported assets and liabilities. Deficiencies in accounting systems prevented us from auditing reported expenses. Accounting systems deficiencies and procedural problems also prevented us from verifying the quantities and values for much of the Army's assets and liabilities. The reasons for our disclaimer are generally the same as we reported last year (Auditor's Report on the Army's Principal Financial Statements for Fiscal Years 1996 and 1995, Audit Report: AA 97-133) and are summarized in the following paragraphs. Details and specific recommendations are in separate audit reports.

ACCOUNTING SYSTEMS

The primary reason we couldn't render an opinion on the Army's financial statements is that the accounting systems—and the systems which interface with the accounting systems (such as the Army's logistics systems)—weren't designed for financial statement-type reporting and therefore can't produce reliable and auditable financial statements. The Defense Accounting Service owns and operates most of the systems used to account for the Army's resources, and it is working on a new accounting system—the Defense Joint Accounting System—which is intended to resolve many of the problems with existing systems. However, the new system won't be fully fielded for several years. Accordingly, we cannot assess the extent to which it will resolve existing problems.

FINANCIAL STATEMENT AMOUNTS

The processes used to compute and report the amounts for several material lines in the financial statements didn't produce reliable and auditable numbers. We summarize the most significant problems we found in the following paragraphs.

Fund Balance With Treasury. We weren't able to attest to the reasonableness of the reported total for fund balance with Treasury (about \$30.6 billion as of 30 September 1997). Treasury reports showed about \$1.4 billion of unresolved discrepancies between Treasury records and disbursing officer statements of accountability for checks issued. If all the discrepancies were resolved in the direction currently indicated, the Army's reported amounts for fund balance with Treasury and for appropriated capital would be understated by \$1.4 billion. Data was not available to determine the extent of any such discrepancies for FY 96.

Property, Plant and Equipment, Net. We weren't able to attest to the reported value for property, plant and equipment, net (about \$132.0 billion and about \$124.9 billion as of 30 September 1997 and 1996 respectively). These values were misstated by unknown, but probably material, amounts because of reporting problems related to the following sub-elements which account for over 98 percent of the total amounts reported for this line.

- The reported values for military equipment were misstated by unknown amounts because of several problems.
 - Prices used to value this equipment weren't current. The total understatement for the sample of items we checked was more than \$10 billion for FY 97 and the account was adjusted accordingly. However, the account balance was still misstated by an unknown amount at the end of the reporting period.
 - Reported values didn't include the value of items accepted at contractors' plants but not yet received by the using unit.
 - Contractor reports—used to account for equipment held by contractors—weren't complete or accurate.
 - There was no assurance that all units reported their property or that values were based on DOD asset reporting thresholds.
 - As stated in the notes to the financial statements, the Army values its military equipment at latest acquisition cost or standard prices rather than actual cost.

- The reported values for real property (land, structures, facilities, and leasehold improvements) were misstated by unknown amounts because Army and DOD reporting guidance wasn't clear and wasn't consistently implemented. Specific problems included the duplicate reporting of commissaries and nonappropriated fund assets, and the incomplete reporting of tenant activity construction. During FY 97 the Real Property Integrated Process Team developed an extensive set of proposals on real property accounting to meet the requirements of the Chief Financial Officers Act, but these proposals have not been approved or issued as official policy. For FY 96 we also stated that real property assets were understated by an unknown amount because the Army's financial interest in State National Guard facilities wasn't recorded as an asset. Although the Army's financial interest wasn't recorded for FY 97 either, a definitive policy on reporting this interest was not yet clearly defined.
- The reported values for construction in progress were misstated by unknown amounts because the portion pertaining to government-furnished materiel was based on contractor reports that weren't accurate or complete. For FY 96 we also reported that the \$1.7 billion for Army National Guard construction in progress included an unknown amount for completed projects. The National Guard agreed to remove completed projects and reported only about \$491 million for construction in progress for FY 97. However, we have not yet verified that all completed projects have been removed.

War Reserves. The reported values for war reserves (about \$46.8 billion and about \$35.8 billion as of 30 September 1997 and 1996 respectively) were misstated by unknown, but probably material, amounts because the assets weren't properly valued. The values were overstated by unknown amounts because excess assets and assets in an unknown condition were valued at full standard price. War reserves were reported as inventory, net in the Army's Statement of Financial Position as of 30 September 1996 (and we reported last year that the total amount in that account was not reliable). Although we consider this change in asset classification an improvement, the valuation problems for war reserve assets remain unresolved.

Other Entity Assets. The reported values for other entity assets (\$0 and about \$5.5 billion as of 30 September 1997 and 1996, respectively) were misstated by unknown amounts. The FY 96 amount was derived from contractor reports which weren't complete and didn't include accurate values. We previously recommended that the Army not use source data that was known to be unreliable. Therefore, the Army didn't include this data for FY 97.

Accounts Receivable. The reported amount for accounts receivable (about \$1.3 billion as of 30 September 1997) was not reliable, and existing accounting systems and procedures prevented the determination of reliable account balances. The Defense Accounting Service didn't use the Army's general ledger as a source for the reported balances as required. Instead, it made unsupported corporate-level adjustments to force the general ledger to agree with fund status data. In addition, the accounting systems didn't have subsidiary ledgers for accounts receivable that could be used to help verify the reported amounts. We didn't attempt to audit accounts receivable reported as of 30 September 1996 (about \$1.2 billion) but that amount also may not be reliable.

Accounts Payable. The reported balances of accounts payable covered by budgetary resources for Federal and non-Federal entities (about \$2.3 billion and about \$3.8 billion as of 30 September 1997 and 1996 respectively) weren't reliable, and existing accounting systems and procedures prevented the determination of reliable values for these accounts. Accounts payable frequently weren't recorded (i) when goods or services were received, (ii) for yearend unpaid invoices on Defense-administered Army contracts, and (iii) for progress payment holdbacks. In addition, the Defense Accounting Service made corporate-level adjustments to the Army's accounts payable which, because of procedural problems, distorted rather than improved the reported numbers. The adjustments were made to force the general ledger to equal the funds status data which was considered to be more reliable. But even if it were more reliable, the adjustment process didn't maintain the integrity of the division of accounts payable status data between Federal and non-Federal.

Other Liabilities. We could not attest to the amounts reported for other non-Federal liabilities not covered by budgetary resources (about \$27.7 billion and about \$16.1 billion as of 30 September 1997 and 1996 respectively). The Army increased its reporting of these liabilities for FY 97, but some internal control weaknesses still existed at activities responsible for tracking and valuing these liabilities. These weaknesses relate to the Army not having controls to ensure that all liabilities are disclosed by Army organizations. Consequently, we couldn't verify that all reportable liabilities were identified and properly valued.

Total Expenses. Prior audit results have shown that the accounting systems don't have subsidiary ledgers showing the detailed transactions that make up the summary numbers reported for expenses in the Army's financial statements. As a result, there was a lack of audit trails, and we didn't attempt to audit the expenses (about \$65.4 billion for FY 97 and about \$64.7 billion for FY 96) reported in the Army's statements. The Defense Accounting Service (the owner and operator of the Army's primary accounting systems) has acknowledged the deficiency and is working on a new accounting system to replace those currently in use.

This deficiency likely will continue as long as the existing systems are in use.

Other Reporting Problems

Our audit work identified other problems which don't prevent us from rendering an audit opinion, but which must be resolved to ensure that the affected data is properly presented in the Army's financial statements.

Assets Under Capital Lease. The Army's overseas real property holdings (about \$4.6 billion for FY 97) were still misclassified within the notes as assets under capital lease instead of reported in the normal real property accounts. Based on our audit report covering the Army's financial statements for fiscal years 1996 and 1995, the Office of the Under Secretary of Defense (Comptroller) plans to modify applicable guidance to require that agreements with foreign governments for the occupancy of overseas real property be treated as capital leases only when such agreements meet the standard criteria. In addition, real property assets funded by host nations or international organizations that were provided (donated) to the Army will be recorded at fair value at the time of transfer and properly disclosed and explained in the notes to the financial statements. However, the Office of the Under Secretary didn't modify the guidance in time for the current reporting period.

Operating Materials and Supplies. Based on guidance from the Under Secretary of Defense (Comptroller), the Army expenses the inventories of repair parts owned by its combat divisions and separate brigades. We reported last year that we believe the inventories of these units (authorized to stock parts inventories worth about \$800 million) meet the definition of operating materials and supplies, and that expensing them understated the Army's total assets. This is a DOD-wide issue currently being addressed by the Inspector General, DOD.

Problem Disbursements. The reported totals for unmatched disbursements and negative unliquidated obligations increased during FY 97. These disbursements are a financial management concern because they represent disbursements that have not been matched to the original obligation or that do not agree with the amount of the original obligation. As of 30 September 1997, the Army reported unmatched disbursements of about \$883 million and negative unliquidated obligations of about \$286 million. These totals may not be directly comparable to the lower amounts reported for the prior year because of changes in reporting procedures. However, the balances have continued to increase during the early part of FY 98. In response to this

situation, the Army and the Defense Accounting Service plan to increase their combined efforts to reduce problem disbursements.

Progress Areas

During our audit work we verified some positive conditions and determined that the Army has made progress in resolving some previously reported problems.

Mission Assets. During FY 97 we participated in a DOD-wide effort to validate the onhand quantities of mission assets. This effort was prompted by a new Federal financial accounting standard that requires reporting of mission assets in a supplementary stewardship report beginning in FY 98. Within the Army the review was designed to validate accountability (existence) for the five largest categories of mission assets: aircraft, combat tracked vehicles, communications equipment, missiles, and missile support equipment. We selected 786 items from a universe valued at about \$23.5 billion for validation. We also reverse (floor to book) sampled 1,055 items. In total we validated 1,839 of the 1,841 items. The sample was designed on a "pass/fail" basis for each of the five categories, and the Army successfully met this standard for each category.

Equipment Reporting Systems. In July 1997 the Army chartered the General and Mission Equipment Workgroup. Its overall objective is to conduct a detailed review of the financial reporting process for Army equipment and to assess the capabilities of current and future systems to meet reporting requirements. The workgroup has identified several problem areas with current systems and has recommended changes to systems that will improve the accuracy of equipment data. The workgroup is also working closely with the Global Combat Service Support System-Army project management office to ensure that financial reporting requirements for equipment are identified during system development.

Unserviceable Equipment. In prior years we found that the Army reported unserviceable equipment at full value and therefore overstated the value of military equipment in the financial statements. For FY 97 U.S. Army Materiel Command reduced the reported value of unserviceable equipment to more closely reflect its actual value. The value of repairable equipment was reduced to 35 percent of its standard unit price to allow for the potential repair cost. The value of non-repairable equipment was reduced to its salvage value of 2.7 percent.

Equipment In Transit From Customers. In prior years we found that the Commodity Command Standard System classified equipment as in

transit when a field return authorization was issued, but that the unit continued to report the equipment through the property book system. This double reporting caused an overstatement in the equipment balances. Data was not available for FY 96, but for FY 97 Materiel Command made an adjustment of about \$550 million to correct the overstatement caused by duplicate reporting of equipment in transit from field customers.

Equipment Held by Project Managers. In prior years we found that the application used by the Commodity Command Standard System understated the reported balances for equipment because it omitted Army-owned equipment held by project managers. For FY 97 Materiel Command modified the system to include the value of this equipment.

Training of Logistics Personnel. In prior years we found that the Army had not provided its logisticians with financial training. Materiel Command initiated action to improve the level of financial understanding of its logistics personnel. As of FY 98, the Army incorporated financial training into its revamped major item manager course.

Natural Resources. The Army reduced the value of reported timber from \$1.7 billion in FY 96 to \$17 million in FY 97 so the balance would only reflect estimated timber sales for the next year. The FY 96 balance assigned a value to all timber, regardless of whether it would be harvested. The conservative approach adopted by the Army is reasonable until more specific guidance is issued by the Federal Accounting Standards Advisory Board.

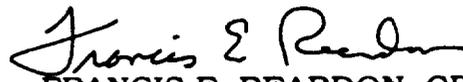
Other Liabilities. The Army has continued to make progress in reporting its liabilities not covered by budgetary resources (about \$27.7 billion for FY 97). This is the second year of significantly expanded reporting in this area. For FY 96 the Army recognized about \$15 billion of these liabilities for the first time. For FY 97 additional liabilities recognized for the first time included about \$10.6 billion for chemical demilitarization programs, about \$972 million for environmental restoration at closing installations, about \$414 million for the Voluntary Separation Incentive Program, and about \$185 million for claims and litigation. Although, as previously noted, some internal control weaknesses still existed, the Army improved its controls for identifying and reporting liabilities.

Military Personnel and Payroll. The Army and the Defense Accounting Service are continuing their efforts to integrate the personnel and pay systems. Fielding of software upgrades, which will result in automated interfaces between the personnel and pay systems, is scheduled to begin during FY 98. This integration should increase data accuracy and minimize improper payments.

Travel Advances. The Army continued to emphasize the collection of outstanding travel advances and the use of government travel cards to reduce the need for advances. Reported travel advances as of 30 September 1997 totaled about \$62 million. This represented a decrease of about 15 percent compared with the total as of 30 September 1996. It was the third consecutive year with a reduction in the total.

Outlook

Although fundamental problems continued to exist during FY 97, the Army's progress in correcting several problems within its power to resolve indicates its commitment to implement the Chief Financial Officers Act successfully. Solving all the major problems will likely take several more years, but we continue to believe the outlook is positive.


FRANCIS E. REARDON, CPA
The Auditor General

13 February 1998

ANNEXES

AUDIT SCOPE AND METHODOLOGY

Army management, with support provided by the Defense Finance and Accounting Service, is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles.
- Establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers Financial Integrity Act are met.
- Complying with applicable laws and regulations.

We were responsible for auditing the financial statements and evaluating related internal controls and compliance with laws and regulations. In carrying out these responsibilities, we:

- Evaluated and, as necessary, tested relevant internal controls encompassing:
 - Fund Balance With Treasury.
 - Wholesale asset quantities.
 - Wholesale asset values.
 - Real property.
 - Contingent and other liabilities.
 - Financial statement preparation procedures.
- Conducted limited followup reviews on previously reported problems and recommendations related to:
 - Accounting systems.
 - Travel advances.
 - Payroll.
 - Retail equipment.

ANNEX A

- Government-furnished property.
 - Accounts payable.
 - Progress payments.
 - National Guard reporting.
 - Inventory, net.
 - Problem disbursements.
- Tested compliance with selected laws and regulations.
 - Assessed data in the Overview section of the Annual Financial Report for consistency with data reported in the financial statements.

We didn't conduct audit work on programs that are classified for national security.

To the extent possible, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 93-06 (Audit Requirements for Federal Financial Statements) as amended. However, as noted in the body of our report, the scope of our work had significant limitations.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS	<u>1997</u>	<u>1996</u>
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$30,638,662	\$31,343,151
(2) Investments, Net (Note 4)	1,010	1,068
(3) Accounts Receivable, Net (Note 5)	1,146,531	953,735
(4) Interest Receivable	0	0
(5) Advances and Prepayments	19,990	4,304
(6) Other Federal (Intragovernmental)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments	0	0
(2) Accounts Receivable, Net (Note 5)	129,059	260,244
(3) Credit Program Receivables/ Related Foreclosed Property, Net	0	0
(4) Interest Receivable, Net	0	273
(5) Advances and Prepayments	2,536,775	424,246
(6) Other Non-Federal (Governmental)	0	0
c. Cash and Other Monetary Assets (Note 3)	24,680	19,802
d. Inventory, Net (Note 8)	1,526,589	1,899,923
e. Work in Process	0	0
f. Operating Materials/Supplies, Net (Note 10)	0	0
g. Stockpile Materials, Net (Note 11)	0	0
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)	132,030,736	124,867,674
l. War Reserves	46,760,379	35,769,856
m. Other Entity Assets	0	5,476,723
n. Total Entity Assets	<u>\$214,814,411</u>	<u>\$201,020,999</u>
2. Non-Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$213,364	(\$134,337)
(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.

ANNEX B

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army Statement of Financial Position As of September 30, 1997 (Thousands)		
ASSETS, Continued	1997	1996
2. Non-Entity Assets:		
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	\$62,182	\$6,478
(2) Interest Receivable, Net	1,305	6,058
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	164,069	143,252
d. Other Non-Entity Assets	0	0
e. Total Non-Entity Assets	<u>\$440,920</u>	<u>\$21,451</u>
3. Total Assets	<u>\$215,255,331</u>	<u>\$201,042,450</u>
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	\$1,495,701	\$2,069,074
(2) Interest Payable	0	0
(3) Debt (Note 16)	0	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	1,499,660	725,319
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	795,710	1,789,207
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	2,273,792	1,957,061
(b) Annual Accrued Leave	0	0
(c) Severance Pay and Separation Allowance	393,899	327,984
(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)	319,082	218,865
c. Total Liabilities Covered by Budgetary Resources:	<u>\$6,777,844</u>	<u>\$7,087,510</u>
The accompanying notes are an integral part of these statements.		

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army Statement of Financial Position As of September 30, 1997 (Thousands)		
LIABILITIES, Continued	<u>1997</u>	<u>1996</u>
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)	337,434	769,119
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	124,273	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	1,482,069	1,313,935
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	27,712,155	16,128,481
c. Total Liabilities Not Covered by Budgetary Resources	<u>\$29,655,931</u>	<u>\$18,211,535</u>
6. Total Liabilities	<u>\$36,433,775</u>	<u>\$25,299,045</u>
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	\$27,286,281	\$27,461,855
b. Invested Capital	181,592,741	168,160,756
c. Cumulative Results of Operations	(401,535)	(1,667,671)
d. Other	0	0
e. Future Funding Requirements	(29,655,931)	(18,211,535)
f. Total Net Position	<u>\$178,821,556</u>	<u>\$175,743,405</u>
8. Total Liabilities and Net Position	<u>\$215,255,331</u>	<u>\$201,042,450</u>
The accompanying notes are an integral part of these statements.		

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army Statement of Operations and Changes in Net Position For the Period Ended September 30, 1997 (Thousands)		
	<u>1997</u>	<u>1996</u>
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used	\$57,008,818	\$55,643,717
2. Revenues from Sales of Goods and Services		
a. To the Public	497,750	627,185
b. Intragovernmental	5,384,010	5,552,692
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	356	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	2,333,553	929,604
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	(548,897)	(432,977)
8. Total Revenues and Financing Sources	\$64,675,590	\$62,320,221
EXPENSES		
9. Program or Operating Expenses (Note 23)	\$57,616,961	\$57,789,003
10. Cost of Goods Sold (Note 24)		
a. To the Public	497,750	627,185
b. Intragovernmental	5,384,010	5,552,692
11. Depreciation and Amortization	0	0
12. Bad Debts and Writeoffs	14,544	23,252
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	20,711	1,576
14. Other Expenses (Note 25)	1,885,089	735,136
15. Total Expenses	\$65,419,065	\$64,728,844
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	(\$743,475)	(\$2,408,623)
17. Plus (Minus) Extraordinary Items (Note 26)	0	0
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(\$743,475)	(\$2,408,623)
The accompanying notes are an integral part of these statements.		

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army		
Statement of Operations and Changes in Net Position		
For the Period Ended September 30, 1997		
(Thousands)		
	<u>1997</u>	<u>1996</u>
EXPENSES, Continued		
19. Net Position, Beginning Balance, as Previously Stated	\$175,743,405	\$211,231,585
20. Adjustments (Note 27)	(15,069,514)	(13,685,466)
21. Net Position, Beginning Balance, as Restated	<u>\$160,673,891</u>	<u>\$197,546,119</u>
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(743,475)	(2,408,623)
23. Plus (Minus) Non Operating Changes (Note 28)	18,891,140	(19,394,091)
24. Net Position, Ending Balance	<u>\$178,821,556</u>	<u>\$175,743,405</u>

The accompanying notes are an integral part of these statements.

ANNEX B

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army Statement of Cash Flows For the Period Ended September 30, 1997 (Thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES	<u>1997</u>	<u>1996</u>
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(\$67,903)	(\$421,324)
Adjustments Affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	(2,895)	111,109
4. Decrease (Increase) in Other Assets	405,259	551,089
5. Increase (Decrease) in Accounts Payable	(108,254)	(49,979)
6. Increase (Decrease) in Other Liabilities	(201,409)	(306,985)
7. Depreciation and Amortization	0	0
8. Other Unfunded Expenses	0	0
9. Other Adjustments	36,885	20,025
10. Total Adjustments	<u>\$129,586</u>	<u>\$325,259</u>
11. Net Cash Provided (Used) by Operating Activities	<u>\$61,683</u>	<u>(\$96,065)</u>
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	<u>\$0</u>	<u>\$0</u>
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	0	0
23. Net Appropriations	<u>\$0</u>	<u>\$0</u>
The accompanying notes are an integral part of these statements.		

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Department of the Army Statement of Cash Flows For the Period Ended September 30, 1997 (Thousands)		
	<u>1997</u>	<u>1996</u>
CASH FLOWS FROM FINANCING ACTIVITIES, Continued		
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
	\$0	\$0
29. Net Cash Provided (Used) by Financing Activities	\$0	\$0
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	\$61,683	(\$96,065)
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	63,613	159,678
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	\$125,296	\$63,613
Supplemental Disclosure of Cash Flow Information:		
	<u>1997</u>	<u>1996</u>
33. Total Interest Paid	\$0	\$0
Supplemental Schedule of Financing and Investing Activity:		
	<u>1997</u>	<u>1996</u>
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
The accompanying notes are an integral part of these statements.		

DEPARTMENT OF THE ARMY

**NOTES TO THE
PRINCIPAL
FINANCIAL STATEMENTS**

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS****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 Department of the Army, as required by the Chief Financial Officers (CFO) Act, and other appropriate legislation. They have been prepared from the books and records of the Army in accordance with Department of Defense (DoD) guidance on the form and content of financial statements as adopted from Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," and subsequent issues. Consequently, these statements are different from the periodic accounting reports, also prepared by the Army pursuant to OMB directives, that are used to monitor and control DoD's use of budgetary resources.

The Army's financial statements are prepared from a consolidation of accounting information reported from multiple field level accounting systems as well as departmental level data input by the Defense Finance and Accounting Service (DFAS) - Indianapolis Center. This consolidated accounting data is maintained in the Headquarters Accounting and Reporting System (HQARS) departmental general ledger located at DFAS-IN.

General ledger account balances have been verified to the year-end departmental budget execution and expenditure reports. Department level budget execution reports are prepared from installation budget execution reports that are certified for accuracy and completeness by installation commanders. Other methods, to include feeder reports, must be used to verify the accuracy of general ledger balances in those instances where budget execution and expenditure reports don't contain the required information - for example, "Government Furnished Property".

B. Reporting Entity:

The Army's primary mission is to train and equip forces for the conduct of prompt and sustained combat operations on land. The accompanying audited financial statements account for all funds for which the Army is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified.

The accounts used to prepare the principal statements are classified as entity/non-entity and by type of fund. Entity accounts consist of resources that the agency has the authority to decide how to use, or where management is legally obligated to use funds to meet entity

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

obligations. Non-entity accounts are assets that are held by an entity but are not available for use in operations.

Designators with X, F, and R indicate availability for an indefinite period of time. Appropriations with a designator "*" are for a specific period of time.

Entity Accounts:**Revolving Funds**

21X4528 - Working Capital Fund, Army Conventional Ammunition

Trust Funds

21X8063 - Bequest of MG Fred C. Ainsworth, Library, Walter Reed Army Medical Center

21X8927 - General Gift Fund

General Funds

21*7020 - Military Construction, Family Housing

21*7025 - Operation & Maintenance, Family Housing

21*1705 - National Board for the Promotion of Rifle Practice, Army

21X1805 - Cemeterial Expenses, Army

21*2010 - Military Personnel, Army

21*2020 - Operations & Maintenance, Army

21*2031 - Aircraft Procurement, Army

21*2032 - Missile Procurement, Army

21*2033 - Procurement of Weapons and Tracked Combat Vehicles, Army

21*2034 - Procurement of Ammunition, Army

21*2035 - Other Procurement, Army

21*2040 - Research, Development, Test & Evaluation, Army

21*2050 - Military Construction, Army

21*2060 - National Guard Personnel, Army

21*2065 - Operations & Maintenance, Army National Guard

21*2070 - Reserve Personnel, Army

21*2080 - Operation & Maintenance, Army Reserve

21*2085 - Military Construction, Army National Guard

21*2086 - Military Construction, Army Reserve

Special Funds

21X5095 - Wildlife Conservation, etc., Military Reservations, Army

21X5098 - Restoration, Rocky Mountain Arsenal

21X5194 - DoD 50th Anniversary of World War II Commemoration Account

21X5285 - Forest and Wildlife Conservation, Military Reservations

21X5286 - National Science Center, Army

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 1B Continued**Non-Entity Accounts:****Deposit Funds****21X6001 - Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property-Army****21X6002 - Personal Funds of Deceased, Mentally Incompetent or Missing Personnel,
Army****21X6010 - Army Member Savings Deposit-Desert Shield/Desert Storm Savings Program****21X6031 - Effects of Mentally Incompetent Soldiers - United States Army****21X6050 - Employees' Payroll Allotment Account, United States Savings Bonds****21*6060 - Estates of Deceased Soldiers, Regular Army****21X6075 - Withheld Allotment of Compensation for Payment of Employees****Organization Dues****21X6083 - Withheld Allotment of Compensation for Charitable Contributions****21X6105 - Withheld Employee Contributions, State or Territorial Retirement****21X6108 - Employer Contributions, State or Territorial Retirement****21X6112 - Withheld Employee Contributions, State or Territorial Disability Benefits****21X6113 - Withheld Employee Contributions, State or Territorial Death Benefits****21X6129 - Foreign Taxes Withheld****21X6131 - Employee and Employer Contributions, Private Insurance Plans, Dept of the
Army****21X6134 - Amounts Withheld for Civilian Pay Allotments****21X6208 - Amounts Withheld for Group Life Insurance, National Guard Members****21X6275 - Withheld Income Taxes (State, County, City)****21X6434 - Servicemen's Group Life Insurance Funds, Suspense, Dept of the Army****21*6763 - Gains and Deficiencies on Exchange Transactions-Army****21X6875 - Budget Clearing Account (Misc.)****21X6999 - Accounts Payable, Check Issue Underdrafts****Special Funds (Receipt Accounts)****21R0891 - Miscellaneous Fees for Regulatory and Judicial Services not Otherwise
Classified****21R1020 - Fines, Penalties, and Forfeitures, Economic Stabilization Laws****21R1030 - Fines, Penalties, and Forfeitures, Immigration and Labor Laws****21R1060 - Forfeitures of Unclaimed Money and Property****21R1099 - Miscellaneous Fines, Penalties and Forfeitures****21R1125 - Recoveries Under Military Occupation****21R1210 - Contributions to Conscience Fund****21R1292 - Residue of Funds of Quasi-Governmental Organizations****21R1299 - Gifts--To the United States not otherwise classified**

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**Note 1B Continued**

- 21R2462 - Deposits for Survivor Annuity Benefits
- 21R3019 - Recoveries for Government Property Lost or Damaged, Not Otherwise Classified
- 21R3041 - Recoveries Under Foreign Aid Programs -- Foreign Military Sales
- 21R3102 - Recoveries From Federal Agencies Resulting for Reductions in Civilian Salaries of Military Retirees -
- 21R3200 - Collections of Receivables from Canceled Accounts
- 21R3210 - General Fund Miscellaneous Income and Recoveries not Otherwise Classified
- 21R3220 - General Fund Proprietorship Receipts
- 21R5095 - Sale of Hunting and Fishing Permits, Military Reservations
- 21R5098 - Restoration, Rocky Mountain Arsenal, Army-Reimbursements from Private Industry
- 21R5194 - Royalties for Use of DoD-Military Insignia and Trademarks
- 21R5285 - Forest and Wildlife Conservation, Military Reservations
- 21R5286 - National Science Center - Facilities
- 21R8063 - Bequest of MG Fred Ainsworth to Walter Reed Army Medical Center
- 21R8927 - Trust Fund Receipt Accounts for Department of the Army General Gift Fund

Special Funds

- 21F0109 - Federal Tax withheld from payments to nonresident aliens
- 21F3845 - Proceeds of Sales, Personal Property
- 21F3875 - Budget Clearing Account (Misc.)
- 21F3878 - Budget Clearing Account (Chargebacks)
- 21F3879 - Undistributed & Letter of Credit Differences (Suspense)
- 21F3880 - Unavailable Check Cancellations
- 21F3885 - Undistributed Intra-government Payments
- 21F3886 - Federal Employee Retirement System (FERS) - Thrift Savings Plan Account

C. Budgets and Budgetary Accounting:

The Assistant Secretary of the Army (Financial Management and Comptroller) is responsible for directing the Army's budget and monitoring its execution against funds appropriated by Congress. Funds are distributed by appropriation directors through major commands to installations responsible for accomplishing the diverse missions for which the Army is responsible. As missions are performed, installations report obligations and disbursements against the applicable appropriations.

The Army's appropriations are divided into the general, revolving, trust, special and deposit funds. These accounts are used to fund and report how the resources have been used in the course of executing the Army's missions.

General funds contain the bulk of Congressional appropriations, including personnel, operations, research and development, investment, and construction accounts.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

The Conventional Ammunition Working Capital Fund, a **revolving fund**, accounts for the procurement, production, storage, distribution, maintenance, and demilitarization of conventional ammunition for all services.

Trust funds are used to record the receipt of funds held in trust for the government. **Special funds** are comprised of receipt and expenditure accounts that can only be used in accordance with specific provisions of law. **Deposit funds** generally are used to hold assets that are awaiting legal determination or for which the Army acts as agent or custodian. These accounts may also be used for unidentified remittances.

D. Basis of Accounting:

Transactions are generally recorded on an accrual basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability has been incurred, without regard to the actual receipt or payment of cash. Budgetary accounting is accomplished through unique general ledger accounts which facilitate Army's compliance in meeting both legal and internal control requirements associated with the use of federal funds. All known intrafund balances have been eliminated.

E. Revenues and Other Financing Sources:

The Army receives the majority of funding required to support its programs and missions through Congressional appropriations. A financing source, "Appropriated Capital Used", is recognized each fiscal year to the extent that appropriated funds have been consumed. Purchases of capital items and accruals of unfunded liabilities are excluded from the "Appropriated Capital Used" account.

Appropriations are, when authorized, supplemented by revenues generated by sales of goods or services through a reimbursable order process. Revenue is recognized to the extent the revenue is payable to the Army from other federal agencies and the public as a result of costs incurred or services performed on their behalf. Revenue is recognized when earned under the reimbursable process. The Conventional Ammunition Working Capital Fund recognizes revenues at the point of delivery.

Other revenues and financing sources include donated revenue and inventory and other gains. Donations to the Army are recognized as a financial source upon acceptance of the donated asset. Revenue is recorded for the value of the increase to the asset account. Certain expenses, such as annual and military leave earned but not taken, are not funded when accrued. Such expenses are financed in the period in which payment is required. Therefore, for the Army's general funds, an amount due from future financing sources (appropriations to be provided) is recognized as an offset to equity in the Statement of Operations and Changes in Net Position.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

F. Accounting for Intra-governmental Activities:

The Army, as an agency of the Federal Government, interacts with and is dependent upon the financial activities of the Federal Government as a whole. However, it should be noted that these financial statements do not reflect the results of all financial decisions applicable to the Department as though the agency were a stand alone entity.

The Army's proportionate share of public debt and related expenses of the federal government are not included in the financial statements. Debt incurred by the federal government and the related interest are not apportioned to federal agencies. The Army's financial statements do not reflect any portion of the public debt or interest thereon, nor do the statements reflect the source of public financing (e.g. debt issuance, tax revenues). The related interest costs incurred in the construction of Army facilities are also not capitalized since Treasury does not allocate interest costs to the benefiting agencies.

The Army's permanent civilian employees and military personnel are covered under the Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS) and the Military Pay Retirement System (MRS) plans.

CSRS - Army makes matching contributions equal to 7 percent of civilian pay.

FERS - Army contributes to FERS, Social Security (SS) and Thrift Savings Plan for civilian employees hired after December 31, 1983, or CSRS employees that elected to be covered under FERS.

MRS - Army contributes to the Military Pay Retirement Fund for Active Component and Reserve/National Guard members.

The Army also contributes to the FERS Thrift Savings Plan on behalf of its participating employees. The following page shows Army's contributions to the retirement plans and FERS Thrift Savings Plan (TSP).

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

**Retirement Contributions
(Thousands)**

	<u>FY 97</u>
CSRS	\$263,774
FERS	385,635
MRS	3,985,444
Social Security	344,314
	<u>\$4,979,167</u>
TSP	\$ 132,282

The Army funds a portion of the pension benefits under these retirement plans. No amounts are reported as assets or liabilities in the Statement of Financial Position because the funds are maintained and reported by the Office of Personnel Management for CSRS and FERS; and DoD for MRS. Overseas commands obligate mission funds to pay separation and severance pay for Foreign Nationals in accordance with the Status of Forces Agreements.

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

The Army's funding resources are maintained in Treasury receipt and expenditure accounts. The account balance with Treasury represents the aggregate of all Army appropriations. The Army is an agent for the Department of the Treasury for cash on hand.

Fund Balance With Treasury is adjusted for the amount of undistributed disbursements and collections reported in the departmental expenditure system. A corresponding adjustment is also processed to both accounts payable and accounts receivable respectively. These adjustments represent Army's in-float (undistributed) disbursements/collections for transactions that have been reported by a disbursing station but not recorded by the appropriate accountable station. See Note 2, "Fund Balance with Treasury".

Cash in the accounts of Army officials was reported in the financial statements as "Cash and Other Monetary Assets". Other cash reported included imprest funds and undeposited collections. Army disbursing officers also maintain small on hand balances of foreign currencies when acting as an agent for the Treasury Department in overseas locations. These foreign currency balances are reported at the U.S. Dollar equivalent using the exchange rate in effect on the last day of the reporting period. See Note 3, "Cash, Foreign Currency, and Other Monetary Assets".

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**H. Foreign Currency:**

The Department conducts a significant portion of its operations overseas. Gains and losses from foreign currency fluctuations are computed as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of the fiscal year.

I. Accounts Receivable:

As presented in the Statement of Financial Position, accounts receivable includes accounts, claims, and refunds receivable from other entities. Allowances for uncollectible accounts are based on an analysis of collection experience by fund type. Accounts receivable are adjusted for the amount of undistributed collections reported in the departmental expenditure system. A corresponding adjustment is also processed to Fund Balance With Treasury. These transactions represent the Army's in-float (undistributed) collections for transactions that were reported by a disbursing station but not recorded by the appropriate accountable station. Accounts Receivable that were established under accounts that have been canceled are immaterial in amount and are therefore excluded from these financial statements. See Note 5, "Accounts Receivable, Net".

J. Loans Receivable: Not applicable

K. Inventory:

Currently, inventory is not recorded in the financial statements at the approximate historical cost in accordance with Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property". Instead, inventory is valued at a standard price (sale price) which includes the purchase price plus cost recovery factors (commonly called surcharges) necessary to recover operating costs and anticipated inflation rate changes. Gains or losses that result from valuation changes for inventory are not recognized and reported in the Statement of Operations. Such gains or losses are, however, reflected in the inventory asset valuation and related invested capital account in the Statement of Financial Position. See Note 8, "Inventory, Net".

L. Investments in U.S. Government Securities:

Investments in U.S. Government securities are reported at cost, net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment. The reporting entity's intent is to hold investments to maturity. Consequently, no provision is made for unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity. See Note 4, "Investments, Net".

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**M. Property, Plant and Equipment:**

Property, Plant and Equipment (PP&E) represents the majority of total assets recorded on the Statement of Financial Position. Property accountability systems maintain the subsidiary records that support the general ledger balances as recorded in the financial accounting systems. Property book officers generally report PP&E end of period balances to the supporting accounting offices on a quarterly basis.

Current DoD financial capitalization policy requires that assets previously capitalized at lower thresholds - \$5,000 prior to FY 91; \$15,000 from FY 91 - FY 93; \$25,000 in 1994; \$50,000 in 1995; and \$100,000 in 1996 - remain in the PP&E accounts subsequent to the raising of capitalization thresholds. Most of the Army's property accountability systems can't comply with financial capitalization reporting requirements. Consequently, these systems are generally using the current \$100,000 capitalization threshold criteria for items having an estimated useful life of two or more years, regardless of when acquired.

Real property comprising land, buildings, and other facilities is valued using historical costs. The asset capitalization threshold was generally applied to the total costs (acquisition and capital improvements) of each facility supported by the Army's primary real property accountability system, the Integrated Facilities System. The other real property system generally reported asset costs in excess of \$25,000. Personal property (military equipment) is generally valued using latest acquisition costs or standard prices. During FY 97, Office of Under Secretary of Defense (Comptroller) and DoD Agencies, with the help of the Army Audit Agency, developed an interim approach to the valuation of natural resources. An interim solution is required until further guidance is promulgated by the FASAB. In past years, Army recorded the value of standing timber without regard to whether the timber would ever be harvested. Army recorded \$1.7 Billion in the Natural Resources Account for FY 96. However, in FY 97, only installations with commercial timber programs were instructed to submit the estimated value of FY 98 timber sales. The change in the method of estimating timber values resulted from an agreement reached between auditors and management and satisfied a prior year audit recommendation. Consequently, the value of Natural Resources reported for FY 97 is significantly smaller than reflected in previous CFO Reports. The FY 97 value was determined by multiplying planned volumes of forest products to be sold in FY 98 by the estimated market value of the forest products. Planned volumes are developed from adjusted Integrated Natural Resources Management Plans. Market values are estimated regionally using trade journals, market research, and projected business cycles.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

New buildings are capitalized upon acceptance by the installation. Gains or losses from transfer of assets or liabilities between agencies are not recognized, except when assets are transferred to the Base Realignment and Closure Account. This account is not allowed to accumulate gains or losses on disposal. Any gain or loss must be transferred back to the original/losing command.

Government furnished material and property (GFM/GFP) are reported quarterly in the departmental general ledger. Contractors are required to maintain accountable records for GFM/GFP. The contractor data is used to supplement the general ledger balances. Land and buildings also include amounts for real property in the hands of contractors.

No gains or losses were recognized in the Statement of Operations for revaluation changes and/or the loss of equipment. However, the assets and related investment accounts do reflect both pricing and value changes based on a periodic update to the general ledger. Depreciation is not currently recorded for assets financed by general fund appropriations because the property systems were not originally developed to provide this data. DoD is in the process of addressing this reporting deficiency. Routine maintenance and repair costs are expensed when incurred. See Note 15, "Property, Plant and Equipment".

N. Prepaid and Deferred Charges:

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and reported as an asset on the Statement of Financial Position. Prepaid charges are recognized as expenditures and expenses when the related goods and services are received.

O. Leases:

As of September 30, 1997, the Army was committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for the rental of equipment, space, rights of way, and operating facilities. The Army owns substantially all of the facilities and real property used in its domestic operations. Capital assets overseas are purchased with appropriated funds; however, title is retained by the host country.

Real property assets at overseas locations are classified as Capital Leases in accordance with DoD accounting policy. The policy requires that real property assets recorded under foreign government agreements permitting DoD occupancy of facilities - which require maintenance to be provided by DoD - be recorded as a capital lease. These "capital leases" do not fit the criteria of a typical capital lease due to the nature of the agreements with foreign governments and the fact that the assets have already been funded and disbursements have already been made out of appropriated funds. Consequently, no capital lease liability related to overseas real property assets is required for financial statement recognition. See also Note 18.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**P. Contingencies:**

Most legal actions, other than contract claims, to which the Department may be a named party are covered by the provisions of the federal tort claims act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the Department's appropriations or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the Army's operations or financial position.

Q. Accrued Leave:

Civilian annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for annual and military accrued leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of nonvested leave are expensed as taken. To the extent appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources.

R. Equity:

Equity consists of invested capital, cumulative results of operation, and unexpended appropriations less unfunded liabilities. Invested capital, as presented in the Statement of Financial Position, represents the value of the Army's capital assets reported at average or actual cost. The portion of invested capital attributable to land and buildings represents their undepreciated cost. Increases to invested capital are recorded when capital assets are acquired or constructed or when asset valuations increase as a result of increases in average costs. Decreases occur as capital assets are consumed in operations, or when average costs are decreased.

Cumulative results of operation represents the excess of revenues over expenses since fund inception, less refunds and returns to the U.S. Treasury for all funds other than the General Fund. The excess of revenues over expenses for the General Fund is reported in "Invested Capital". Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which neither legal liabilities for payments have been incurred nor actual payments made.

S. Aircraft/Ship Crashes: Not applicable to Army

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T. Treaties for Use of Foreign Bases:

The Army has the use of land, buildings, and other facilities which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the Army continued use of these properties until the treaties expire. These assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Army. In the event treaties or other agreements are terminated and use of foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets after negotiations between the United States and the host country have been concluded, to determine the amount due the United States for such capital investments. Operating expenses for overseas bases are included in the Statement of Operations.

U. Comparative Data:

Comparative data from FY 96 has been included in the Army's FY 97 Principal Statements. Army's financial statements will continue to reflect restatements and reclassifications due to the evolving nature of federal accounting standards and the development of new reporting financial systems. Restatement of lines 1.d. and 1.l. resulted from new DoD guidance relating to reclassification of War Reserve Materials from the "Inventory, Net" line to a new line entitled "War Reserves."

Statement of Financial Position:

(Thousands)			
<u>FY 96 Line</u>	<u>FY 96 Balance</u>	<u>Change</u>	<u>FY 96 Restated</u>
1.d.	\$37,669,779	(\$35,769,856)	\$ 1,899,923
1.l	\$0	\$35,769,856	\$35,769,856

V. Undelivered Orders:

The Army was obligated to pay for undelivered orders (goods and services that have been ordered but not yet received) amounting to \$28.1 Billion at fiscal year-end. No liability for payment has been established in the financial statements because goods/services have yet to be delivered.

Note 2. Fund Balances with Treasury:

This account balance represents the aggregate of all Army appropriations. The schedule below identifies, by fund type, the status of the resources maintained in the Treasury accounts.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Amounts that have been restricted by Congress, OMB, Treasury or DoD have been separately identified. Special, Deposit, and Receipt account balances have been consolidated into "Other Fund Types".

A. Fund and Account Balances

(Thousands)	Entity Assets				Total
	Trust Funds	Revolving Funds	Appropriated Funds	Other Fund Types	
Unobligated Balance Available:					
Available	\$580	\$108,752	\$3,664,820	\$102,704	\$3,876,856
Restricted	89	16,544	1,029,151	0	1,045,784
Reserve For Anticipated Resources	0	0	0	0	0
Obligated (but not expensed)	0	0	25,837,928	1,093	25,839,021
Unfunded Contract Authority	0	0	(122,999)	0	(122,999)
Unused Borrowing Authority	0	0	0	0	0
Treasury Balance	<u>\$669</u>	<u>\$125,296</u>	<u>\$30,408,900</u>	<u>\$103,797</u>	<u>\$30,638,662</u>

B. Other Information. As of 30 September, 1997, there were a significant number of aged unresolved check issue discrepancies between the records of Treasury and Army. As a result, Fund Balance with Treasury is misstated by an indeterminate amount. The amount, as provided by Treasury, includes discrepancies caused by numerous events. Potential loss of funds result from the holder of the check altering the amount causing the negotiated amount to differ from the reported amount. Additionally, checks may be written by the Disbursing Office for an amount differing from the prepared disbursing voucher authorizing the payment. These categories of check issue discrepancies are considered to be immaterial in amount. Check issue discrepancy reports are prepared by Treasury based on a comparison of monthly accountability reports (showing dollar amount of checks issued) against monthly check issuance reports (showing check issue by serial number and amount). Discrepancies can arise when the accounting business month used by the Disbursing Office has a cut-off that differs from the calendar month used for the check issuance report. Early accounting cut-offs were common in the past and account for a significant number of the aged discrepancies. Early cut-offs were necessary due to the manually intensive processes required for closing out the monthly business. Improvements in accounting and disbursing systems now allow business to be conducted up to the last day of the month, thereby minimizing the occurrence of this timing problem. Another major cause of the aged discrepancies resulted from incomplete check issue reporting by the field Disbursing Offices to the Treasury. Technical advances made in the check issue reporting process have significantly enhanced the ability of the financial community to monitor and initiate research in a more timely fashion than was possible in the past.

ANNEX B**FINANCIAL STATEMENTS AND NOTES—UNAUDITED**

The fund balances of canceled and closed accounts in the amount of \$3.5 Billion have been reopened for the processing of accounting adjustments. Balances related to the reopened canceled and closed accounts have no effect on these financial statements and have been disclosed for information purposes only.

(Thousands)	<u>Non-Entity Assets</u>
Beginning Balance	(\$134,337)
Funds Collected	24,728,743
Funds Disbursed	<u>(24,381,042)</u>
Ending Balance	<u>\$213,364</u>

Note 3. Cash, Foreign Currency, and Other Monetary Assets:

(Thousands)	<u>Entity Assets</u>	<u>Non-Entity Assets</u>
A. Cash	\$5,933	\$164,069
B. Foreign Currency	18,747	0
C. Other Monetary Assets:		
(1) Gold	0	0
(2) Special Drawing Rights	0	0
(3) U.S Reserves in the Inter- national Monetary Fund	0	0
(4) Other	<u>0</u>	<u>0</u>
(5) Total Other Monetary Assets	<u>0</u>	<u>0</u>
D. Total Cash, Foreign Currency and Other Monetary Assets	<u>\$24,680</u>	<u>\$164,069</u>

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 4. Investments, Net:

The Army Gift Fund was established to control and account for the disbursement and use of monies donated to the Army and the receipt of interest arising from investment of such donations. The related earnings are allocated to appropriate Army activities to be used in accordance with the directions of the donor. As of September 30, 1997, the Army reported \$1 Million of investments.

(Thousands)	(1) <u>Cost</u>	(2) <u>Market Value</u>	(3) <u>Amorti- zation Method</u>	(4) <u>Amortized Premium/ (Discount)</u>	(5) <u>Investments Net</u>
A. Intragovernmental Securities:					
(1) Marketable	\$1,010	\$0	_____	\$0	\$1,010
(2) Non-Marketable Par Value	0	0	_____	0	0
(3) Non-Marketable Market Based	0	0	_____	0	0
Subtotal	<u>\$1,010</u>	<u>\$0</u>		<u>\$0</u>	<u>\$1,010</u>
B. Governmental Securities:					
(1) _____	\$0	\$0		\$0	\$0
(2) _____	0	0		0	0
(3) _____	0	0		0	0
Subtotal	<u>\$0</u>	<u>\$0</u>		<u>\$0</u>	<u>\$0</u>
Total	<u>\$1,010</u>	<u>\$0</u>		<u>\$0</u>	<u>\$1,010</u>

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 5. Accounts Receivable, Net:

Accounts Receivable include all receivables due from federal and non-federal sources, net of allowance for estimated uncollectible accounts. The allowance for uncollectible accounts was based on an analysis of collection experience by fund type for current and noncurrent receivables.

(Thousands)	(1) Gross Amount Due	(2) Allowance For Estimated Uncollectibles	(3) Allowance Method Used	(4) Net Amount Due
A. Entity Receivables:				
Intragovernmental	\$1,146,531	\$0	_____	\$1,146,531
Governmental	229,823	100,764	_____	129,059
B. Non-Entity Receivables:				
Intragovernmental	\$0	\$0	_____	\$0
Governmental	62,638	456	_____	62,182

C. Other Information: Accounts receivable include reimbursements receivable and refunds receivable such as out-of-service debts from former service members, contractor debt and unused travel tickets.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets:

Army has no activity in this asset category.

Note 7. Loans and Loan Guarantees, Non-Federal Borrowers: Not applicable to Army's Financial Statements.

Note 8. Inventory, Net:

Inventory held for current sales is contained in the revolving fund, Conventional Ammunition Working Capital Fund (CAWCF). "Inventory, Net" includes FY 1997, CAWCF adjustments for unserviceable, excess and obsolete inventory. The adjustments were based on "purpose codes" that identify the condition of the asset. The FY 96 Financial Statements included War Reserve Material as a component of Inventory in accordance with DoD guidance. However, FY 97 DoD guidance now requires that War Reserve Material be reported separately in the Statement of Financial Position. This change in classification accounts for the significant decrease of the FY 97 Inventory line over last year's CFO reported values. The components of the Army's inventory are shown on the following page. See also Note 31.

Note 8. Inventory, Net (Continued):

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

(Thousands)	(1) Inventory Amount	(2) Allowance For Losses	(3) Inventory, Net	(4) Valuation Method
A. Inventory Categories:				
(1) Held for Current Sale	\$1,547,622	\$35,757	\$1,511,865	Latest Acquisition Cost
(2) Held in Reserve for Future Sale	0	0	0	
(3) Excess, Obsolete and Unserviceable	14,724	0	14,724	
(4) Held for Repair	0	0	0	
Total	<u>\$1,562,346</u>	<u>\$35,757</u>	<u>\$1,526,589</u>	

Note 9. Work in Process: DoD guidance does not provide for work in process for General Fund statements.

Note 10. Operating Materials and Supplies (OM&S), Net: Does not apply to Army General Fund financial statements.

Note 11. Stockpile Materials, Net: Not applicable to Army General Fund financial statements.

Note 12. Seized Property: Not applicable to Army General Fund financial statements.

Note 13. Forfeited Property, Net: Not applicable to Army General Fund financial statements.

Note 14. Goods Held Under Price Support and Stabilization Programs, Net: Not applicable to Army General Fund financial statements.

ANNEX B

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 15. Property, Plant and Equipment, Net:

(Thousands)	(1) Depreci- ation Method	(2) Service Life	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
<u>Classes of Fixed Assets</u>					
A. Land	N/A	_____	\$614,530	\$0	\$614,530
B. Structures, Facilities, & Leasehold Improvements	N/A	_____	33,637,032	0	33,637,032
C. Military Equipment	N/A	_____	86,191,487	0	86,191,487
D. ADP Software	N/A	_____	6,986	0	6,986
E. Equipment	N/A	_____	0	0	0
F. Assets Under Capital Lease	N/A	_____	4,809,559	0	4,809,559
G. Other	N/A	_____	45,226	0	45,226
H. Natural Resources	N/A	_____	17,223	0	17,223
I. Construction-in-Progress	N/A	_____	6,708,693	0	6,708,693
Total			\$132,030,736	\$0	\$132,030,736

Depreciation is not currently recorded for assets financed by general fund appropriations because the property systems were not originally developed to provide this data. DoD is in the process of addressing this reporting deficiency. Real property assets at overseas locations are classified as Capital Leases in accordance with DoD accounting policy. The policy requires that real property assets recorded under foreign government agreements permitting DoD occupancy of facilities - which require maintenance to be provided by DoD - be recorded as a capital lease. These "capital leases" do not fit the criteria of a typical capital lease due to the nature of the agreements with foreign governments. Consequently, no capital lease liability has been established. See also Note 18.

The reduction of "Natural Resources" is based on the revised method of calculating the value of timber reserves reported in the financial statements. FY 97 values are based only on the number of board feet planned to be sold in FY 98. FY 96 reported values were based on the total board feet estimated to exist on Army property without regard for whether the timber would ever be harvested. See also Note 1.M.

Government furnished material and property (GFM/GFP) are reported quarterly in the departmental general ledger. Contractors are also required to maintain accountable records

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

for GFM/GFP. The contractor data is used to supplement the general ledger balances. Balances reported in this asset category include items related to the Working Capital Fund (WCF). A practical method for breaking out WCF and non-WCF GFM/GFP balances has not been developed. However, WCF amounts included in the GFM/GFP values are believed to be immaterial to the balances reported in the financial statement line "Property, Plant and Equipment".

Note 16. Debt:

The Army's proportionate share of public debt and related expenses of the federal government are not included in the financial statements. Debt incurred by the federal government and the related interest are not apportioned to federal agencies. The Army's financial statements do not reflect any portion of the public debt or interest thereon, nor do the statements reflect the source of public financing (e.g. debt issuance, tax revenues). The related interest costs incurred in the construction of Army facilities are also not capitalized since Treasury does not allocate interest costs to the benefiting agencies.

Note 17. Other Liabilities:

The schedule on the following page shows those liabilities that will be liquidated with funds that have already been received (Covered by Budgetary Resources) as well as those liabilities that will have to be funded with future appropriations (Not Covered by Budgetary Resources). Additionally, components making up the balances in "Other Liabilities" are further segregated by source and include "Other Federal" (Intragovernmental) and "Non-Federal" (Governmental).

The FY 97 value for Line 4a.(4) "Other Intragovernmental Liabilities" is significantly higher than FY 96. This apparent increase is due primarily to the impact of an abnormal balance reported last year in an Army deposit fund. The abnormal balance reported in the FY 96 CFO Report was the result of erroneous postings of cross disbursement transactions (payments and collections made by another DoD entity citing Army appropriations).

Legal actions brought by employees of the Army for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the Department of Labor (DOL). DOL bills Army annually as DOL claims are paid. However, payment on these bills is deferred two years to allow for funding through the budget process. Army has recorded \$337 Million for DOL bills that, while received, are not yet payable out of current appropriations.

ANNEX B

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

A. Other Liabilities Covered by Budgetary Resources: (Thousands)

	<u>Noncurrent Liability</u>	<u>Current Liability</u>	<u>Total</u>
1. Intragovernmental			
(a) Unearned Revenue, Advances	\$0	\$736,555	\$736,555
(b) Treasury Cash Advances	0	190,525	190,525
(c) Deposit Fund Liabilities	0	572,580	572,580
Total	<u>\$0</u>	<u>\$1,499,660</u>	<u>\$1,499,660</u>

	<u>Noncurrent Liability</u>	<u>Current Liability</u>	<u>Total</u>
2. Governmental			
(a) Unearned Revenue, Advances	\$0	\$255,596	\$255,596
(b) Deferred Credits	0	63,486	63,486
(c) _____	0	0	0
Total	<u>\$0</u>	<u>\$319,082</u>	<u>\$319,082</u>

B. Other Information:

C. Other Liabilities Not Covered by Budgetary Resources:

	<u>Noncurrent Liability</u>	<u>Current Liability</u>	<u>Total</u>
1. Intragovernmental			
(a) Canceled Budget Authority	\$0	\$0	\$0
(b) FECA	0	337,434	337,434
Total	<u>\$0</u>	<u>\$337,434</u>	<u>\$337,434</u>

	<u>Noncurrent Liability</u>	<u>Current Liability</u>	<u>Total</u>
2. Governmental			
(a) Canceled Budget Authority	\$0	\$1,352	\$1,352
(b) Accrued Annual Leave, Civ Unfunde	0	729,121	729,121
(c) Accrued Annual Leave, Mil Unfunde	0	319,283	319,283
(d) Other	0	26,662,399	26,662,399
Total	<u>\$0</u>	<u>\$27,712,155</u>	<u>\$27,712,155</u>

D. Other Information:

The following schedule provides a breakout showing the various liabilities that account for the majority of recorded "Other Non-Federal (Governmental) Liabilities" not covered by budgetary resources. Liabilities relating to Chemical Demil and Environmental Restoration-BRAC Programs were not recognized in previous CFO Reports. Effective FY 97, Statement

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of Federal Financial Accounting Standards (SFFAS) Number 5 requires these liabilities be recorded in the records of Army.

(Thousands)

Chemical Demil Program Stockpile	9,500,000
Chemical Demil Program Non-Stockpile	1,100,000
Environmental Restoration	6,117,000
Environmental Restoration-FUDS	7,700,000
Environmental Restoration-BRAC	972,000
Low Level Radioactive Waste Cleanup	169,514
Overseas Restructure/Downsizing-Panama	202,400

- **Environmental Compliance/Restoration** - Liabilities for the Army's Environmental Program are primarily comprised of estimates to clean up contamination at Army installations.

- **Radioactive Waste** - Liabilities are recognized or disclosed as a result of having to correct the results of improper handling and disposal of low level radioactive waste.

- **Restructuring** - Anticipated costs relating to the movement of troops, material and equipment in connection with consolidation of missions and the turnover of facilities.

Note 18. Leases:

As of September 30, 1997, the Army was committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for the rental of equipment, space, rights of way, and operating facilities. Real property assets at overseas locations are classified as Capital Leases in accordance with DoD accounting policy. The policy requires that real property assets recorded under foreign government agreements permitting DoD occupancy of facilities - which require maintenance to be provided by DoD - be recorded as a capital lease. These assets will revert to foreign ownership once the treaties expire. The schedules on the following page pertain to Operating and Capital Leases for Section 801 family housing leases (privately owned housing leased by the Army).

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Capital Leases - Section 801 Family Housing (Rounded to Dollars)

Future Payments Due by Fiscal Year:	
1998	\$ 20,784,925
1999	20,784,925
2000	20,784,925
2001 -	20,784,925
2002	20,784,925
After 5 Years	128,620,599
Total Future Lease Payments	\$232,545,224
Less: Estimated Executory Costs ¹	(39,753,982)
Less: Imputed Interest ²	(68,517,765)
Net Capital Lease Liability	\$124,273,477

¹ Future executory costs were based on the FY 97 actual executory costs.

² Amount necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases.

Operating Leases - Section 801 Family Housing (Rounded to Dollars)

Future Payments Due by Fiscal Year	
1998	\$ 16,369,424
1999	16,369,424
2000	16,369,424
2001	16,369,424
2002	16,369,424
After 5 Years	97,948,049
Total Future Lease Payments	\$179,795,169

Note 19. Pensions and Other Actuarial Liabilities:

Future workers' compensation figures are provided by the Department of Labor. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's, June 10, 1997 economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5 and thereafter</u>
6.24%	5.82%	5.60%	5.45%	5.40%

The amount of unfunded FECA liability accrued as of September 30, 1997 was \$1.5 Billion. A corresponding amount has been established as a future funding requirement.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**Note 20. Net Position:**

Net Position is comprised of the following components:

Unexpended appropriations - amount of budget authority remaining for disbursement against current or future obligations. Unobligated balances are classified as available or unavailable. Certain unobligated balances are restricted for future use and are not available for current use. "Undelivered Orders" represent those goods and services that have not yet been received/performed. Multi-year appropriations remain available to the Army for obligation in future periods. However, unobligated balances associated with appropriations expiring at fiscal year end remain available only for obligation adjustments until the account is closed. Generally speaking, accounts close five years after the appropriation expires.

Invested capital - represents the net investment of the Government in the Army. Includes the initial investment and subsequent appropriations to finance program activities and the net balance of assets and liabilities that have been transferred in and out from/to DoD Components or other U.S. Government Agencies without reimbursement. Also, for General fund appropriations, includes the cumulative net difference between (1) expenses and losses and (2) financing sources to include appropriations, revenues and gains.

Cumulative results of operations - represents the cumulative net difference between (1) expenses and losses and (2) financing sources (includes appropriations, revenues and gains) of the Trust, Revolving, and Special Funds.

Other - represents other components of net position not specifically identified above. In prior years, Army financial statements showed balances in this account relating to miscellaneous receipts. Guidance from the Department of the Treasury requires the miscellaneous receipt balances to be excluded from Army's "Net Position" since the receipts are considered withdrawn by Treasury immediately upon collection.

Future Funding Requirements - Accrued expenses such as annual and military leave earned but not taken are not funded in the period the expense is recorded. These future funding requirements are recognized as an offset to "Net Position".

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Net position is presented in the following table by fund type. "Other" fund types have been included in the "Appropriated Funds" column.

(Thousands)	<u>Revolving Funds</u>	<u>Trust Funds</u>	<u>Appro- priated Funds</u>	<u>Total</u>
A. Unexpended				
Appropriations:				
(1) Unobligated,				
a. Available	\$0	\$580	\$3,767,525	\$3,768,105
b. Unavailable	0	0	906,152	906,152
(2) Undelivered Orders	0	4	22,612,020	22,612,024
B. Invested Capital	42,720	1,010	181,549,011	181,592,741
C. Cumulative Results				
of Operations	274,038	0	(675,573)	(401,535)
D. Other	0	0	0	0
E. Future Funding				
Requirements	0	0	(29,655,931)	(29,655,931)
F. Total	<u>\$316,758</u>	<u>\$1,594</u>	<u>\$178,503,204</u>	<u>\$178,821,556</u>

A breakout of line (E) from the schedule above follows. Also see Note 17 for additional information on "Other Governmental Liabilities".

FUTURE FUNDING REQUIREMENTS

(Thousands)

Other Governmental Liabilities	26,662,397
Annual Leave	1,048,404
Workman's Comp. and Medical Claims	337,434
Actuarial Liability for Federal Employees -	
Future Workman's Comp Benefits	1,482,069
Canceled Budget Authority (A/P)	1,353
Capital Lease Liability	124,273
Other	2
Total	<u>\$29,655,931</u>

Note 21. Taxes: Not applicable

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Note 22. Other Revenue and Financing Sources:

(Thousands)	<u>1997</u>	<u>1996</u>
A. Other Revenues and Financing Sources:		
(1) Investment Gains	\$0	\$212
(2) Miscellaneous Reimbursements	2,333,553	471,448
(3) Inventory Gains	0	457,944
Total	<u>\$2,333,553</u>	<u>\$929,604</u>

B. Other Information:

Statement of Federal Financial Accounting Standards (SFFAS) Number 5 established accounting and reporting standards for liabilities relating to the Federal employee benefit programs (Retirement, Health Benefits and Life Insurance). The adoption of SFFAS-5 is required for FY 97 and results in a significant increase of "Other Revenues and Financing Sources" over previous reporting years. The imputed pension and Other Retirement Benefits (ORB) recorded in Miscellaneous Reimbursements follows:

	(Thousands)
CSRS/FERS Retirement	\$1,257,285
Health	\$ 375,600
Life Insurance	\$ 1,374

The Office of Personnel Management (OPM) is the administrative entity for pensions and other retirement benefits (ORB). OPM accounts for and reports the pension liability in the financial statements while the employer discloses the imputed financing. OPM actuaries provide the normal cost rates which are used to calculate the imputed financing.

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FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 23. Program or Operating Expenses:

(Thousands)	<u>1997</u>	<u>1996</u>
A. Operating Expenses by Object Classification:		
(1) Personal Services and Benefits	\$33,321,413	\$31,612,018
(2) Travel and Transportation	2,324,235	2,947,507
(3) Rental, Communication and Utilities	1,454,370	1,300,032
(4) Printing and Reproduction	93,722	86,056
(5) Contractual Services	14,411,961	15,518,590
(6) Supplies and Materials	3,757,376	4,442,067
(7) Equipment not Capitalized	513,850	476,632
(8) Grants, Subsidies and Contributions	130,511	123,212
(9) Insurance Claims and Indemnities	55,455	69,361
(10) Other (describe):		
(a) Annual Leave Expense	1,554,068	1,213,528
(11) Total Expenses by Object Class	<u>\$57,616,961</u>	<u>\$57,789,003</u>
	<u>1997</u>	<u>1996</u>
B. Operating Expenses by Program:		
(1) Revolving Fund	\$137,379	\$184,226
(2) General Fund	57,479,343	57,604,657
(3) Trust Fund	239	120
(4) Unallocated Expense	0	0
Totals	<u>\$57,616,961</u>	<u>\$57,789,003</u>

Note 24. Cost of Goods Sold:

(Thousands)	<u>1997</u>	<u>1996</u>
Public	\$497,750	\$627,185
Intragovernmental	5,384,010	5,552,691
	<u>\$5,881,760</u>	<u>\$6,179,876</u>

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 25. Other Expenses:

The adoption of SFFAS-5 is required for FY 97 and results in a significant increase of "Other Expenses" over previous reporting years. Period expenses are now required to be recorded on the Army's statements for costs associated with the pension, health benefits, and life insurance programs. The following represents the imputed expense for pensions and Other Retirement Benefits (ORB) recorded in FY 97:

	(Thousands)
CSRS/FERS Retirement	\$1,257,285
Health	\$ 375,600
Life Insurance	\$ 1,374

The Office of Personnel Management (OPM) is the administrative entity for pensions and other retirement benefits (ORB). OPM accounts for and reports the pension liability in the financial statements while the employer discloses the imputed expenses. OPM actuaries provide the normal cost rates which are used to calculate the imputed expenses. See also Note 22.

(Thousands)	<u>1997</u>	<u>1996</u>
A. Other Expenses:		
(1) Losses on Disposition of Assets	\$13	\$0
(2) Inventory Losses or Adjustments	12,509	733,513
(3) Other Miscellaneous Losses	1,405	1,623
(4) Other Expenses	1,871,162	
Total	<u>\$1,885,089</u>	<u>\$735,136</u>

Note 26. Extraordinary Items: Not applicable

Note 27. Prior Period Adjustments: Statement of Federal Financial Accounting Standard Number Six "Property, Plant, and Equipment", requires that the offsetting charges against liabilities recognized for environmental cleanup costs are to be recorded as a prior period adjustment. Accordingly, Army has recorded prior period adjustments of \$15.1 Billion in FY 97 for estimated liabilities relating to cleanup costs.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

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

	<u>1997</u>	<u>1996</u>
A. Increases:		
(1) Transfers-In:	\$34,574,194	(\$2,811,700)
(2) Unexpended Appropriations	(175,574)	(504,258)
(3) Donations Received	0	0
(4) Other Increases	15,095,046	773,655
(5) Total Increases	\$49,493,666	(\$2,542,303)
B. Decreases:		
(1) Transfers-Out:	\$21,142,151	\$12,586,930
(2) Donations	0	0
(3) Other Decreases	9,460,375	4,264,858
(4) Total Decreases	\$30,602,526	\$16,851,788
C. Net Non-Operating Changes (Transfers)	\$18,891,140	(\$19,394,091)

Note 29. Intrafund Eliminations:

The schedules on the following pages show the values of the transactions that were required to be eliminated from the Statement of Financial Position and the Statement of Operations (and Changes in Net Position) since they represented activity between Army appropriations or activity with other DoD and Federal entities.

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Schedule A. Records sales within the General Fund activity by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity.

Selling Activity:	<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
	Accounts Receivable	Revenue	Unearned Revenue	Collections
Operation and Maintenance	\$495,323	\$2,707,696	\$0	\$2,632,459
Procurement	\$7,198	\$70,030	\$0	\$65,647
Research and Development	\$87,645	\$791,773	\$0	\$777,019
Military Construction	\$43,674	\$950,023	\$0	\$1,009,315
Other funds and accounts	\$150,776	\$946,296	\$0	\$728,048
Unearned Revenue	\$0	\$0	\$568,935	\$0
Total	<u>\$784,616</u>	<u>\$5,465,818</u>	<u>\$568,935</u>	<u>\$5,212,488</u>
Customer Activity:	<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
	Accounts Payable	Expenses	Advances	Disbursements
Operation and Maintenance	\$495,323	\$2,707,696	\$0	\$2,632,459
Procurement	\$7,198	\$70,030	\$0	\$65,647
Research and Development	\$87,645	\$791,773	\$0	\$777,019
Military Construction	\$43,674	\$950,023	\$0	\$1,009,315
Other funds and accounts	\$150,776	\$946,296	\$0	\$728,048
Advances	\$0	\$0	\$623,592	\$0
Total	<u>\$784,616</u>	<u>\$5,465,818</u>	<u>\$568,935</u>	<u>\$5,212,488</u>

Schedule B. Not applicable

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 29. Intrafund Eliminations (Con't):

Schedule C. Records sales or services between the Army and other DoD reporting entities by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity.

Selling Activity:	<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
	Accounts Receivable	Revenue	Unearned Revenue	Collections
Department of the Army	\$640,818	\$4,772,171	N/A	\$4,787,243
Unearned Revenue	\$0	\$0	\$627,573	\$0
Total	<u>\$640,818</u>	<u>\$4,772,171</u>	<u>\$627,573</u>	<u>\$4,787,243</u>
Customer Activity:	<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
	Accounts Payable	Expenses	Advances	Disbursements
Department of the Army	\$0	\$0	N/A	\$0
Department of the Navy	\$80,609	\$527,657	N/A	\$500,929
Department of the Air Force	\$83,574	\$690,638	N/A	\$711,772
Army WCF	\$24,672	\$268,121	N/A	\$273,001
Navy WCF	\$15,759	\$56,242	N/A	\$52,191
Air Force WCF	\$553	\$11,173	N/A	\$11,725
DLA WCF	\$13,340	\$84,205	N/A	\$95,083
DISA WCF	\$2,698	\$8,243	N/A	\$8,007
DFAS WCF	\$40,822	\$74,508	N/A	\$89,224
DeCA WCF	\$15,690	\$39,961	N/A	\$36,660
JLSC WCF	\$7,453	\$3,167	N/A	(\$3,793)
Other WCF	\$13,739	\$91,441	N/A	\$90,632
U.S. TRANSCOM WCF	\$2,916	\$30,675	N/A	\$39,055
DoD Military Retirement Trust Fun	\$0	\$0	N/A	\$0
National Defense Stockpile	\$0	\$0	N/A	\$0
U.S. Army Corps of Engineers	\$13,949	\$43,651	N/A	\$39,962
Other Defense Organizations	\$325,044	\$2,842,489	N/A	\$2,842,795
Advances	\$0	\$0	\$627,573	\$0
Total	<u>\$640,818</u>	<u>\$4,772,171</u>	<u>\$627,573</u>	<u>\$4,787,243</u>

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

Note 29. Intrafund Eliminations (Con't):

Schedule D. Records sales or services between the Army and other Federal reporting entities by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity.

Selling Activity:	<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
	Accounts Receivable	Revenue	Unearned Revenue	Collections
Department of the Army	\$227,687	\$322,705	n/a	\$198,967
Unearned Revenue	\$0	\$0	\$7,021	\$0
Total	<u>\$227,687</u>	<u>\$322,705</u>	<u>\$7,021</u>	<u>\$198,967</u>
Customer Activity:	<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
	Accounts Payable	Expenses	Advances	Disbursements
Defense Security Assistance Agency	\$0	\$0	n/a	\$0
General Services Administration	\$141,451	\$181,087	n/a	\$81,050
Interior	\$552	\$1,117	n/a	\$1,264
NASA	\$14,271	\$29,815	n/a	\$29,898
State	\$2,409	\$4,749	n/a	\$4,371
Transportation	\$14,181	\$13,020	n/a	\$7,274
Veterans Affairs	\$1,028	\$2,635	n/a	\$170
Dept of Commerce	\$1,934	\$524	n/a	\$489
Dept of Treasury	\$4,175	\$11,893	n/a	\$12,130
Dept of Justice	\$10,834	\$20,425	n/a	\$18,865
Dept of Labor	\$7	\$10	n/a	\$11
Dept of Energy	\$716	\$2,183	n/a	\$1,959
Dept of Agriculture	\$696	\$1,013	n/a	\$787
Republic of Panama	\$70	\$64	n/a	\$37
Federal Emergency Mgt	\$3,513	(\$177)	n/a	\$761
Environmental Protection	\$554	\$1,465	n/a	\$1,772
Dept of Health Services	\$4,076	\$3,930	n/a	\$4,277
Dept of Housing	\$822	\$888	n/a	\$72
Legislative Branch	\$0	\$14	n/a	\$14
Judiciary	\$0	\$10	n/a	\$10
Office of the President	\$2,389	\$9,967	n/a	\$2,284
Energy Research	\$68	\$251	n/a	\$290
Selective Service System	\$7,858	\$4,987	n/a	\$1,696
Nuclear Regulatory Comm	\$170	\$427	n/a	\$380
All Other Federal Agencies	\$15,913	\$32,408	n/a	\$29,106
Advances	\$0	\$0	\$7,021	\$0
Total	<u>\$227,687</u>	<u>\$322,705</u>	<u>\$7,021</u>	<u>\$198,967</u>

FINANCIAL STATEMENTS AND NOTES—UNAUDITED**Note 30. Contingencies:**

The Army is subject to various asserted claims for over \$100 Million. These claims are in various phases ranging from investigation to appeal. While no opinion has been expressed regarding the likely outcome of a specific claim or associated loss, experience indicates that many such claims either have a remote chance of materializing, are settled for less than claimed, or are dismissed altogether.

Note 31. Other Disclosures:

FY 96 reported values for "Other Entity Assets" included \$5.5 Billion of military property in the hands of contractors. Army Audit Agency (AAA) recommended this category of Government Furnished Property no longer be included in the financial statements. Field work by AAA determined that the values reported by the contractors for this category of property were highly unreliable. Army concurred with the recommendation and excluded this category of property from the FY 97 financial statements.

The value reported on Line 1.b (5), "Advances and Prepayments" appears significantly higher than reflected in FY 96's CFO Statements due to the application of DoD policy guidance requiring progress payments to be reported on Line 1.b (5). In previous years, progress payments were reclassified as "Construction in Progress" and included in the "Plant, Property, and Equipment" line of the Statement of Financial Position.

War Reserves: The reporting of items held for future use in case of conflict or other emergent need is not clearly addressed in the Statements of Federal Financial Standards (SFFAS). For example, munitions could be reported as operating materials and supplies, as general property, plant and equipment (PP&E), or as National Defense PP&E. Since these items are not held for sale, they will not be reported as inventory. Until the SFFAS is clarified, items held for future use, in case of conflict or other emergent need, will be reported as War Reserves. Reported values show a significant increase over last years reported values, however, the impact of this variance has yet to be determined.

Problem Disbursements: The Army transacts a significant portion of its business utilizing a centralized clearance system at DFAS-IN which allows an installation to make disbursements citing another installation's funds. The transactions include intra-service transactions by others, interfund billings and cross-disbursements by others. Problem disbursements represent disbursements of Army funds that have been reported to Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursement.

Problem disbursements represent a significant financial management concern because:
(1) the accuracy of accounting reports is affected; (2) available funding picture is

FINANCIAL STATEMENTS AND NOTES—UNAUDITED

distorted; and (3) the research and resolution process can be very labor intensive. Initiatives such as prevalidation of payments, are well underway to reduce or eliminate problem disbursements. In the case of prevalidation efforts, entitlement personnel and accountants are now required to jointly ensure that an obligation of funds sufficient to cover the amount of the proposed disbursement has been recorded in the accounting records. This validation must be done for all payments exceeding a specified threshold. Eventually, all payments will be prevalidated prior to the disbursement of funds.

The following table shows the unmatched transactions and Negative Unliquidated Obligations (NULO's) as of September 30, 1997. Increases in the unmatched disbursements over FY 96 values are attributed to changes in the reporting process. FY 96 did not include a category of unmatched disbursements that related to partially cleared "Transactions By Others." The increase in NULO's over FY 96 are attributed to improvements made in the data gathering, analysis and NULO reporting processes.

(\$'s in Thousands)

	<u>FY 97</u>	<u>FY 96</u>
Unmatched	\$883,737	\$118,910
NULO	\$286,894	\$ 90,557

Accounts Payable: Accounts payable and operating expenses are understated by the accrual amount that should be recorded for contractor services/goods that have been performed/delivered but not yet paid. Since current contractor payment systems were not designed to provide this accrual data for entry to the accounting systems, a reasonable accrual estimate has not been determined. Existing systems/processes are being modified to provide this accrual data for future use in Army's financial statements. Line 4a. (1) Accounts Payable (Federal) and Line 4b. (1) Accounts Payable (Non-Federal) were significantly lower than last year as a result of abnormal "Accounts Payable" balances reported in the Army Procurement Appropriations. These abnormal balances resulted from the inability of the accounting system to generate timely accruals based on the receipt of goods and services. Additionally, charges to erroneous appropriations by the bill paying office create an understatement of accounts payables on the books of Army. In the case of erroneous charges, the bill paying office can charge Army funds for contracts that should be funded by another DoD Agency. Erroneous charges have misstated the true accounts payable balances and will be corrected in subsequent periods.

SUPPORTING AUDIT REPORTS

1. Proposed Adjustments and Comments Regarding Army's FY 97 Annual Financial Report (AA 98-95)
2. Report on Internal Controls and Compliance With Laws and Regulations (AA 98-xxx)
3. Financial Reporting of Section 801 Family Housing Leases (AA 98-57).
4. Financial Reporting of Wholesale Munitions (AA 98-98)
5. Financial Reporting of Wholesale Equipment (AA 98-xxx)
6. Financial Reporting of Accounts Receivable (AA 98-xxx)
7. Financial Reporting of Selected Liabilities (AA 98-xxx)
8. Financial Reporting of Mission Assets (AA 98-xxx)
9. Financial Reporting of Real Property (AA 98-xxx)
10. Financial Reporting of Fund Balance With Treasury (AA 98-xxx)
11. Audit of the Compilation of the Army's FY 97 Financial Statements at the Defense Finance and Accounting Service-Indianapolis Center (Inspector General, DOD, Project #7FI-2031)

OTHERS RECEIVING COPIES OF THE REPORT

Chief of Staff, Army
 Under Secretary of the Army
 Vice Chief of Staff
 Assistant Secretary of the Army (Civil Works)
 Assistant Secretary of the Army (Financial Management and Comptroller)
 Assistant Secretary of the Army (Installations, Logistics and Environment)
 Assistant Secretary of the Army (Manpower and Reserve Affairs)
 Assistant Secretary of the Army (Research, Development and Acquisition)
 General Counsel
 Director of the Army Staff
 The Inspector General
 Chief of Legislative Liaison
 Chief of Public Affairs
 Chairman, Army Reserve Forces Policy Committee
 Deputy Chief of Staff for Logistics
 Deputy Chief of Staff for Operations and Plans
 Deputy Chief of Staff for Personnel
 Assistant Chief of Staff for Installation Management
 Chief, National Guard Bureau
 Deputy Assistant Secretary of the Army for Budget
 Director, Program Analysis and Evaluation
 Commander in Chief, U.S. Army, Europe and Seventh Army
 Commanders

- U.S. Army Forces Command
- U.S. Army Training and Doctrine Command
- U.S. Army Materiel Command
- U.S. Army, Pacific
- U.S. Army Military District of Washington
- U.S. Army Corps of Engineers
- U.S. Army Criminal Investigation Command
- U.S. Total Army Personnel Command
- U.S. Army Aviation and Missile Command
- U.S. Army Communications-Electronics Command
- U.S. Army Industrial Operations Command
- U.S. Army Tank-automotive and Armaments Command
- U.S. Army Logistics Evaluation Agency
- U.S. Army War Reserves Support Command
- XVIII Airborne Corps and Fort Bragg
- I Corps and Fort Lewis
- 3rd Military Police Group, U.S. Army Criminal Investigation Command
- 6th Military Police Group, U.S. Army Criminal Investigation Command

ANNEX D

**Executive Director, U.S. Army Materiel Command Logistics Support
Activity**

Directors

Armament and Chemical Acquisition and Logistics Activity

U.S. Army Research Laboratory

U.S. Army Center for Public Works

Commandant, U.S. Army Logistics Management College -

Director, Center for Army Lessons Learned

Inspector General, Department of Defense

Directors

Defense Finance and Accounting Service

Defense Finance and Accounting Service-Indianapolis Center

Defense Finance and Accounting Service-Columbus Center

Defense Intelligence Agency

Defense Logistics Agency

Defense Logistics Studies Information Exchange

Auditors General

Air Force Audit Agency

Naval Audit Service

Appendix C. Audit Process

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the "Chief Financial Officers Act of 1990," as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," we performed oversight of the independent audit conducted by the Army Audit Agency (AAA) of the Army General Fund Financial Statements for FYs 1997 and 1996. Our purpose was to determine whether we could rely on the AAA audit. We reviewed the AAA audit approach and planning and monitored the progress of the audit at key points.

Reviewing the AAA Audit Approach. We used the "Federal Financial Statement Audit Manual," January 1993, issued by the President's Council on Integrity and Efficiency, and the "Financial Audit Manual," December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the AAA audit approach. Specifically, we reviewed the engagement letter, documentation for the entrance conference, formulation of strategy, and audit plans and programs. We also participated in audit planning conferences and workshops coordinated by the AAA.

Monitoring Audit Progress. Through the DoD Financial Statement Executive Steering Committee and Integrated Audit Process Team, we provided a forum for a centrally managed exchange of guidance and information leading to a focused DoD-wide audit of the DoD Consolidated Financial Statements, including the supporting financial statements of major DoD Components. We participated in working groups on significant topics in financial reporting for the Army General Fund. We also reviewed and commented on related draft audit reports issued by AAA, including the audit opinion report and the report on evaluation of internal controls and compliance with laws and regulations.

In addition to the oversight procedures, we performed other procedures necessary to determine the fairness and accuracy of the AAA audit approach and conclusions. We reviewed findings and recommendations in previous AAA reports.

Audit Period and Standards. We performed this financial statement audit from August 27, 1997, through February 27, 1998, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data or statistical sampling procedures to conduct the audit.

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

Appendix D. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

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

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
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 Indianapolis Center

Non-Defense Federal Organizations

Inspector General, Department of Education
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 Forces
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

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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Craig W. Michaels
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