

Audit



Report

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE
ARMY AUDIT AGENCY AUDIT OF THE FY 1997
ARMY WORKING CAPITAL FUND FINANCIAL STATEMENTS

Report Number 98-105

April 7, 1998

Office of the Inspector General
Department of Defense

Additional Information and Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, homepage at: www.dodig.osd.mil.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8908 (DSN 664-8908) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.osd.mil; or by writing to the Defense Hotline, Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

AAA
GAO
IG

Army Audit Agency
General Accounting Office
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 FY 1997 Army Working Capital Fund Financial
Statements (Report No. 98-105)

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 FY 1997 Army Working Capital Fund Financial Statements, along with the "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Auditor's Report." An audit of the Army Working Capital Fund Financial Statements is required by the "Chief Financial Officers Act of 1990," as amended by the "Federal Financial Management Act of 1994." Because 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) 604-9175 (DSN 664-9175, e-mail rbird@dodig.osd.mil) or Mr. Jack L. Armstrong, Audit Project Manager, at (317) 510-3846 (DSN 699-3846, e-mail jarmstrong@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.


David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-105)
(Project No. 7FI-2034.01)

April 7, 1998

**Inspector General, DoD, Oversight of the Army
Audit Agency Audit of the FY 1997 Army
Working Capital Fund Financial Statements**

Executive Summary

Introduction. An audit of the Army Working Capital 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. On January 16, 1997, we delegated the audit of the FY 1997 Army Working Capital Fund Financial Statements to the Army Audit Agency. This report provides our endorsement of the Army Audit Agency disclaimer of opinion on the FY 1997 Army Working Capital Fund Financial Statements, along with the "Army Working Capital Fund Principal Financial Statements for FY 1997: Auditor's Report."

Audit Objectives. Our objective was to determine the accuracy and completeness of the Army Audit Agency audit of the FY 1997 Army Working Capital Fund Financial Statements. See Appendix C for a discussion of the audit process.

Audit Results. The "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Auditor's Report," February 13, 1998, stated that the Army Audit Agency was unable to express an opinion on the reliability of the FY 1997 Army Working Capital Fund Financial Statements. 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.

Internal Control Structure and Compliance With Laws and Regulations. The Army Audit Agency issued reports on internal controls and compliance with laws and regulations in the Army. Those reports are included in the Army Audit Agency report.

Table of Contents

Executive Summary	i
Appendix A. Inspector General, DoD, Endorsement Memorandum (pages 1-2)	1
Appendix B. Army Audit Agency Report “Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Auditor’s Report” (pages 1-58)	5
Appendix C. Audit Process	7
Appendix D. Report Distribution	8

**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 Department of
the Army Working Capital Fund Financial Statements
(Project No. 7FI-2034)

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. Before FY 1992, DoD operated a significant number of its commercial and industrial facilities under a revolving fund concept. In FY 1992, the revolving funds were consolidated to form the Defense Business Operations Fund (DBOF). On December 11, 1996, the Under Secretary of Defense (Comptroller) restructured DBOF into separate working capital funds. The Inspector General (IG), DoD, was responsible for auditing both the DBOF financial statements and working capital fund financial statements. On January 16, 1997, we delegated to the Army Audit Agency (AAA) the audits of the Army Working Capital Fund financial statements.

Summarized below are the AAA disclaimer of opinion on the FY 1997 financial statements and the results of our review of the work conducted by the AAA. We endorse the disclaimer of opinion expressed by AAA (see the Enclosure).

Disclaimer of Opinion. The AAA disclaimer of opinion on the FY 1997 Army Working Capital Fund financial statements, dated February 27, 1998, states that 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 Material uncertainties existed regarding the reported values of assets and liabilities because of insufficient audit trails.
- o Procedural and compliance problems resulted in unreliable amounts for selected accounts on the financial statements.
- o The account balance for Government furnished materials was misstated by \$534 million because systems could not accurately identify consumable material in the possession of contractors.
- o Defense Finance and Accounting Service (DFAS) personnel made \$899.5 million in absolute value adjustments to Fund Balance With Treasury that were not supported.

In addition, the AAA did not render an opinion on the FY 1996 financial information included in the FY 1997 Army Working Capital financial statement for comparative purposes. The AAA audited the Army portion of the FY 1996 DBOF

financial statements in support of the IG, DoD, audit of the FY 1996 DBOF consolidated financial statements. The IG, DoD, was unable to render an opinion on the FY 1996 DBOF consolidated financial statements because of significant deficiencies in the accounting systems and the lack of a sound internal control structure.

Internal Controls. Internal controls did not ensure that the Army Working Capital Fund financial statements contained no material misstatements. As a result, the risk of material financial misstatement is high. The Army and the DFAS have recognized some of the associated 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 necessary to determine the accuracy and reliability of the audit approach and conclusions.

We conducted our review of the AAA work on the FY 1997 Army Working Capital Fund financial statements from March 21, 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 Working Capital
Fund Principal Financial
Statements for Fiscal
Year 1997**

Auditor's Report

**13 February 1998
Audit Report: AA 98-111**



U.S. Army Audit Agency





DEPARTMENT OF THE ARMY
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 Working Capital Fund Principal Financial Statements for the fiscal year ended 30 September 1997. We performed our work pursuant to the Chief Financial Officers Act of 1990 (Public Law 101-576) as amended.

We were unable to express an opinion on the financial statements primarily because of 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 present more detailed discussions in the supporting audit reports that have been or will 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

CONTENTS

	Page
Auditor's Report	5
 Annexes	
A - Audit Scope and Methodology	21
B - Principal Statements	23
C - Supporting Audit Reports	55
D - Others Receiving Copies of the Report	57

AUDITOR'S REPORT



DEPARTMENT OF THE ARMY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596



Acting Secretary of the Army

In accordance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the Army prepared the accompanying Army Working Capital Fund Principal Financial Statements for the fiscal year ended 30 September 1997. Before FY 91, DOD operated a significant number of commercial and industrial facilities under a revolving fund concept. In FY 91, the revolving funds were consolidated to form the Defense Business Operations Fund. The Inspector General, DOD was responsible for auditing and rendering opinions on the Defense Fund Consolidated Financial Statements.

In December 1996, the Under Secretary of Defense (Comptroller) restructured the Defense Fund into separate working capital funds. For FY 97 and subsequent years, the Inspector General, DOD is responsible for auditing and rendering opinions on the financial statements of the nine working capital fund reporting entities formerly reported under the Defense Fund. On 16 January 1997, the Inspector General, DOD delegated the responsibility of auditing and rendering an opinion on the FY 97 Army Working Capital Fund financial statements to us.

The FY 97 Army Working Capital Fund financial report presented figures from portions of the FY 96 Defense Fund Consolidated Financial Statements for comparative purposes. We conducted audit work on the Army portion of the FY 96 Defense Fund financial statements in support of the Inspector General, DOD audit of the FY 96 Defense Fund Consolidated Financial Statements. As a result, we did not render an opinion on the FY 96 financial information used in the Army Working Capital Fund financial statements. The Inspector General, DOD was unable to render an opinion on the FY 96 Defense Fund Consolidated Financial Statements as a whole because of significant deficiencies in the accounting systems and the lack of a sound internal control structure.

We were unable to express an opinion on the Army Working Capital Fund Principal Financial Statements for the fiscal year ended 30 September 1997. We did not render an opinion on the accompanying figures of the financial statements for the fiscal year ended 30 September 1996. The reasons for our disclaimer were insufficient audit trails and unreliable amounts for several types of assets and liabilities. Procedural and compliance problems also contributed to the lack of reliable

amounts in the Army Working Capital Fund financial statements. In this report, we explain the reasons for our disclaimer plus other reporting problems. We also cite areas where the Army and the Defense Finance and Accounting Service are making progress.

Internal controls weren't fully effective to ensure there were no material misstatements in the financial statements. As a result, the risk of material financial misstatements is high. The Army and the Accounting Service have recognized some of the associated financial reporting weaknesses and reported them in their FY 97 annual assurance statements. Our audit efforts didn't disclose any instances of significant unreported failures to comply with laws and regulations related to the Army Working Capital Fund financial statements. We will present details on these matters in our separate report on internal controls and compliance with laws and regulations.

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). However, as noted in the body of our report, there were limitations to the scope of our work.

Reasons for Disclaimer

The Army continues to experience major financial reporting problems, which precluded us from rendering an opinion on its working capital fund financial statements. The specific reasons for our disclaimer were insufficient audit trails and unreliable amounts for several types of assets and liabilities. The Army and the Accounting Service are working on these problems but complete solutions aren't likely for several years.

The Army reported \$14.5 billion in assets and \$1.9 billion in liabilities in its working capital fund financial statements for FY 97. Building on prior years' audit results, we audited major portions of the reported assets and liabilities. This year, because we knew several lines on the Statement of Financial Position would require us to disclaim an opinion on the financial statements as a whole, we did limited work on the Statement of Operations and Changes in Net Position. The following paragraphs briefly summarize our results. Complete details on these subjects, including specific recommendations, are in the supporting audit reports that have been or will be issued separately.

ASSETS

The Statement of Financial Position, with \$14.5 billion in total assets, had five asset lines with unreliable amounts. The amounts for these five lines totaled \$13.3 billion. We describe the most significant problems in the following paragraphs.

Fund Balance With Treasury

We couldn't attest to the reported value of \$405.8 million for Fund Balance with Treasury because we could not substantiate adjustments that had an absolute value of about \$899.5 million. Defense Finance and Accounting Service-Indianapolis Center personnel adjusted general ledger information to agree with certified status reports and Treasury reports and to meet other reporting requirements. They made these adjustments without reconciling the differences. They made other adjustments without documentation or without realizing the effect of the adjustment on the Fund Balance with Treasury amount in the financial statements.

Accounts Receivable, Federal

We couldn't attest to the reported value of \$278.5 million for accounts receivable because we could not substantiate adjustments with an absolute value of about \$214.2 million. Indianapolis Center personnel adjusted general ledger information to agree with certified status reports and Treasury reports and to meet other reporting requirements. They made these adjustments without reconciling the differences. They made other adjustments without documentation or without realizing the effect of the adjustment on the accounts receivable amount in the financial statements.

Advances and Prepayments, Federal

The reported value of advances and prepayments (\$254.3 million for FY 97) was misstated by an unknown, but probably material amount, because progress payments weren't always paid and liquidated at the rate the contract authorized. We've made recommendations to the Accounting Service to correct this weakness.

Inventory, Net

The FY 97 inventory (net value of about \$10.2 billion) was misstated by an unknown, but probably material amount, because we couldn't attest to the value in the general ledger accounts for inventory held for repair, government furnished material, and inventory in transit from procurement.

Inventory Held for Repair. Inventory held for repair was not properly reported. This caused Inventory, Net and Excess of Revenue and Other Financing Sources Over Total Expenses to be misstated by unknown, but material amounts.

Federal accounting standards require inventory in need of repair to be valued net of expected repair expense. As inventory in need of repair is received, a repair allowance account should be established to reduce the value of the inventory. At the same time, the financial statements should recognize the estimated repair expense. Accounting systems currently capture the estimated repair expense in the inventory held for sale allowance account. When inventory held for repair is presented net of the allowance account, it is valued net of its estimated repair expense. However, during FY 97 accounting systems recognized about \$916 million in repair expenses as Program and Operating Expenses; it should have been used to reduce the allowance account. The allowance also would need to be adjusted by the difference between actual and estimated repair costs. The amount of this adjustment is not readily available. However, we believe that Inventory, Net is still understated, but by an unknown amount.

Also, amounts on the Statement of Operations were misstated by unknown amounts. Repair expense for the year should have been the estimated repair expense for unserviceable, reparable items that were added to the inventory. In addition, beginning and ending inventory figures were used to compute cost of goods sold, causing a misstatement of these inventory amounts.

Until the Army implements changes to correctly record repair expenses, we won't be able to determine the accuracy of amounts shown for Inventory, Net and Excess of Revenues and Other Financing Sources Over Expenses.

Government-Furnished Material. The government-furnished material account value, \$534 million for FY 97, was misstated because of a scope limitation on the ability of logistical or financial management systems to accurately identify consumable material in the possession of contractors.

The amount represented consumable items that the Army furnished to contractors to incorporate into higher level components.

Controls over recording and reporting of consumable material in the possession of contractors weren't adequate to ensure that all transactions in the accounts were valid or that all transactions were included. Numerous audit reports and commodity command reviews have documented problems with accountability of the material. The problems continue to be that:

- Contractors rarely report consumption of material to the Army.
- The system that contractors used to report onhand balances wasn't designed for financial reporting and didn't identify the onhand assets by type of funding. In addition, the contractors prepared the reports inconsistently and inaccurately.
- Commodity commands used different methods to purge material transactions from the general ledger.

DOD and the Army, recognizing these long-standing problems, have initiated action to make improvements. DOD established an integrated process team to focus on the recording and reporting of government furnished property. The Army engaged a commercial accounting firm to evaluate the problems and issues associated with government property in the possession of contractors.

Inventory In Transit from Procurement. The account value of \$598 million for inventory in transit from procurement was misstated by unknown but material amounts. This account is part of Inventory, Net; it represents assets purchased from contractors for which payments have been made, but receipts haven't been recorded. Our FY 97 audit results showed that automated systems rejected receipts for various reasons and personnel didn't always reconcile the rejected transactions. Some of the inventory classified as in transit had actually been received but not properly recorded. These actions caused the value to be recorded as both inventory in transit and on hand. We've identified similar results in prior years' audits. Several of our recommendations to the Army and the Accounting Service are still in process.

Property, Plant and Equipment, Net

We weren't able to attest to the reported value for property, plant and equipment, net (\$2.2 billion for FY 97) because the value of real property

was misstated by unknown amounts. Army's depot maintenance activities didn't have a standard financial system in place that provided data needed for accurate financial accounting of real property. The current real property system (Integrated Facilities System) didn't:

- Adequately reconcile accounting data with supporting property records.
- Accurately identify and track the cost of real property.
- Identify costs incurred to maintain and support information regarding real property.
- Capitalize and depreciate real property.

The U.S. Army Center for Public Works has submitted a systems change request to interface the Integrated Facilities System with the Defense Property Accountability System—the system that performs financial accounting for equipment. Implementing this change would allow the Accountability System to perform the financial accounting of real property. The goal is to complete the interface by FY 99.

LIABILITIES

Of the \$1.9 billion in total liabilities, two accounts payable lines on the Statement of Financial Position had unreliable amounts. The amounts for these two lines totaled about \$0.7 billion. We describe the most significant problems in the following paragraphs.

Accounts Payable, Federal and Non-Federal

The reported balances of accounts payable for Federal and non-Federal entities (\$681.6 million for FY 97) weren't reliable. Existing procedures precluded the determination of reliable values for these accounts. Inadequate or no documentation for adjusting entries at the Indianapolis Center and procedural weaknesses at lower level activities caused the amounts to be unreliable.

Indianapolis Center. We couldn't attest to the reported value for accounts payable because we could not substantiate adjustments with an absolute value of \$1.2 billion. Indianapolis Center personnel adjusted general ledger information to agree with certified reports and Treasury reports, and to meet other reporting requirements. They made

adjustments to general ledger information so it agreed with other reports but did not reconcile the differences. They made other adjustments without having documentation or without realizing the effect of the adjustments on the payables amounts in the financial statements.

Lower-Level Activities. Finance activities didn't have detailed transactions to support accounts payable amounts.

Accounts payable weren't established according to Federal accounting standards. The Federal standards require that accounts payable be established when the Government accepts goods or when title passes. The current Army policy recognizes an accounts payable when the item is received. This procedure caused the line to be misstated by an unknown amount.

In addition, subsidiary ledgers didn't support general ledger balances and accounting activities made adjustments to general ledgers without supporting detailed transactions. The accounting activities also allowed the automated system to automatically delete rejected receipt transactions from the accounting records without review or correction. We've made recommendations to the Accounting Service to correct these conditions, but the Accounting Service had not replied to the recommendations at the time of this report.

Other Reporting Problems

We found other problems which don't preclude us from rendering an audit opinion, but which the Army must resolve to ensure the affected data is properly presented in the Army Working Capital Fund financial statements.

Financial Management Systems

The Accounting Service's financial management systems didn't meet all aspects of the Federal Financial Management Improvement Act of 1996. However, the systems that field reporting activities used generally provided the data the Army needed to trace reported amounts back to originating transactions. Also, the lack of a single integrated general ledger and the differences between certified reports and general ledger accounts caused the financial statement process at the Indianapolis Center to be complicated and lengthy. The process produced adjustments to the financial statements that were not always supported with detailed documentation.

A transaction-driven general ledger did not support at least five material lines in the Statement of Financial Position. Reporting activities had differences between subsidiary ledgers and general ledgers for inventory on hand. Also, the Indianapolis Center made substantial adjustments to general ledger balances without documentation or reconciliation.

Several of our disclaimer points in this report are the result of inadequate accounting systems, but poor controls or accounting applications that needed to be modified caused others. Efforts were in process to resolve the inadequate accounting systems. Also, we made recommendations in other audit reports to improve internal controls and to change the accounting applications.

Logistical and Financial Records

Although prior tests of physical inventory accuracy showed that the recorded value of inventory was correct, the tests also showed that not all logistical transactions were being recorded in the financial records. Wholesale and retail level activities didn't develop and maintain accurate general ledger balances for inventory. Instead, the activities accepted logistical records as accurate and adjusted the financial records accordingly. By adjusting, but not reconciling, the financial records to match logistical records, the activities couldn't be sure that the inventory balances shown in the financial statements were correct.

Monthly, the wholesale and retail automated systems generated automated reports that identified the dollar variance between logistical records and the general ledger for inventory on hand. The general ledger amount automatically adjusted to match the dollar value of logistical records. As of 30 September 1997, the wholesale variance alone was about \$677 million excluding the variance for Communications-Electronics Command (the variance data wasn't available due to the transfer of the command's financial records to the St. Louis Operating Location). The imbalance between the logistical and financial records for inventory on hand is a long-standing, DA-wide problem. The Army has identified implementation of the Single Stock Fund in fiscal year 2000 as a solution to the problem.

Allowance Accounts

The reported value for the allowance accounts included with inventory, net (about \$2.4 billion in FY 97) was generally reliable, except as discussed earlier regarding repair expense. The internal controls were

adequate to ensure that the allowance for unrealized holding gains and losses were accurately recorded. However, the allowance subaccounts contained some period cost gains and losses that should be recognized in the period incurred. DOD accounting personnel agreed that some subaccounts were period costs. They were in the process of considering revisions to the DOD accounting policy to comply with Federal accounting standards. DOD is reviewing the remaining subaccounts and should have a decision on them and the accounting policy during February 1998.

Material Return Program

A portion (\$177 million) of the amount shown for Other Entity Assets should be eliminated from the financial statements and another portion (\$326 million) should either be reclassified as Inventory, Net or written off as Prior Period Adjustments.

In the materiel return program, retail activities expect to receive credit for the assets they return to wholesale activities and wholesale activities expect to give credit to retail activities for the assets received. The credit that retail activities expect to receive is in a general ledger account that maps to Other Entity Assets. The credit that wholesale activities expect to give is in an account that maps to Other Federal Liabilities. At the end of FY 97, these lines were overstated by \$503 million and \$177 million, respectively. These accounts represented intra-entity transactions and should have been eliminated from the consolidated statements.

In our adjustment report (Audit Report AA: 98-91), we recommended that Indianapolis Center reduce Other Entity Assets and Other Federal Liabilities by \$177 million. The center didn't agree, saying the Financial Management Regulation made no provisions for eliminating transactions between Other Entity Assets and Other Federal Liabilities. Although we believe the Office of Management and Budget Bulletin 97-01 (Form and Content) provides the necessary guidance for eliminating intra-entity transactions, we'll address the need for the Financial Management Regulation to be clarified in a separate report.

If logistics and financial systems operated efficiently and if personnel did their jobs effectively, the amounts of credit expected to be given and received should equal. If the elimination transactions had been made, there should have been a zero balance in the two accounts. However, a balance of \$326 million still would have remained in the account that mapped to Other Entity Assets. We've written several audit reports addressing the differences between these two accounts, but a review is

needed before we can recommend an accurate adjusting entry for the \$326 million. The two most likely statement lines that would be affected by eliminating the remaining balance in the Other Entity Assets line would be Inventory, Net and Prior Period Adjustments.

Progress Areas

The Army and the Accounting Service are dedicated to improving the Army Working Capital Fund financial statements. Each have initiatives in process that should contribute to this goal.

Army Initiatives

Inventory on Hand. The Army has at least two initiatives in process that should improve internal controls. Our prior years' observation of physical inventories revealed an unacceptably high error rate between physical counts and recorded balances. In addition, not all activities conducted the required physical inventories nor did they conduct proper research to identify root causes for inventory adjustments. Here are the two initiatives in process:

- **Approved Military Standard Transaction Reporting and Accounting Procedures Change Letter 8a** moves accountability for assets to the Defense Logistics Agency depots. This should simplify the inventory and reconciliation process. Letter 8a also requires depots to implement a sampling plan. Implementation is expected by 31 March 1998.
- **The Single Stock Fund** will combine the current separation of wholesale and retail supply into one operation. This will provide better visibility to the Supply Management business area and simplify financial statement preparation and presentation. Implementation is scheduled for FY 00.

Real Property Integrated Process Team. The Army recognized the magnitude and cross-cutting nature of the problems in financially accounting for real property. It initiated the establishment of a DOD-wide Real Property Integrated Process Team. The team's objectives included defining data elements needed in real property systems for financial reporting, recommending needed policy changes to DOD, and identifying the process for integrating the Defense Property Accountability System with the various real property management

systems. The team has met several times since being formed in FY 96 and plans to hold future meetings at least twice a year until the Army resolves financial reporting problems. The team's goal is to have real property data loaded into the Defense Property Accountability System by the end of FY 98.

Government-Furnished Property. The Assistant Secretary of the Army (Financial Management and Comptroller) hired a commercial accounting firm to study the numerous problems with the financial accountability of government-furnished property. The firm produced a report dated July 1997 that called for a two-phase approach to resolve the long-standing and complex problem of gaining fiscal accountability and physical control of government property. The study stated that both phases will require substantial resources—time, people, and funds. The Office of Assistant Secretary of the Army (Financial Management and Comptroller) sent the report to the DOD Comptroller and requested a meeting to discuss the report findings and recommended solutions. At the time of this report, goals had not been established for correcting the reporting problems of government-furnished property.

Command-Initiated Adjustments. An Army representative provided several recommended changes to the footnotes that accompanied Version 2 of the statements. As a result, the footnotes for Version 3 of the statements were more accurate. This initiative signifies an enhanced recognition of the need to take ownership of the financial reporting process and is one that should be encouraged.

Accounting Service Initiatives

The Accounting Service has continued some initiatives and started others to improve financial management. Several of the more notable initiatives that pertain to the Working Capital Fund are discussed in the following paragraphs:

- **Problem Disbursements.** In coordination with the Assistant Secretary of the Army (Financial Management and Comptroller), the Indianapolis Center has established a goal to reduce problem disbursements in each of the three categories (Intransit Disbursements; Unmatched Disbursements; and Negative Unliquidated Obligations) by 50 percent in FY 98.
- **Centralized Disbursing.** Once fully implemented, one disbursing station will service all finance and accounting support capitalized under the Indianapolis Center, including all Army CONUS

disbursements. This will allow all payments to eventually be considered "for self" transactions and, thus, eliminate problematic "for other" transactions.

- **Prevalidation of Disbursements.** In an effort to reduce unmatched disbursements, the Indianapolis Center implemented procedures in FY 95 for prevalidating disbursements of \$5 million or more. The center reduced this amount to \$1 million in FY 97, and plans are underway towards a zero-dollar threshold.

- **Rule Book.** This publication identifies the procedures and practices that the Indianapolis Center's operating locations should follow. Some topics addressed in the March 1996 update were financial accountability for real and personal property, operation of standard financial systems, guidelines for researching and correcting unmatched disbursements and negative unliquidated obligations, and monthly financial reporting. In addition, the annual yearend financial reporting instructions are now available through the internet.

The Accounting Service has made substantial progress toward consolidating and standardizing financial systems and operations. The service is identifying the best financial payment systems in its inventory, modifying the systems to meet DOD-wide requirements, and implementing them as migratory systems throughout DOD. As of 30 September 1997, the Accounting Service had identified six migratory systems.

In addition, DOD developed a strategy of interim migratory systems to accelerate the consolidation of DOD accounting systems. As part of this strategy, the Accounting Service is:

- Upgrading interim migratory systems to incorporate the standard general ledger, standard budget, and accounting classification architecture with limited improvements to address other deficiencies that both users and auditors have noted.

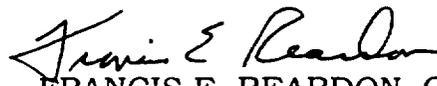
- Interfacing and linking the upgraded accounting systems with other support systems, such as those for logistics, procurement and contracting.

- Replacing nonselected legacy systems with the interim migratory systems.

As the interim migratory systems are deployed, the Accounting Service and Indianapolis Center will use fewer systems and consolidate accounting functions. However, the center will continue to use existing accounting systems until DOD selects and implements standard systems.

Outlook

The initiatives we discussed in this report are precisely the type of efforts needed to improve financial reporting and integrate functional and financial management, as intended by the Chief Financial Officers Act. They give evidence both to the Army's and the Accounting Service's commitment to the act and the progress toward successful implementation. Thus, although some problems remain and full solutions are still several years distant, 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.
 - Accounts Receivable.
 - Advances and Prepayments.
 - Inventory, Net.
 - Work in Process.
 - Property, Plant and Equipment.
 - Other Entity Assets.
 - Accounts Payable.
 - Other Federal Liabilities.
 - Eliminations and Adjustments.
 - Financial Statement Preparation Procedures.

ANNEX A

- Conducted followup reviews on previous recommendations related to the Army Working Capital Fund.
- Tested compliance with selected laws and regulations.
- Assessed data contained 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 were classified for national security purposes.

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). However, as noted in the body of our report, there were limitations to the scope of our work.

ARMY WORKING CAPITAL FUND CONSOLIDATING FINANCIAL STATEMENTS FOR FISCAL YEAR 1997

The final consolidating financial statements for Army Working Capital Fund activities for fiscal year 1997 are in this annex. We didn't include the overview and the financial statements and related footnotes for the individual business areas.

DEPARTMENT OF ARMY

***WORKING CAPITAL
FUND***

***CONSOLIDATED
STATEMENTS***

Principal Statements

Department of Defense
 Army Working Capital Fund - Consolidated Statements
 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)	\$405,841	\$624,162
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	278,538	194,706
(4) Interest Receivable	0	0
(5) Advances and Prepayments	3,478	0
(6) Other Federal (Intragovernmental) (Note 6)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	0
(2) Accounts Receivable, Net (Note 5)	34,662	32,235
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0
(4) Interest Receivable, Net	0	0
(5) Advances and Prepayments	254,275	224,603
(6) Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	10,186,464	10,760,131
e. Work in Process (Note 9)	296,014	363,307
f. Operating Materials/Supplies, Net (Note 10)	148,798	219,871
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)	2,197,140	2,202,679
l. Other Entity Assets	680,951	800,924
m. Total Entity Assets	<u>\$14,486,161</u>	<u>\$15,422,618</u>
2. Non-Entity Assets:		
a. Transactions With Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$0	\$0
(2) Accounts Receivable, Net (Note 5)	0	0
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	0	0

The accompanying notes are an integral part of these statements.

Version 3
 February 6, 1998
 Consolidated

ANNEX B

Principal Statements

Department of Defense
Army Working Capital Fund - Consolidated Statements
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)	\$0	\$0
(2) Interest Receivable, Net	0	0
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Other Non-Entity Assets	0	0
e. Total Non-Entity Assets	<u>\$0</u>	<u>\$0</u>
3. Total Assets	<u>\$14,486,161</u>	<u>\$15,422,618</u>
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	\$373,277	\$165,191
(2) Interest Payable	0	0
(3) Debt (Note 16)	0	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	488,129	688,079
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	308,338	490,786
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	\$2,365	77,009
(b) Annual Accrued Leave	71,733	69,409
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	0	0
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	60,655	66,199
c. Total Liabilities Covered by Budgetary Resources:	<u>\$1,384,497</u>	<u>\$1,556,673</u>

The accompanying notes are an integral part of these statements.

Version 3
February 6, 1998
Consolidated

Principal Statements

Department of Defense
 Army Working Capital Fund - Consolidated Statements
 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)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	128,876	48,886
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	387,128	3,017
c. Total Liabilities Not Covered By Budgetary Resources	<u>\$516,004</u>	<u>\$51,903</u>
6. Total Liabilities	<u>\$1,900,501</u>	<u>\$1,608,576</u>
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	(\$225,439)	(\$225,439)
b. Invested Capital	16,780,820	14,724,904
c. Cumulative Results of Operations	(3,453,717)	(633,520)
d. Other	0	0
e. Future Funding Requirements	(\$16,004)	(\$1,903)
f. Total Net Position	<u>\$12,585,660</u>	<u>\$13,814,042</u>
8. Total Liabilities and Net Position	<u>\$14,486,161</u>	<u>\$15,422,618</u>

The accompanying notes are an integral part of these statements.

Version 3
 February 6, 1998
 Consolidated

Principal Statements

Department of Defense
 Army Working Capital Fund - Consolidated Statements
 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	\$0	\$0
2. Revenues from Sales of Goods and Services		
a. To the Public	68,118	424,179
b. Intragovernmental	9,489,006	10,054,573
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	146,513	(10,425)
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0	0
8. Total Revenues and Financing Sources	<u>\$9,703,637</u>	<u>\$10,468,327</u>
EXPENSES		
9. Program or Operating Expenses (Note 23)	\$1,264,551	\$1,218,950
10. Cost of Goods Sold (Note 24)		
a. To the Public	73,479	154,784
b. Intragovernmental	9,049,980	7,615,091
11. Depreciation and Amortization	54,249	54,163
12. Bad Debts and Writeoffs	0	0
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	0	1
14. Other Expenses (Note 25)	1,052,666	1,189,828
15. Total Expenses	<u>\$11,494,925</u>	<u>\$10,232,817</u>
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	(\$1,791,288)	\$235,510
17. Plus (Minus) Extraordinary Items (Note 26)	<u>(22,684)</u>	<u>(13,664)</u>
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>(\$1,813,972)</u>	<u>\$221,846</u>

The accompanying notes are an integral part of these statements.

Version 3
 February 6, 1998
 Consolidated

Principal Statements

Department of Defense
 Army Working Capital Fund - Consolidated Statements
 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	\$13,814,042	\$12,735,383
20. Adjustments (Note 27)	(1,436,160)	1,239,614
21. Net Position, Beginning Balance, as Restated	<u>\$12,377,882</u>	<u>\$13,974,997</u>
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(1,813,972)	221,846
23. Plus (Minus) Non Operating Changes (Note 28)	<u>2,021,750</u>	<u>(382,801)</u>
24. Net Position, Ending Balance	<u><u>\$12,585,660</u></u>	<u><u>\$13,814,042</u></u>

The accompanying notes are an integral part of these statements.

Version 3
 February 6, 1998
 Consolidated

ANNEX B**Principal Statements**

Department of Defense
 Army Working Capital Fund - Consolidated Statements
 Statement of Cash Flows
 For the Period Ended September 30, 1997
 (Thousands)

	<u>1997</u>	<u>1996</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(\$1,813,972)	\$221,846
Adjustments affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	(86,262)	16,436
4. Decrease (Increase) in Other Assets	2,199,967	(2,219,603)
5. Increase (Decrease) in Accounts Payable	25,637	(125,514)
6. Increase (Decrease) in Other Liabilities	266,289	(33,002)
7. Depreciation and Amortization	54,249	54,163
8. Other Unfunded Expenses	0	0
9. Other Adjustments	(743,640)	2,198,846
10. Total Adjustments	<u>\$1,716,240</u>	<u>(\$108,674)</u>
11. Net Cash Provided (Used) by Operating Activities	<u>(\$97,732)</u>	<u>\$113,172</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
12. Sale of Property, Plant and Equipment	\$0	\$0
13. Purchase of Property, Plant and Equipment	(165,228)	58,588
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>(\$165,228)</u>	<u>\$58,588</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
20. Appropriations (Current Warrants)	\$0	\$0
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	44,639	(107,647)
22. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	0	0
23. Net Appropriations	<u>\$44,639</u>	<u>(\$107,647)</u>

The accompanying notes are an integral part of these statements.

Version 3
 February 6, 1998
 Consolidated

Principal Statements

Department of Defense
 Army Working Capital Fund - Consolidated Statements
 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
29. Net Cash Provided (Used) by Financing Activities	<u>\$44,639</u>	<u>(\$107,647)</u>
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	(\$218,321)	\$64,113
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	<u>624,162</u>	<u>560,049</u>
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	<u><u>\$405,841</u></u>	<u><u>\$624,162</u></u>
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.

Version 3
 February 6, 1998
 Consolidated

Footnotes to the Consolidated Statements

NOTE 1: Summary of Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Army managed portion of the Working Capital Fund, as required by the Chief Financial Officers (CFO) Act, and other appropriate legislation. The information used was derived from a consolidation of accounting information reported from various installation systems, Defense Accounting Offices, DFAS Operating Locations, and DFAS-IN. The consolidated information is maintained in the Federal Financing System (FFS) general ledger located at DFAS-IN. The statements have been prepared in accordance with DoD guidance on the form and content of the 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. These statements are therefore different from the financial reports, also prepared by the Army pursuant to OMB directives, that are used to monitor and control Army's use of budgetary resources. Accounts used in preparing these statements are the same accounts as used in preparation of the Consolidated Monthly Report on Operations (1307 Report). Intrafund eliminations were included for Army Materiel Command installations only. The amounts presented in the financial statements are rounded to the thousands of dollars. Consolidating statements showing each of the individual business areas, the component level adjustments and the eliminations used in arriving at the consolidated statements can be found following these footnotes.

B. Reporting Entity

Historically the Department of the Army has operated a significant number of its organic commercial and industrial facilities to control inventory and provide goods and services used to support both peacetime and wartime operations. Beginning in FY 1991 the funds used to operate these functions were consolidated with the like functions from other Department of Defense Agencies to form the Defense Business Operations Fund subsequently changed to the Defense Working Capital Fund. Fiscal year 1997 represents the sixth year that the Army has prepared audited financial statements for this fund as required by the CFO Act and the Government Management Reform Act (GMRA).

The accompanying audited financial statements account for all Working Capital Funds for which the Army is responsible except for the Conventional Ammunition Working Capital Fund. The

Footnotes

information relative to classified assets, programs and operations has been aggregated and reported in such a manner that it is no longer classified. The audited statements are presented on the accrual basis of accounting as required by DoD accounting policies.

C. Budgets and Budgetary Accounting

The DoD expanded the use of business like financial management practices through the establishment of the Defense Business Operations Fund on October 1, 1991. On December 11, 1996 the Defense Business Operations Fund became the Defense Working Capital Fund. The Defense Working Capital Fund (the Fund) operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The Fund builds on revolving fund principles previously used for industrial and commercial-type activities.

The Army's working capital funds are primarily included within the Fund. The Supply Management business area provides supplies and inventories to its customers on a commercial type basis. This material is purchased from vendors and held in inventory for sale to authorized recipients. Receipts derived from resale operations are normally available in their entirety for use without further congressional action. In FY 1997, Supply Management recorded an operating deficit of \$1.541 billion.

Supply Management
Sales, Cost of Sales and Expenses,
and Net Operating Results
(in thousands)

	<u>Sales</u>	<u>Cost of Sales and Expenses</u>	<u>Net Operating Results</u>
Supply	\$9,304,074	\$10,845,118	(\$1,541,044)

ANNEX B

Footnotes

The Army's industrial funds are also included within the Fund. These divisions provide industrial and electronic information services to other Army and DoD components through buyer-seller relationships. The Fund recorded an operating deficit of \$163 million in fiscal year 1997 due to industrial fund type work.

Other AWCF Activity Groups
Revenues, Expenses and Net Operating Results
by Business Area
(in thousands)

	<u>Revenues</u>	<u>Expenses</u>	<u>Net Operating Results</u>
Depot - Other	\$1,448,902	\$1,576,396	(\$127,494)
Depot - Ordnance	478,408	516,036	(37,628)
Information Systems	<u>154,593</u>	<u>159,734</u>	<u>(5,141)</u>
Total	<u>\$2,081,903</u>	<u>\$2,252,166</u>	<u>(\$170,263)</u>

Amounts are shown before intra-agency eliminations.

D. Basis of Accounting

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

Accounts payable for goods and services are recognized based on receipt of a receiving report provided notification of acceptance of goods or services. Accounts payable are adjusted for the amount of undistributed disbursements reported to the departmental expenditure system. These transactions represent Army's in-float (undistributed) disbursements for transactions that have not yet been recorded at the responsible station.

Some balances in the consolidated statements contain component-level adjustments. These are adjustments made to the consolidated figures for transactions applicable to the Army Working Capital Fund but not yet been identified to a specific business area. Values can be found in the Consolidating Statement following these footnotes.

Footnotes

E. Revenues and Other Financing Sources

Revenue for business fund activities is recognized at the point the rendered service is completed and billed or at the point inventory items are sold. Revolving fund appropriations are funded by revenues generated by sales of goods or services through a reimbursable order process. This process allows the seller to increase funds available by recording a sale for the cost of the supplies and/or services ordered by the customer. Funds received prior to delivery of the goods or services are treated as unearned revenue and recorded as a liability of the Army.

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. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Fund as though the agency were a stand-alone entity.

1. The Fund's proportionate share of the public debt and related expenses of the Federal Government are not included. Debt issued by the Federal Government and the related interest costs are not apportioned to the Federal agencies. The Fund's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

2. Financing for the construction of DoD facilities is obtained through budget appropriations. To the extent this financing may have been ultimately obtained through the issuance of public debt, interest costs have not been capitalized since the Treasury Department does not allocate interest costs to the benefiting agencies.

3. The Fund's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). Additionally, employees and personnel covered by the FERS also have varying coverage under Social Security. The Fund funds a portion of and discloses the assets or actuarial data on the accumulated plan benefits or unfunded pension liabilities of its employees. Reporting pension benefits under these retirement systems is the responsibility of the Office of Personnel Management. In fiscal year 1997, the Fund contributed the following amounts to the retirement plans and Social Security.

	(in thousands)
CSRS	\$41,708
FERS	31,647
Social Security	<u>35,621</u>
	<u>\$108,976</u>

ANNEX B

Footnotes

The Fund also contributed \$11.5 million to the FERS Thrift Savings Plan on behalf of it participating employees.

4. Most legal actions, other than contract claims, to which the Fund may be 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. Either because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the Funds assets 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 Funds operations or financial condition.

G. Funds with U. S. Treasury and Cash

The Fund's fund resources are maintained in U.S. Treasury accounts. Its cash receipts and disbursements are processed by the Treasury Department, and the balance with the U.S. Treasury represents the aggregate of all unexpended balances. As of September 30, 1997, the Fund had \$406 million in funds with the U.S. Treasury.

H. Foreign Currency

The Fund engaged in no foreign currency transactions in FY 1997.

I. Accounts Receivable

Accounts Receivable are adjusted for the amount of undistributed collections reported in the departmental expenditure system in the amount of (\$36.9) million. Of this balance (\$35.6) million has been identified to the Fund entity but not yet identified to a particular business area (a corporate level adjustment). These transactions represent Army's in-float (undistributed) transactions that have not yet been recorded at the responsible funded station. Accounts Receivable also includes refunds receivable. Allowances for uncollectible accounts are based upon analysis of collections experience by the fund over the last three years. The results of this analysis are as follows:

<u>FY</u>	<u>Amount</u>
95	\$ 316.70
96	-0-
97	28.50

Based on these results, no allowance of uncollectible accounts was recorded.

J. Loans Receivable

The Fund reported no Loans Receivable in FY 1997.

K. Inventories

Inventories, including operating supplies and nonconsumable items, are valued at Latest Acquisition Cost (LAC) as required by DoD accounting policies. Generally, LAC is determined by subtracting appropriate surcharges from the Standard Cost to arrive at the price most recently paid for a carried item. Losses that result from revaluation of excess, obsolete and unserviceable inventory are recognized in the Statement of Operations.

L. Investments in U.S. Government Securities

The Fund has no investments in U.S. Government Securities.

M. Property, Plant, and Equipment

The General Accounting Office (GAO) has determined that real property used by the Fund, but under jurisdiction of the Military Departments, represents an asset of the Fund and such property should be reported on the financial statements to show the full costs of all resources and assets used in the Fund operations.

Land and facilities are valued at cost. Buildings are capitalized when constructed or at the date of acquisition. Significant improvements to land and buildings normally are capitalized and depreciated over their remaining useful life. Audits of the Fund's financial statements have shown that documentation to support the recorded acquisition cost of many older properties is no longer available. Obtaining appraisals for older property for which original acquisition records are no longer available is not cost effective, especially considering the number and age of many of the Fund's real property assets. As a reasonable solution to this dilemma, when original records to support the acquisition cost of property are no longer available, recorded valuations of property, or other available information, if the value has not been formally recorded, would be permitted for financial statement purposes when such valuation represents the best available information.

Routine maintenance and repair costs are expensed when incurred. Depreciation for the Fund property and equipment is calculated using the straight line basis.

N. Prepaid and Deferred Charges

ANNEX B

Footnotes

Payments in advance of the receipt of goods and services are recorded as prepaid charges (advances) 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 Fund was committed to no operating leases or rental agreements.

P. Contingencies

At any given time, the Fund may be party to various legal and administrative actions and claims brought against it. These relate primarily to tort claims resulting from vehicle accidents, property and environmental damages resulting from Fund activities, and contract disputes.

Most legal actions, other than contract claims, to which the Fund may be named party are covered by the provision of the Federal Tort Claims Act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Either because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the Fund's assets 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 Fund's operations or financial condition.

Q. Accrued Leave

Civilian annual leave is accrued as earned and the accrued amounts are reduced as leave is taken. The balance for annual 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. Annual leave is accrued as it is earned and the accrual is adjusted to reflect current pay rates.

R. Equity

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

Footnotes

Decreases occur as capital assets are depreciated or consumed in operations, or when average costs are decreased. Donated capital has been included in invested capital.

Cumulative results of operations represents the excess of revenues over expenses and since fund inception, less refunds to customers and returns to the U.S. treasury.

Unexpended appropriations represent amounts of authority which were transferred to the fund at time of fund inception.

S. Aircraft/Ship Crashes

No operating losses were recognized by the Fund in fiscal year 1997.

T. Treaties for Use of Foreign Bases

There were no Fund activities involving the use of foreign bases in FY 1997.

U. Comparative Data

Comparative data from FY 1996 CFO financial statements is provided.

V. Undelivered Orders

The Fund is obligated for goods and services which have been ordered but not yet received (undelivered orders) as of September 30, 1997. Aggregate undelivered orders amounted to \$3.031 billion.

ANNEX B**Footnotes****NOTE 2: Fund Balances with Treasury (in thousands):**

A. Fund and Account Balances

	<u>Entity Assets</u>
	<u>Revolving Funds</u>
Unobligated Balances Available:	-
Available	\$1,070,635
Restricted	0
Reserve for Anticipated Resources	0
Obligated (but not expensed)	702,240
Unfunded Contract Authority	(1,367,034)
Unfunded Borrowing Authority	0
Treasury Balance	<u>\$405,841</u>

B. Other Information: None

NOTE 3. Cash, Foreign Currency and Other Monetary Assets (in thousands): Not applicable

NOTE 4. Investments (in thousands): Not applicable

NOTE 5. Accounts Receivable, Net (in thousands):

	<u>Gross Amount Due</u>	<u>Allowance For Estimated Uncollectibles</u>	<u>Allowance Method Used</u>	<u>Net Amount Due</u>
A. Entity Receivables				
Intragovernmental	\$278,538	\$0		\$278,538
Governmental	\$34,662	\$0	See Item C	\$34,662
B. Non Entity Receivables				
Intragovernmental	\$0	\$0		\$0
Governmental	\$0	\$0		\$0

C. Other Information: Calculation of allowance for estimated uncollectibles was based on actual uncollectible amounts written off during the past three fiscal years. See Note 11 for additional comments.

Footnotes

NOTE 6. Other Assets (in thousands): Not applicable

NOTE 7. Loans and Loan Guarantees, Non-Federal Borrowers(in thousands): Not applicable

NOTE 8. Inventory, Net (in thousands):

	Inventory Amount	Allowance for Losses	Inventory Amount, Net	Valuation Method
A. Inventory Categories				
(1) Held for Current Sale	\$11,589,679	\$2,326,510	\$9,263,169	See Item B.
(2) Held in Reserve for Future Sale	154,854		154,854	
(3) War Reserve Materiel	786,472	57,820	728,652	
(4) Excess, Obsolete and Unserviceable	39,789		39,789	
(5) Held for Repair			0	
Total	<u>\$12,570,794</u>	<u>\$2,384,330</u>	<u>\$10,186,464</u>	

B. Other Information: Inventory is valued at standard price less surcharge (Latest Acquisition Cost), less the value of potentially excess inventory. Surcharges are based on a percentage of potential excess derived from the March stratification report and applied to the September 30, 1997 inventory balances.

During the 1970's, \$56.774 million was provided to the Army and Air Force Exchange Service to provide supplies to the soldiers. The Exchange Service used this money to establish an inventory and it requisitions merchandise directly from DLA. This process isn't in accordance with accounting principles or regulations. Actions are currently underway to identify and remove it from the inventory balances.

ANNEX B**Footnotes****NOTE 9. Work in Process (in thousands):**

	<u>Work In Process Amount</u>	<u>Valuation Method</u>
A. Work in Process:		
1. In House	\$296,014	Other
2. Contractor	0	
3. Other Government Activities	0	
4. Government Furnished Materiel	0	
Total	<u>\$296,014</u>	

B. Other Information: Work In Process represents labor, material and overhead cost incurred during the period but not recognized as revenue.

NOTE 10. Operating Materials and Supplies (OM&S), Net (in thousands):

	<u>OM&S Amount</u>	<u>Allowance for Losses</u>	<u>OM&S Net</u>	<u>Valuation Method</u>
A. OM&S Categories				
1. Held for Use	\$145,791	\$0	\$145,791	Other
2. Held in Reserve for Future Use	2,088	0	2,088	
3. Excess, Obsolete & Unserviceable	919	0	919	Other
Total	<u>\$148,798</u>	<u>\$0</u>	<u>\$148,798</u>	

B. Other Information: Inventories are valued at the standard prices established by the National Inventory Control Point. Excess, obsolete and unserviceable material is valued at estimated net realizable value.

NOTE 11. Stockpile Materials, Net (in thousands): Not applicable**NOTE 12. Seized Property (in thousands):** Not applicable**NOTE 13. Forfeited Property, Net (in thousands):** Not applicable

Version 3
February 6, 1998
Consolidated

NOTE 14. Goods Held Under Price Support and Stabilization Programs, Net (in thousands): Not applicable

NOTE 15. Property, Plant, and Equipment, Net (in thousands):

	Depreci- ation Method*	Service Life*	Acquisition Values	Accumulated Depr.	Net Book Value
<u>Classes of Fixed Assets</u>					
A. Land			\$12,109	\$0	\$12,109
B. Structure, Facilities, and Leasehold Improvements	SL	11-20	2,071,214	664,804	\$1,406,410
C. Military Equipment	SL	6-10	1,274,035	601,466	\$672,569
D. ADP Software	SL	1-5	78	56	\$22
E. Equipment			58,286	41	\$58,245
F. Assets Under Capital Lease	SL	6-10	42	31	\$11
G. Other			2,887	1,457	\$1,430
H. Natural Resources			35,749	0	\$35,749
I. Construction-in-Progress			10,595	0	\$10,595
Total			<u>\$3,464,995</u>	<u>\$1,267,855</u>	<u>\$2,197,140</u>

J. Other Information: Line E. Equipment includes the amount of equipment intransit. Equipment intransit is not depreciated.

* Keys:

Depreciation Methods

SL - Straight Line

DD - Double-Declining Balance

SY - Sum of the Years Digits

IN - Interest (sinking fund)

PR - Production (activity or use method)

OT - Other

Range of Service Life

1-5 - 1 to 5 Years

6-10 - 6 to 10 Years

11-20 - 11 to 20 Years

>20 - Over 20 Years

NOTE 16. Debt: Not applicable

ANNEX B**Footnotes****NOTE 17. Other Liabilities (in thousands):****A. Other Liabilities Covered by Budgetary Resources:**

	Non- Current Liabilities	Current Liabilities	Total
1. Intragovernmental			
a. Unearned Revenue, Advances			
From Gov't and Funds	\$0	\$294,112	\$294,112
b. Unearned Revenue, Intra-Army	0	0	0
c. Deposit Fund Liabilities	0	0	0
d. Contingent Liabilities	0	0	0
e. Liability for Property Furnished by Others	0	194,017	194,017
f. Progress Billings to Others	0	0	0
Total	<u>\$0</u>	<u>\$488,129</u>	<u>\$488,129</u>

	Non- Current Liabilities	Current Liabilities	Total
2. Governmental			
a. Contract Holdbacks	\$0	\$21,090	\$21,090
b. Unearned Revenue, Advances			
From Public	0	35,059	35,059
c. Deferred Credits	0	4,506	4,506
d. Prior Liens on Acquired Collateral	0	0	0
Total	<u>\$0</u>	<u>\$60,655</u>	<u>\$60,655</u>

B. Other Information: None**C. Other Liabilities Not Covered by Budgetary Resources:**

	Non- Current Liabilities	Current Liabilities	Total
1. Intragovernmental			
a. Canceled Budget Authority	\$0	\$0	\$0
2. Governmental			
a. Environmental Liabilities	381,049	0	381,049
b. Acquired Leave Liability	0	6,079	6,079
Total	<u>\$381,049</u>	<u>\$6,079</u>	<u>\$387,128</u>

Footnotes

D. Other Information: Leave liability was acquired when the Information Services business entity was capitalized.

NOTE 18. Leases (in thousands): Not applicable

NOTE 19. Pensions and Other Actuarial Liabilities (in thousands):

<u>Activities</u>	<u>Plan Benefits</u>	<u>Rate (%)</u>	<u>Benefits</u>	<u>Liability</u>
A. Pension and Health Plans				
B. Insurance/Annuity Programs:				
C. Other:				
1. Workman's Compensation	\$128,876	See Item E.	\$0	\$128,876
D. Total	<u>\$128,876</u>		<u>\$0</u>	<u>\$128,876</u>

E. Other Information: 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:

1997

6.24 % in year 1
5.82 % in year 2
5.60 % in year 3
5.45 % in year 4
5.40 % in year 5 and thereafter

ANNEX B**Footnotes****NOTE 20. Net Position (in thousands):**

	Revolving Funds	Trust Funds	Appro- priated Funds	Total
A. Unexpended Appropriations				
1. Obligated				
a. Available	\$0	\$0	\$0	\$0
b. Unavailable	(225,439)	0	0	(225,439)
2. Undelivered Orders	0	0	0	0
B. Invested Capital	16,780,820	0	0	16,780,820
C. Cumulative Results of Operations	(3,453,717)	0	0	(3,453,717)
D. Other	0	0	0	0
E. Future Funding Requirements	(516,004)	0	0	(516,004)
F. Total	<u>\$12,585,660</u>	<u>\$0</u>	<u>\$0</u>	<u>\$12,585,660</u>

G. Other Information: The balance shown for unavailable appropriations was carried forward from the initial capitalization of the maintenance and ordnance depots into the Army Industrial Fund. The balance in Future Funding Requirements is composed of estimated costs for environmental cleanup, pensions and actuarial liabilities, and accrued annual leave. The annual leave was brought forward from the capitalization of the Information Services business area.

NOTE 21. Taxes (in thousands): Not applicable

Footnotes

NOTE 22. Other Revenues and Financing Sources (in thousands):

A. Other Revenues and Financing Sources:	<u>1997</u>	<u>1996</u>
1. Pensions/ORB's	\$142,109	\$0
2. Other Miscellaneous Gains	4,404	(10,425)
Total	<u>\$146,513</u>	<u>(\$10,425)</u>

B. Other Information: Imputed Pension and Other Retirement Benefits (ORB):		
CSRS/FERS Retirement	\$109,329	
Health	\$32,661	
Life Insurance	\$119	

The \$142,109 represents the imputed financing for pensions and other retirement benefits. 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.

NOTE 23: Program or Operating Expenses (in thousands):

A. Operating Expenses by Object Classification:	<u>1997</u>	<u>1996</u>
1. Personal Services	\$326,304	\$282,026
2. Travel and Transportation	8,056	18,889
3. Rental, Communication and Utilities	5,526	39
4. Printing and Reproduction	441	25
5. Contractual Services	918,346	904,195
6. Supplies and Materials	3,236	5,725
7. Equipment not Capitalized	2,642	8,051
8. Grant, Subsidies and Contributions	0	0
9. Insurance Claims and Indemnities	0	0
10. Other (describe)	0	0
11. Total Expenses by Object Class	<u>\$1,264,551</u>	<u>\$1,218,950</u>

C. Other Information: Repair costs for Depot Level Repairables was \$916,208 and is included in line 5, Contractual Services.

ANNEX B**Footnotes****NOTE 24. Cost of Goods and Services Sold (in thousands):**

A. Cost of Goods Sold	
1. Beginning Work-in-Process	\$363,307
2. Plus: Operating Expenses	2,124,132
3. Minus: Ending Work-in-Process	296,014
4. Minus: Completed Work for Activity Retention	0
Cost of Services Sold	<u>\$2,191,425</u>
 B. Cost of Material Sold from Inventory	
1. Beginning Inventory - L.A.C.	\$11,905,759
2. Less: Beginning Allowance for Unrealized Holding Gains (Losses)	1,145,628
3. Plus: Purchases at Cost	6,523,536
4. Plus: Customer Returns - Credit Given	2,971,370
5. Plus: DLR Exchange Credits	0
6. Less: Inventory Losses Realized	1,172,193
7. Less: Ending Inventory - L.A.C.	12,570,793
8. Plus: Ending Allowance for Unrealized Holding Gains (Losses)	2,384,329
9. Less: Equity Transfers of Inventory to Others	331,943
10. Plus: Equity Transfers of Inventory from Others	192,046
11. Equals Cost of Goods Sold from Inventory	<u>\$8,756,483</u>
 C. Intra eliminations	 1,824,449
 D. Total	 <u>\$9,123,459</u>

E. Other Information: Beginning and ending inventories are shown at standard less the surcharge for calculation of the cost of goods sold. The break-out between Cost of Goods Sold to the Public and Cost of Goods, Intragovernmental was calculated by proration based on revenues generated. Intra eliminations are subtracted to exclude transactions between Army Working Capital Fund entities. The reflected amount is from footnote 29 schedule B.

Footnotes

NOTE 25. Other Expenses (in thousands):

	<u>1997</u>	<u>1996</u>
A. Other Expenses		
1. Transfers to Property Disposal	\$1,628,215	\$1,420,323
2. Potential Excess Inventory Loss	(456,022)	(80,083)
3. Operating Materials and Supplies Variance	(12,063)	3,059
4. Payroll Variances	(17,422)	4,171
5. Losses on Sale of Fixed Assets	3,196	2,010
6. Retirement/ORB	142,109	
7. Other Miscellaneous Losses	(235,347)	(159,652)
Total Other Expenses	<u>\$1,052,666</u>	<u>\$1,189,828</u>

B. Other Information: Imputed Pension and Other Retirement Benefits (ORB):

CSRS/FERS Retirement	\$109,329
Health	\$32,661
Life Insurance	\$119

The \$142,109 represents the imputed financing for pensions and other retirement benefits. 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

NOTE 26. Extraordinary Items (in thousands):

A. Extraordinary Items:

1. BRAC Cost	<u>(\$22,684)</u>
--------------	-------------------

B. Other Information: None

ANNEX B

Footnotes

NOTE 27. Prior Period Adjustments (in thousands):

A. Prior Period Adjustments	
1. Change in Inventory Valuation	(\$1,129,426)
2. Write-off of Prior Year Accounts Receivable and Payable	0
3. Environmental Cleanup Liabilities	(381,049)
4. Funding for Prior Period Unfunded BRAC Costs	62,852
5. Other	11,463
Total	<u>(\$1,436,160)</u>

B. Other Information: 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.

NOTE 28. Non-Operating Changes - (Transfers and Donations) (in thousands):

	<u>1997</u>	<u>1996</u>
A. Increases		
1. Transfers-In:		
a. Cash	\$307,213	\$160,420
b. Property	2,873,178	230,819
2. Unexpended Appropriations	0	0
3. Donations Received	0	0
4. Other Increases	0	60,040
5. Total Increases	<u>\$3,180,391</u>	<u>\$451,279</u>
B. Decreases		
1. Transfers-Out		
a. Cash	\$262,573	\$0
b. Property	816,078	782,178
2. Donations	0	0
3. Other Decreases	79,990	51,902
4. Total Decreases	<u>\$1,158,641</u>	<u>\$834,080</u>
C. Net Non-Operating Changes (Transfers)	<u>\$2,021,750</u>	<u>(\$382,801)</u>

D. Other Information: Balance shown as Other Decreases includes the changes in unfunded liability for future workers compensation benefits.

Footnotes

NOTE 29. Intrafund Eliminations (in thousands):

Intrafund eliminations were included for Wholesale Supply Management, Depot Maintenance - Other, Depot Maintenance - Ordnance, and Information Services business areas. Revenues/Expenses eliminations may be misstated as the general ledger data used to produce the revenue figure did not include material returns (gross revenue) while status report data used to generate the elimination's included material returns (net revenue).

Schedule A Not applicable

Schedule B

Selling Activity:	Accounts	Revenue	Unearned	Collections
	Receivable		Revenue	
Supply Management	\$40,950	\$1,481,666	n/a	\$1,507,089
Depot Maintenance	14,073	341,869	n/a	342,278
Information Services	129	914	n/a	3,615
Total	\$55,152	\$1,824,449	n/a	\$1,852,982

Customer Activity:	Accounts	Expenses	Advances	Disbursements
	Payable			
Supply Management	\$39,307	\$1,553,143	n/a	\$1,564,458
Depot Maintenance	15,716	271,118	n/a	288,464
Information Services	129	188	n/a	60
Total	\$55,152	\$1,824,449	n/a	\$1,852,982

ANNEX B**Footnotes**
Schedule C

Selling Activity:	Accounts		Unearned	
	Receivable	Revenue	Revenue	Collections
Army - WCF	\$199,109	\$6,426,642	n/a	\$6,299,686
Unearned Revenue	0	0	\$224,878	0
Total	\$199,109	\$6,426,642	\$224,878	\$6,299,686

Customer Activity:	Accounts		Advances	Disbursements
	Payable	Expenses		
Department of the Army	\$157,244	\$5,277,759	n/a	\$5,133,053
Department of the Navy	9,064	174,823	n/a	193,225
Department of the Airforce	1,232	43,204	n/a	42,737
Army WCF	0	0	n/a	0
Navy WCF	2,264	63,355	n/a	63,496
Airforce WCF	3,384	161,067	n/a	164,586
DLA WCF	9,853	44,728	n/a	40,661
DISA WCF	717	6,298	n/a	7,007
DFAS WCF	478	2,971	n/a	3,695
DeCA WCF	330	287	n/a	466
JLSC WCF	0	(425)	n/a	(395)
U.S. TRANSCOM WCF	60	387	n/a	1,045
Other WCF	1,240	10,969	n/a	12,811
DoD Military Retirement Trust Fund	0	0	n/a	0
National Defense Stockpile	0	0	n/a	0
U.S. Army Corps of Engineers	392	905	n/a	915
Other Defense Organizations	12,851	640,314	n/a	636,384
Advances	0	0	\$224,878	0
Total	\$199,109	\$6,426,642	\$224,878	\$6,299,686

Footnotes

Schedule D

Selling Activity:	Accounts	Revenue	Unearned	Collections
	Receivable		Revenue	
Army - WCF	\$7,862	\$11,713	n/a	\$35,132
Unearned Revenue	0	0	\$356	0
Total	\$7,862	\$11,713	\$356	\$35,132

Customer Activity:	Accounts	Expenses	Advances	Disbursements
	Payable		Advances	
Defense Security Assistance Agency	\$0	\$0	n/a	\$0
General Services Administration	3,473	4,817	n/a	7,824
Agriculture	137	142	n/a	115
Interior	723	432	n/a	1,157
NASA	33	62	n/a	62
State	29	1,482	n/a	1,474
Transportation	1,481	2,948	n/a	1,918
Treasury	187	169	n/a	131
Veterans Administration	0	0	n/a	16
Other	1,799	1,661	n/a	22,435
Advances	0	0	\$356	0
Total	\$7,862	\$11,713	\$356	\$35,132

NOTE 30. Contingencies (in thousands): Not applicable

ANNEX B

Footnotes

NOTE 31. Other Disclosures

Problem Disbursements (in thousands):

The Fund 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 by a Treasury Disbursing Station Symbol Number (DSSN) 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 distorted; and (3) the research and resolution process can be very labor intensive. The following table shows the unmatched disbursements and Negative Unliquidated Obligations (NULO's) as of September 30, 1997. The dramatic increase in unmatched disbursements is attributable mainly to a change in reporting criteria during the year. In FY 1996 only the uncleared rejects were reported while in FY 1997 both uncleared rejects and the partial clearances are being used. If only the uncleared amount is considered for FY 1997, the increase is \$2,044 or 22.42%. This increase and the increase in NULO balances can be attributed to implementation of controls during FY 1997 to insure collection of data from all reporting stations. These controls should result in more accurate reporting and greater decreases in problem disbursements in future years.

	<u>1996</u>	<u>1997</u>	<u>Change</u>	<u>Percentage Change</u>
Unmatched Disbursements	\$9,118	\$51,647	\$42,529	466.43%
Negative Unliquidated Obligations	\$11,384	\$17,396	\$6,012	52.81%

SUPPORTING AUDIT REPORTS

Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997, Report On Internal Controls And Compliance With Laws and Regulations

Recommended Adjustments to Draft Army Working Capital Fund FY 97 Financial Statements

Army Working Capital Fund FY 97 Financial Statements, Fund Balance With Treasury

Army Working Capital Fund FY 97 Financial Statements, Accounts Receivable, Federal

Army Working Capital Fund FY 97 Financial Statements, Advances and Prepayments

Army Working Capital Fund FY 97 Financial Statements, Inventory, Net

Army Working Capital Fund FY 97 Financial Statements, Allowance for Unrealized Holding Gains and Losses

Army Working Capital Fund FY 97 Financial Statements, Assembly/Disassembly

Army Working Capital Fund FY 97 Financial Statements, Government Furnished Material

Army Working Capital Fund FY 97 Financial Statements, Materiel Return Program

Army Working Capital Fund FY 97 Financial Statements, Work in Process

Army Working Capital Fund FY 97 Financial Statements, Property, Plant and Equipment

Army Working Capital Fund FY 97 Financial Statements, Accounts Payable

Army Working Capital Fund FY 97 Financial Statements, Unearned Revenue

ANNEX C

Army Working Capital Fund FY 97 Financial Statements, Followup
Issues

Army Working Capital Fund FY 97 Financial Statements, Accounting
Support

Audit of the Compilation of the Army Working Capital Fund FY 97
Financial Statements at the Defense Finance and Accounting
Service - Indianapolis Center (Inspector General, DOD)

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
 Commander in Chief, U.S. Army, Europe and Seventh Army
 Commanders
 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. 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
 3rd MP Group, USACIDC
 6th MP Group, USACIDC
 Executive Director, U.S. Army Materiel Command Logistics Support Activity
 Directors
 Armament and Chemical Acquisition and Logistics Activity
 U.S. Army Center for Public Works
 Commandant, U.S. Army Logistics Management College
 Director, Center for Army Lessons Learned

ANNEX D

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 FY 1997 Army Working Capital Fund Financial Statements. 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,” issued by the President’s Council on Integrity and Efficiency, January 1993, and the “Financial Audit Manual,” December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the AAA audit. Specifically, we reviewed the engagement letter, documentation for the entrance conference, formulation of strategy, and audit plans and programs. We also reviewed additional documentation and participated in audit planning conferences and workshops coordinated by the AAA.

Monitoring Audit Progress. Through the DoD Financial Statement Audit 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 Working Capital Fund. We also reviewed and commented on related draft reports issued by the 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

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Denver Center

Non-Defense Federal Organizations and Individuals

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

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

F. Jay Lane
Salvatore D. Guli
Richard B. Bird
Jack L. Armstrong
Leslie M. Barnes
John E. Aber
James W. Chunn
Susanne B. Allen