Audit Report

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS FOR THE FY 1997 FINANCIAL STATEMENTS OF THE JOINT LOGISTICS SYSTEMS CENTER WORKING CAPITAL FUND

Report Number 98-146 June 5, 1998

Office of the Inspector General
Department of Defense

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Acronyms

DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
IG	Inspector General
FFMIA	Federal Financial Management Improvement Act
JFMIP	Joint Financial Management Improvement Program
JLSC	Joint Logistics Systems Center
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
USD(C)	Under Secretary of Defense (Comptroller)
USGSGL	U.S. Government Standard General Ledger
WCF	Working Capital Fund

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
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June 5, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
COMMANDER, JOINT LOGISTICS SYSTEMS CENTER

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of the Joint Logistics Systems Center Working Capital Fund (Report No. 98-146)

We are providing this final report for information and use. Because this report contains no recommendations, management comments were not required, and none were received.

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspector General and prescribes the responsibility of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. The Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," requires the Inspector General, DoD, to render an opinion on financial statements such as those of the Joint Logistics Systems Center, and to report on the adequacy of internal controls and compliance with laws and regulations.

On February 27, 1998, we disclaimed an opinion on the FY 1997 Financial Statements of the Joint Logistics Systems Center Working Capital Fund. Appendix C includes copies of our disclaimer of opinion and the financial statements. We found weaknesses in internal controls and compliance with laws and regulations that merit management's attention. Part I includes separate sections on internal controls and compliance with laws and regulations. Part II provides appendixes for management's use.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides, Audit Program Director, at (614) 751-1400, extension 11, e-mail jkornides@DODIG.OSD.MIL, or Mr. John K. Issel, Audit Project Manager, at (614) 751-1400, extension 12, e-mail jissel@DODIG.OSD.MIL. See Appendix F for the report distribution. The audit team member are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 98-146 **June 5, 1998**
(Project No. 8FJ-2001.01)

Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of the Joint Logistics Systems Center Working Capital Fund

Executive Summary

Introduction. This audit was performed as part of our effort to meet the requirements of 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. The Joint Logistics Systems Center (JLSC) was organized in FY 1992 to accomplish the Corporate Information Management goals for the depot maintenance and supply management business areas of the DoD Working Capital Funds. JLSC is responsible for designing, developing, and implementing DoD-wide automated information systems for depot maintenance and supply management. Preparation of the JLSC Working Capital Fund financial statements is the joint responsibility of JLSC and the Defense Finance and Accounting Service (DFAS). JLSC and DFAS are also responsible for establishing and maintaining an internal control structure and for complying with applicable laws and regulations. At the end of FY 1997, JLSC reported $1.59 billion in systems development costs on its financial statements. In September 1997, the Under Secretary of Defense (Comptroller) announced that JLSC would be terminated and directed JLSC to begin transferring its functions to the Military Departments on October 1, 1997.

Audit Objectives. The objective of this audit was to determine whether the FY 1997 Financial Statements of the JLSC Working Capital Fund were presented fairly and in accordance with the Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as modified by the Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. We also assessed the internal control program and compliance with laws and regulations for transactions and events that have a direct and material effect on the Property, Plant, and Equipment account on the JLSC Statement of Financial Position.

Disclaimer of Opinion. We were unable to render an opinion on the JLSC Working Capital Fund Financial Statements for FYs 1997 and 1996 because we did not perform sufficient work. We did not perform sufficient work because JLSC began terminating its operations in October 1997. However, our limited work indicated that because of significant deficiencies in the accounting systems and internal control structure, it was unlikely that the financial statements for FYs 1997 and 1996 were reliable. Our disclaimer of opinion was included in the financial statements transmitted by the Under Secretary of Defense (Comptroller) to the Office of Management and Budget. Appendix C includes copies of our disclaimer of opinion and the financial statements,

and Appendix D includes management and legal representation letters for the JLSC Working Capital Fund.

Internal Controls. Internal controls were not adequate to ensure the accurate reporting of Property, Plant, and Equipment accounts, resulting in material overstatements on the FY 1997 JLSC Working Capital Fund Financial Statements. JLSC inappropriately reported $1 billion in development costs for systems that were already in operation at various Working Capital Fund organizations, and $500 million in development costs for canceled systems. This occurred because the Under Secretary Defense (Comptroller) did not provide adequate guidance to JLSC on how to equitably allocate the systems development costs to the depot maintenance and supply management organizations of the Working Capital Funds, so that those organizations could capitalize and report the value of the assets received.

Compliance With Laws and Regulations. JLSC disclosed in the footnotes to its FY 1997 financial statements that accounting systems did not comply with DoD accounting standards. JLSC stated that it had not implemented the DoD Standard General Ledger chart of accounts or a transaction-driven general ledger system that would consolidate financial data for management decision making and financial statement reporting. Instances of noncompliance with laws and regulations were identified during the audit. JLSC did not fully comply with DoD accounting policy for capital assets. JLSC initially recorded $1.59 billion of systems development costs on the Construction-in-Progress account. However, when the systems were completed and installed, JLSC did not properly transfer about $1 billion in systems development costs to the receiving Working Capital Fund organizations, as required by DoD policy.

Management Comments. We provided a draft of this report to management on April 10, 1998. Because this report contains no recommendations, management comments were not required, and none were received. Therefore, we are publishing this report in final form.

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Part I - Audit Results

Audit Background

Introduction. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires financial statement audits for activities such as the JLSC Working Capital Fund (WCF). The JLSC was organized in FY 1992 to meet Corporate Information Management goals for depot maintenance and supply management business areas of the DoD Working Capital Funds. The JLSC is responsible for designing, developing, and implementing DoD-wide automated information systems for depot maintenance and supply management. At the end of FY 1997, JLSC reported $1.59 billion in systems development costs on its financial statements. In September 1997, the Under Secretary of Defense (Comptroller) (USD[C]) announced that the JLSC would be terminated and directed JLSC to begin transferring its functions to the Military Departments on October 1, 1997.

Accounting Functions and Responsibilities. The Defense Finance and Accounting Service (DFAS) performs accounting functions and prepares financial statements for the JLSC. The DFAS and JLSC jointly prepare the financial statements. DFAS is responsible for entering information from DoD entities into the financial systems, operating and maintaining the financial systems, and ensuring the continued integrity of the information entered. The DoD entities are responsible for providing accurate financial information to DFAS.

Accounting Principles. The JLSC financial statements for FYs 1997 and 1996 were to be prepared in accordance with the OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as amended by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. Footnote 1 of the JLSC financial statements discusses the significant accounting policies followed in preparing the financial statements.

Disclaimer of Opinion. On February 27, 1998, we disclaimed an opinion on the JLSC WCF Financial Statements for FYs 1997 and 1996. We did not allocate the resources needed for a complete audit of the JLSC financial statements. We did not perform a complete audit of JLSC financial statements because JLSC began terminating its operations in October 1997. For us to perform an audit that applies generally accepted accounting principles, a reporting entity must be a going concern. We limited our work to the Property, Plant, and Equipment (PP&E) asset account on the Statement of Financial Position, with primary emphasis on the Construction-in-Progress account because it represented the entire $1.59 billion of the entity's assets, as shown on the FY 1997 financial statements. Our work showed that significant deficiencies existed in the JLSC accounting systems and internal control structure. Consequently, the JLSC financial statements for FYs 1997 and 1996 were not reliable. Our disclaimer of opinion was included in the financial statements transmitted by the USD(C) to the Office of Management and Budget. See Part II, Appendix C, for the financial statements and the audit opinion.

Audit Objectives

The objective of this audit was to determine whether the FY 1997 Financial Statements of JLSC were presented fairly and in accordance with the Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as modified by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. We also assessed the internal control program and compliance with laws and regulations for transactions and events that have a direct and material effect on the PP&E account on the Statement of Financial Position.

Part I. A. - Review of Internal Controls

Introduction

Audit Responsibilities. Our audit objective was to determine whether controls over transactions supporting the accounts in the FY 1997 Financial Statements of the JLSC WCF were adequate to ensure that the accounts were free from material error. In planning and performing our work on the JLSC financial statements for the year ended September 30, 1997, we evaluated internal controls, including the implementation of the DoD management control program. The purposes of this evaluation were:

o to determine our procedures for rendering an opinion on the financial statements, and

o to determine whether an internal control structure had been established.

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

Management Responsibilities. The management of JLSC is responsible for establishing and maintaining internal controls. This responsibility requires management to make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. Internal controls are to provide management with reasonable, but not absolute, assurance that:

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

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

o transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and in compliance with any other laws and regulations that OMB and the entity's management or the auditors have identified as significant and for which compliance can be objectively measured and evaluated.

Internal Control Elements. The purpose of our review of internal controls was to render an opinion on the financial statements. The three elements of internal controls are the control environment, accounting and related systems, and control procedures. The control environment is the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific polices and procedures. Such factors include management's philosophy and operating style, the entity's organizational structure, and personnel policies and practices. The control environment reflects the overall attitude, awareness, and actions of management concerning the importance of controls and the emphasis placed on them by the entity. Accounting and related systems are the methods and records established to identify, assemble, analyze, classify, record, and report on the entity's transactions and to maintain accountability for the related assets and liabilities. Control procedures are the policies and procedures, in addition to the control environment and the accounting and related systems, which management has established to provide reasonable assurance that specific objectives will be achieved.

Reportable Conditions

Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and to ensure the preparation of reliable and accurate financial information for management's use in evaluating performance. A material weakness is a reportable condition in which the design or operation of an internal control structure element does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors or irregularities would be in amounts that would be material to the statements being audited and would not be detected within a timely period by employees in the normal course of performing their functions.

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

Material Weaknesses Reported by Management. In the FY 1997 Statement of Assurance, JLSC reported that the controls necessary to execute its mission effectively were in place and that the management control program did not detect any material control weaknesses.

Overall Conditions Noted by Auditors. Internal controls were not adequate to ensure the accurate reporting of PP&E accounts on the financial statements. The FY 1997 Financial Statements of the JLSC WCF were materially overstated.

DoD financial policy requires that capital assets acquired by JLSC and distributed and installed at WCF organizations must be capitalized and depreciated in the financial records of each receiving organization. After systems were delivered and installed at various WCF organizations, JLSC did not properly transfer the costs of developing the systems to the receiving organizations for capitalization. By the end of FY 1997, JLSC systems developers estimated that they had incurred $1.59 billion in development costs.

Of the $1.59 billion, $1 billion represented the costs of developing systems that had been installed and were operating at various WCF organizations. For example, by the end of FY 1996, JLSC had installed the Programmed Depot Maintenance Scheduling System, which cost over $24 million, at 21 depot maintenance sites.

In addition to the installed systems, JLSC incurred $500 million in development costs for systems that were canceled because of a change in the Corporate Information Management goal of developing DoD-wide systems. For example, JLSC had incurred costs of $111 million for the Material Management Standard System before it was canceled. These costs were shown on the JLSC financial statements as Construction-in-Progress.

JLSC personnel told us that they did not transfer systems development costs because they did not know how to properly implement USD(C) financial policy for the costs of developing systems that had been installed, and because the financial policy did not address accounting for the costs of canceled systems. In September 1994, JLSC requested that the USD(C) provide guidance on the proper method of allocating systems development costs, but the USD(C) stated that this issue should be presented to the former Defense Business Operations Fund Corporate Board (now the WCF Policy Board). The issue has not been presented to the WCF Policy Board, and JLSC has not allocated its systems development costs to the various WCF organizations.

Summary. Internal controls over the financial reporting of JLSC PP&E were not adequate to ensure that when JLSC incurred costs to develop systems that were placed into operation at WCF organizations, the costs were transferred to those organizations. Also, JLSC did not appropriately account for the costs of developing systems that were canceled.

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

Introduction

We evaluated the JLSC WCF for material instances of noncompliance with laws and regulations in FY 1997. Our audit objective was to assess compliance with laws and regulations for transactions and events that could have a direct and material effect on the financial statements. Such tests are required by the "Chief Financial Officers Act of 1990," as amended by the "Federal Financial Management Act of 1994." We reviewed compliance with selected laws and regulations in order to obtain reasonable assurance that the PP&E account on the Statement of Financial Position was free of material misstatements. Our objective was not to render an opinion on overall compliance with such provisions. See Appendix E for a list of the laws and regulations we reviewed.

The USD(C); the Commander, JLSC; and the Director, DFAS, are responsible for ensuring compliance with laws and regulations applicable to JLSC. To obtain reasonable assurance as to whether the PP&E accounts were free of material misstatements, we tested compliance with laws and regulations that may directly affect the account.

Title 31, U.S.C. 3512, "Federal Financial Management Improvement Act of 1996." On September 9, 1997, OMB issued a memorandum, "Implementation Guidance for the Federal Financial Management Improvement Act (FFMIA) of 1996." The FFMIA requires Federal agencies to implement and maintain financial management systems that comply substantially with Federal requirements for financial management systems, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (USGSGL) at the transaction level. The FFMIA also requires that we report on agency compliance with Federal requirements and accounting standards and the USGSGL. These requirements are well-established in the following Federal policy documents.

- OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, establishes Government policy for developing, evaluating, and reporting on financial management systems. It requires financial management systems to provide complete, reliable, consistent, timely, and useful financial management information. To achieve this goal, DoD and other Federal agencies must establish and maintain a single, integrated financial management system using the USGSGL.

- OMB Circular No. A-134, "Financial Accounting Principles and Standards," May 20, 1993, establishes policies and procedures for approving and publishing financial accounting principles and standards.

It also establishes the policies that Executive branch agencies and OMB are to follow in seeking and providing interpretations and other advice related to the standards.

- The Joint Financial Management Improvement Program (JFMIP) is a cooperative undertaking of the OMB, the Department of the Treasury, and the Office of Personnel Management, working with each other and with operating agencies to improve financial management practices throughout the Government. The JFMIP has published a series of "Federal Financial Management System Requirements."

- The "Core Financial System Requirements," September 1995, which are part of the JFMIP "Federal Financial Management System Requirements," establish standard requirements for the foundation modules of an agency's integrated financial management system. These requirements state that a financial management system must support the partnership between program and financial managers and assure the integrity of information for decision making and measuring performance.

As part of our audit to obtain reasonable assurance about whether the FY 1997 JLSC WCF Financial Statements were free of material misstatement, we performed tests of their compliance with certain provisions of laws and regulations when noncompliance could have a direct and material effect on the determination of amounts in the financial statements. We also tested compliance with certain other laws and regulations specified in OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, as modified by OMB Bulletin No. 94-08, "Addendum to OMB Bulletin No. 93-06," January 16, 1998. In planning and performing our tests of compliance, we considered the implementation guidance issued by OMB on September 9, 1997, relating to the FFMIA.

Reportable Conditions

Material instances of noncompliance are failures to follow laws or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures is either material to the financial statements, or that the sensitivity of the matter would cause others to perceive it as significant.

Compliance With Laws and Regulations. Instances of noncompliance with laws and regulations were identified during the audit.

Accounting Policy for PP&E. JLSC did not fully comply with DoD accounting policy for capital assets. DoD 7000.14-R, the "DoD Financial Management Regulation," volume 11B, "Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund," December 1994, chapter 58, section E.6.b., provides accounting policy for capital assets that are acquired by a central agent such as JLSC on behalf of WCF organizations. DoD 7000.14-R states:

> 1. Business areas, such as the Joint Logistics Systems Center, may from time to time be designated as a central agent to procure capital assets for customers within the former Defense Business Operations Fund (DBOF), now the WCFs. The procuring business area shall issue contracts to commercial sources or funded orders to other DBOF activities and DoD Components as necessary, to satisfy the requirement.
>
> 2. Capital assets may be sold or transferred to customers of the central agent at negotiated selling or transfer prices. Negotiated selling or transfer prices shall include the total cost of the capital asset which consists of contractual cost net of discounts taken, reimbursable support cost, applicable overhead, general and administrative costs incurred in the acquisition of the asset plus any approved surcharges.
>
> 3. A capital asset acquired by a central agent and distributed and installed in one or more business areas shall be capitalized in the financial records of each business area and depreciated.
>
> 4. When the share of the cost of a capital asset distributed and installed at a business area fails to meet the investment capitalization criteria, it nevertheless shall be capitalized and depreciated if the aggregate initial cost of the asset distributed to all business areas, satisfies the investment threshold.

JLSC complied with the policy by initially recording systems development costs as Construction-in-Progress in its financial statements. However, when the systems were completed and installed at various WCF organizations, JLSC did not properly transfer the costs of development to the receiving organization, as required by DoD policy. This noncompliance with regulations was also discussed as a reportable condition in our review of internal controls (see Part I.A.), and was previously reported in IG, DoD, Report No. 98-060 (see Appendix B).

Accounting Standards. For FY 1997, the financial management systems that support the JLSC financial statements were not in substantial compliance with the requirements of the FFMIA. The JLSC did not comply with Federal requirements for financial management systems, applicable Federal accounting standards, and the USGSGL at the transaction level. JLSC also reported these conditions in the footnotes to its FY 1997 financial statements.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Statements Reviewed. We examined the JLSC Principal Statements and the Notes to the Principal Statements for FY 1997. The Principal Statements included the Statement of Financial Position and the Statement of Operations and Changes in Net Position. Also included were the Footnotes, Overview, and Supplemental Information. Our disclaimer of opinion is based on the Principal Statements dated September 30, 1997.

Audit Type and Standards. We conducted this financial-related audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General (IG), DoD, and OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements. We also relied on our professional judgment in assessing the materiality of matters affecting the fair presentation of the financial statements, related internal controls, and compliance with laws and regulations.

Accounting Principles. Accounting principles and standards for the Federal Government are under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to three officials for approval. Those three officials are the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. The Director, OMB, and the Comptroller General issue standards agreed on by the three officials. To date, seven accounting standards and two accounting concepts have been published in final form. Accounting Standard No. 8 has been approved by the Federal Accounting Standards Advisory Board, but it must be reviewed by Congress before it is issued. In addition, the Federal Accounting Standards Advisory Board issued an exposure draft, "Amendments to Accounting for Property, Plant, and Equipment," February 13, 1998, proposing amendments to Standards No. 6 and No. 8. These standards and concepts constitute generally accepted accounting principles for the Federal Government. OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01, incorporates these standards and concepts and should be used by Federal agencies to prepare their financial statements. The table below lists the "Statements of Federal Financial Accounting Standards and Concepts."

Statements of Federal Financial Accounting Standards and Concepts

Accounting Standards and Concepts	Title	Status	Fiscal Year Effective
Standard No. 1	Accounting for Selected Assets and Liabilities, March 30, 1993	Final	1994
Standard No. 2	Accounting for Direct Loans and Loan Guarantees, August 23, 1993	Final	1994
Standard No. 3	Accounting for Inventory and Related Property, October 27, 1993	Final	1994
Standard No. 4	Managerial Cost Accounting Concepts and Standards for the Federal Government, July 31, 1995	Final	1998
Standard No. 5	Accounting for Liabilities of the Federal Government, December 20, 1995	Final	1997
Standard No. 6	Accounting for Property, Plant, and Equipment, November 30, 1995	Final*	1998
Standard No. 7	Accounting for Revenue and Other Financing Sources, May 10, 1996	Final	1998
Standard No. 8	Supplementary Stewardship Reporting, June 11, 1996	Approved*	
Concept No. 1	Objectives of Federal Financial Reporting, September 2, 1993	Final	
Concept No. 2	Entity and Display, June 6, 1995	Final	

*FASAB issued an exposure draft, "Amendments to Accounting for Property, Plant, and Equipment," on February 13, 1998. The exposure draft contains proposed amendments to Standards No. 6 and No. 8.

Through FY 1997, agencies were required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01. The FY 1997 hierarchy includes standards agreed to and published by the Director, OMB, the Secretary of the Treasury, and the Comptroller General of the United States. It also includes requirements for the form and content of financial statements outlined in OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01; accounting standards contained in agency accounting policy, procedures, or other guidance as of March 29, 1991; and accounting principles published by other authoritative sources.

Scope of Review. We did not allocate the resources needed to perform a complete audit of the JLSC financial statements. JLSC began terminating its operations in October 1997; for us to perform an audit that applies generally accepted accounting principles, an entity must be a going concern. Also, because the DBOF was separated into WCFs late in FY 1997, we could not perform a complete audit of the JLSC financial statements, as defined by Government auditing standards, in the time allowed. We concentrated on the appropriateness of the PP&E asset account on the JLSC Statement of Financial Position, with primary emphasis on the Construction-in-Progress account because it represented the entire $1.59 billion of the entity's assets as shown on the FY 1997 financial statements.

To perform the audit, we obtained supporting data for all of the PP&E included in the FY 1997 Financial Statements. We also obtained cost data on systems developments as of September 30,1996. Additionally, we reviewed data on WCF program budget decisions that established JLSC system development funding for FYs 1992 through 1999. We also reviewed USD(C) financial policies for the WCF on the capitalization, depreciation, and financial statement reporting of PP&E. With senior managers in the Office of the USD(C) and JLSC, we discussed the equitable transfer of JLSC systems development costs to the depot maintenance and supply management business areas of the WCF. We also tested internal controls and compliance with laws and regulations for the PP&E accounts.

Use of Computer-Processed Data. We relied on computer-processed data from the JLSC Integrated Management System to determine the costs that JLSC incurred to develop automated systems for the depot maintenance and supply management business areas of the WCF. We did not establish the reliability of the data because we did not allocate sufficient resources in order to perform this assessment. Although we did not perform a formal reliability assessment, we determined that the contract numbers, contractor data, and systems development costs generally agreed with the computer-processed data. We did not find errors that would preclude use of the computer-processed data to meet the audit objectives or that would change the conclusions in the report.

Audit Period. The audit was conducted from October 1997 through February 1998.

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

Appendix B. Prior Audit Reports

IG, DoD, Report No. 98-060. This report, "Joint Logistics Systems Center Reporting of Systems Development Costs," was issued on February 3, 1998. The auditors concluded that JLSC did not transfer $1.54 billion of systems development costs, incurred through the end of FY 1996, to the depot maintenance and supply management organizations responsible for capitalizing and reporting the costs on the financial statements. As a result, the JLSC Financial Statements for FY 1996 were materially overstated, and unless the systems development costs are transferred to the appropriate organizations, the JLSC financial statements for FY 1997 and beyond will continue to be overstated. Also, the financial statements of the organizations that received the capital assets (the systems that JLSC developed) will be understated. In addition, unless the depreciation costs of JLSC systems developments are recorded as unfunded costs, customers of the WCF organizations for which the systems were developed will have to pay nearly $2 billion in development costs again.

We recommended that the USD(C) provide guidance to JLSC on how to equitably allocate its systems development costs to the WCF organizations. We recommended that the USD(C) direct those organizations to capitalize JLSC systems development costs and report the costs in their financial statements, as required by DoD 7000.14-R, volume 11B. We also recommended that JLSC systems development costs be exempt from recovery of depreciation costs because those costs were paid previously. Instead, depreciation of JLSC systems development costs should be recorded on accounting records in an unfunded depreciation account. The USD(C) generally concurred with the report and initiated corrective actions.

IG, DoD, Report No. 94-147. This report, "Joint Logistics Systems Center's Financial Statements for FY 1993," was issued on June 24, 1994. The auditors disclaimed an opinion on the FY 1993 financial statements because the accounting system, as JLSC acknowledged in its management representation letter, did not provide the information needed for the financial statements. Additionally, JLSC had not established controls to provide reasonable assurance that material misstatements in the financial statements would be prevented. We recommended that JLSC establish a management control program, capitalize all applicable capital assets and disclose the extent of no-cost usage for facilities and services, discontinue the use of operating funds on capital projects, and establish effective year-end close-out procedures to ensure that the financial statements show all project expenditures. JLSC management generally concurred with the recommendations and stated that they were working with DFAS to correct the deficiencies.

Appendix C. Financial Statements and Auditor Opinion

Joint Logisitcs Systems Center
Working Capital Fund

Chief Financial Officer Annual Financial Statement FY 1997

February 27,1998

JOINT LOGISTICS SYSTEMS CENTER

WORKING CAPITAL FUND

OVERVIEW

Joint Logistics Systems Center
Overview of the Reporting Entity

1. Program Summary

The Joint Logistics Systems Center (JLSC) was established in March 1992 with the mission of achieving Logistics Functional Area goals for the Department of Defense (DoD) Depot Maintenance (DM) and Supply Management (SM) business areas by managing the design, development and implementation of corporate DoD systems and facilitating improved logistics business processes. The JLSC is a jointly staffed organization with military and civilian personnel from each of the Military Services and the Defense Logistics Agency (DLA). Unlike most other Working Capital funds, JLSC does not have an operating budget consisting of revenue and expense. The JLSC operating budget is part of the total capital budget and pays for the normal operations of JLSC; i.e., payroll for personnel assigned to the JLSC, moving expenses, travel, supplies, office equipment, etc. Civilian end strengths and workyears are reflected in the Components' budgets, while salaries are budgeted and paid for by JLSC.

JLSC is working closely with the DoD Logistics community to effectively integrate strategies, business processes, data, information systems, technologies and resources to "equip the warfighters with improved logistics processes, systems and information." The JLSC's primary responsibility is the development of logistics information systems within the DM and SM business areas. The JLSC-developed logistics systems will provide reliable, flexible, and prompt logistics support, information, and services resulting in a more effective and efficient logistics infrastructure.

The JLSC has evolved from an initial strategy of supporting Near Term Initiatives (NTIs), which provided specific capabilities to the Military Services and the DLA resulting in substantial immediate benefits, to a strategy based upon consensus within the Logistics Community. This budget funds development, deployment, and sustainment of the requirements as identified by the Deputy Under Secretary of Defense for Logistics (DUSD{L}). Failure to provide the necessary resources will result in either a delay in the current schedule or fielding systems which do not contain all of the functionality required by the JLSC's customers.

The JLSC will have delivered or deployed most of its projects by the end of FY98, at which time the projects enter the sustainment phase. The objective of the DUSD(L) is to transfer all residual acquisition and sustainment responsibility to the Services by the end of FY 98. FY99 funding is to complete transfer actions of the JLSC projects to the Services and DLA and to complete closure of the JLSC as an organization.

Preliminary plans have been drafted to transfer each of the projects to a Lead Component which will accept and execute all program management responsibilities. In the case where there is more than one Component receiving an application, one is designated as the Lead and the others will receive support. Negotiations are currently underway between the JLSC and Lead Components to prepare Program Management Responsibility Transfer (PMRT) plans for each of the Depot Maintenance (DM) and Materiel Management (MM) projects. Additionally, a second memorandum of agreement will be negotiated between the Lead Component and the supported Components which will address their interaction in areas such as requirements, funding, and configuration management. Program development, maintenance, and configuration management responsibility for the DM and MM projects continue to reside within JLSC until transferred to the Component. No projects were transferred in FY97.

On August 18, 1997, the Acting Under Secretary of Defense (Comptroller) approved the final decisions and approved recommendations resulting from the Working Capital Fund Study Group. Among the decisions was one to terminate JLSC and begin to devolve its programs and responsibilities to the individual Components no later than October 1, 1997. The decision included a prohibition of any new starts at JLSC, required the individual activity groups or Defense Working Capital Funds (DWCFs) to be responsible for financing the liquidation of any unfunded liabilities remaining at JLSC, and directed the return of any unneeded cash and financial assets not used for paying off program liabilities or program shutdown costs or not needed for the initial deployments of systems developed by JLSC.

The Depot Maintenance Systems (DMS) applications address major end item management, commodities repair, and specialized support. The objective is to provide to the user a suite of service specific migration applications with basic interfaces to the legacy environment. This budget through FY98 supports the development, deployment and program management for the DMS applications currently approved by the DUSD(L). The current DMS projects are:

- Manufacturing Resource Planning Commercial Off-The-Shelf System (MRP II COTS)
- Interservice Material Accounting and Control System (IMNACS)
- Depot Maintenance-Hazardous Material Management System (DM-HMMS)
- Enterprise Information System (EIS)
- Facilities and Equipment Maintenance (FEM)
- Laboratory Information Management System (LIMS)
- Tool Inventory Management Application (TIMA)
- Baseline Advanced Inventory Management (BAIM)
- Programmed Depot Maintenance Scheduling System (PDMSS)
- NAVAIR Depot Maintenance (DM) System
- DM System beyond Jax

The Materiel Management Systems (MMS) applications support business processes of the DoD Inventory Control Points (ICPs). The budget through FY98 funds development, deployment, sustainment, and program management of these applications as identified and approved by the DUSD(L). The current MMS projects are:

- Configuration Management Information System (CMIS)
- Maintenance Planning and Execution (MP&E)
- Stock Control System (SCS)
- Math Models
- Commercial Asset Visibility II (CAV II)
- Defense Supply Expert System (DESEX)

In addition to the requirements for the development and deployment of JLSC applications, JLSC received Component legacy funding for "must changes"; i.e., public law, Congressional mandates, and to assist Components in their efforts toward Defense Information Infrastructure Common Operating Environment (DII COE) compliance. Legacy systems are those automated information systems currently in place at the Component's DM and SM business areas. In FY98, most JLSC Legacy funding will be transferred to the Components. The Defense Integrated Subsistence Management System (DISMS) and Defense Medical Logistics Standard System-Wholesale (DMLSS-W), will be transferred from the JLSC to the DLA beginning in FY98.

Also included in the FY97 & FY98 budget is funding for Logistics Community Management (LCM). The LCM charter was coordinated with the Components and signed by DUSD(L) and endorsed by the Logistics Directorate of the Joint Chiefs of Staff (JCS J-4) in July, 1997. The Logistic Community Manager will facilitate the identification of joint requirements, development of interservice common business practices, and the promotion of a common interface with industry. The organization will work with the DII COE to support the needs of the logistics enterprise and orchestrate the transition to management and operations of a shared data environment.

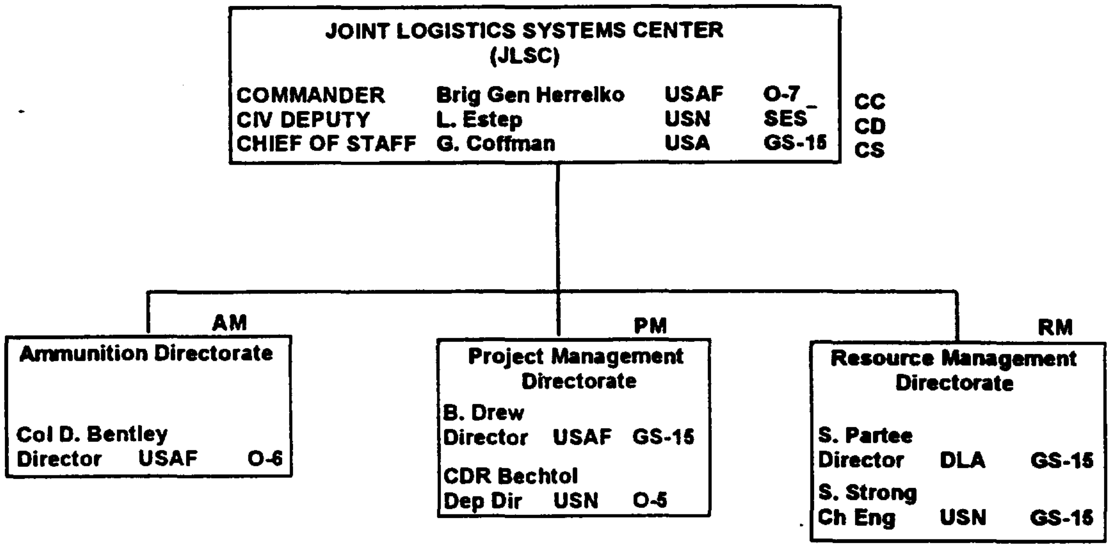
The LCM is not a mission of the JLSC but is currently funded as part of the JLSC because the requirement arose from a central logistics perspective and DUSD(L) identified those requirements in the JLSC budget.

2. Description of the Reporting Entity

The JLSC operates as a joint center at Wright Patterson AFB OH with representation from the Army, Navy, Air Force, Marine Corps and Defense Logistics Agency (the Components). The JLSC receives direction/oversight from four sources: Assistant Secretary of Defense for Command, Control, Communications and Intelligence (ASD C{3}I)-Technical, DUSD(L)-Functional, Office Secretary of Defense Comptroller (OSD-C)-Budget and Air Force/Program Element Office Joint Logistics (AF/PEOJL) -Acquisition/Execution.

Effective 1 Sep 1997, the JLSC restructured its operations. The JLSC organization is depicted below:

Restructured JLSC Organization



Although JLSC is an activity within the Defense Working Capital Fund (DWCF), the JLSC does not have the typical customer-supplier relationships found with other business areas. The JLSC centrally procures investments for the Supply Management and Depot Maintenance business areas within the DWCF. The nature of JLSC's mission is such that it does not routinely sell a product or service to its customers in order to generate revenue to offset costs incurred in the development of software projects. The JLSC's ultimate customers are the functional activities within the Components who will use the JLSC-sponsored capital investments to provide goods and services to their customers. JLSC's costs were to be recouped to the DWCF when software projects under its purview were transferred to the Components and depreciation of these systems commences. However, the Components have been directed to incorporate all JLSC costs into their sales rates, thus recouping these costs through surcharges based on actual JLSC disbursements.

The JLSC's total DWCF Annual Operating Budget (AOB) for FY97 was \$171.3M. The AOB was comprised of JLSC capital authority (\$119.6M), JLSC operating authority (\$29.6M), LCM capital authority (\$12.0M), and direct reimbursable authority (\$10.1M).

The JLSC FY97 workforce profile was as follows:

	Military	Civilian	Total
Air Force	9	77	86
Army	3	40	43
Navy	6	36	42
USMC	3	8	11
DLA	0	47	47
Total	21	208	229

3. Program Performance Measures

During FY97, the JLSC continued implementation of its program to identify and implement performance measures across its programs. These measures were designed specifically to support the needs of program management for day-to-day decision making, as well as provide needed inputs for Joint Program Reviews and Major Automated Information System (MAIS) reporting. There are two categories of measures program managers and project leads use to manage their programs/projects at JLSC, Key Program Measures and Key Software Development Metrics. Among those being used on JLSC projects are these specific measurement areas:

Key Program Measures:

- Funding - compares the amount of funding required to execute the program each year with the amount of funding approved
- Schedule - compares planned program activities (i.e., deployments of applications, interface activities, etc.) to the actual activities completed during the period
- Requirements - compares the functionality deployed by projects to the total functionality to be deployed

Key Software Development Metrics

- Schedule - compares the actual milestones completed to the established milestone schedule
- Development - compares the contractor's development activities to the established development schedule
- Software Size - compares the actual size of the software being developed to the estimated software size
- Requirements Changes - compares the total number of requirements to the cumulative number of requirement changes
- Staffing - compares the contractor's actual staffing and unplanned losses to the planned staffing
- Software Problem Status Report - compares the total number of Class 1 reports that are closed to the total number of Class 1 reports
- Number of Waivers - tracks the total number of waivers that were requested to the JLSC Integrated Technical Architecture/Common Operating Environment (ITA/COE) when finalized

4. Financial Performance Measures

The JLSC is accountable for its performance to its customer community, to the logistics functional managers in OSD, and to the DWCF managers in USD(C). In order to track financial performance and ensure accountability, the JLSC identified the requirement to include financial performance measures as part of its overall performance reporting. In FY97, the JLSC reported the status of obligations and expenditures against a time-phased spend plan and the AOB. This information was presented at all program reviews to both DUSD/L and SAF/AQ.

5. Financial Management Challenges

The JLSC has been approached by some non-DWCF entities and even some non-DoD entities with interest in acquiring some of our systems once completed. With this in mind, the JLSC requested and obtained reimbursable authority from USD(C) for FY97.

With the closure of the JLSC rapidly approaching, FY92-98 accounts are being researched and reconciled for closure. The Air Force (AFMC/FM) has been tasked with follow-on close out actions not completed by JLSC at time of closure. Therefore, the JLSC is trying to clean up as many open accounts as possible before closure, making it less of a burden on the Air Force. A team of four people has been established to work full time on this effort.

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JOINT LOGISTICS SYSTEMS CENTER

WORKING CAPITAL FUND

PRINCIPAL STATEMENTS

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS	1997	1996
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	($103,288)	($165,343)
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	(689)	3
(4) Interest Receivable	0	0
(5) Advances and Prepayments	0	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)	0	0
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0
(4) Interest Receivable, Net	0	0
(5) Advances and Prepayments	0	0
(6) Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	0	0
e. Work in Process (Note 9)	0	0
f. Operating Materials/Supplies, Net (Note 10)	0	0
g. Stockpile Materials, Net (Note 11)	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)	1,593,875	1,305,516
l. War Reserves	0	0
m. Other Entity Assets	0	0
n. Total Entity Assets	$1,489,898	$1,140,176
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.

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
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**	$0	$0
3. Total Assets	$1,489,898	$1,140,176
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$23,100	($30,531)
(2) Interest Payable	0	0
(3) Debt (Note 16)	0	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	211	50
(b) Annual Accrued Leave	767	4,104
(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)	0	0
c. **Total Liabilities Covered by Budgetary Resources:**	$24,078	($26,377)

The accompanying notes are an integral part of these statements.

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
Statement of Financial Position
As of September 30, 1997
(Thousands)

LIABILITIES, Continued	1997	1996
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)	1,804	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. Total Liabilities Not Covered by Budgetary Resources	$1,804	$0
6. Total Liabilities	$25,882	($26,377)
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$0	$0
b. Invested Capital	1,615,241	1,287,737
c. Cumulative Results of Operations	(149,421)	(121,184)
d. Other	0	0
e. Future Funding Requirements	(1,804)	0
f. Total Net Position	$1,464,016	$1,166,553
8. Total Liabilities and Net Position	$1,489,898	$1,140,176

The accompanying notes are an integral part of these statements.

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used	$0	$0
2. Revenues from Sales of Goods and Services		
a. To the Public	0	0
b. Intragovernmental	0	0
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	1,628	0
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0	0
8. Total Revenues and Financing Sources	$1,628	$0
EXPENSES		
9. Program or Operating Expenses (Note 23)	$27,733	$37,994
10. Cost of Goods Sold (Note 24)		
a. To the Public	0	0
b. Intragovernmental	0	0
11. Depreciation and Amortization	555	555
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	0
14. Other Expenses (Note 25)	1,628	0
15. Total Expenses	$29,916	$38,549
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($28,288)	($38,549)
17. Plus (Minus) Extraordinary Items (Note 26)	0	0
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($28,288)	($38,549)

The accompanying notes are an integral part of these statements.

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
EXPENSES, Continued		
19. Net Position, Beginning Balance, as Previously Stated	$1,166,553	$832,383
20. Adjustments (Note 27)	0	0
21. Net Position, Beginning Balance, as Restated	$1,166,553	$832,383
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(28,288)	(38,549)
23. Plus (Minus) Non Operating Changes (Note 28)	325,751	372,719
24. Net Position, Ending Balance	$1,464,016	$1,166,553

The accompanying notes are an integral part of these statements.

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($28.288)	($38,549)
Adjustments Affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	692	7
4. Decrease (Increase) in Other Assets	0	0
5. Increase (Decrease) in Accounts Payable	53,632	(41,233)
6. Increase (Decrease) in Other Liabilities	(1.372)	1,398
7. Depreciation and Amortization	555	555
8. Other Unfunded Expenses	0	0
9. Other Adjustments	(1.749)	1,299
10. Total Adjustments	$51,758	($37,974)
11. Net Cash Provided (Used) by Operating Activities	$23,470	($76,523)
CASH FLOWS FROM INVESTING ACTIVITIES		
12. Sale of Property, Plant and Equipment	$0	$0
13. Purchase of Property, Plant and Equipment	(288.915)	(453,428)
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	($288.915)	($453,428)
CASH FLOWS FROM FINANCING ACTIVITIES		
20. Appropriations (Current Warrants)	$0	$0
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	327,500	371,420
22. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	0	0
23. Net Appropriations	$327,500	$371,420

The accompanying notes are an integral part of these statements.

Department of Defense
Joint Logistics Systems Center - Working Capital Fund
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
CASH FLOWS FROM FINANCING ACTIVITIES, Continued		
24. Borrowing from the Public	$0	$0
25. Repayments on Loans to the Public		0
26. Borrowing from the Treasury and the Federal Financing Bank		0
27. Repayments on Loans from the Treasury and the Federal Financing Bank	0	0
28. Other Borrowings and Repayments		0
29. Net Cash Provided (Used) by Financing Activities	$327,500	$371,420
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	$62,055	($158,531)
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	(165.343)	(6,812)
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	($103.288)	($165,343)

Supplemental Disclosure of Cash Flow Information:	1997	1996
33. Total Interest Paid	$0	$0

Supplemental Schedule of Financing and Investing Activity:	1997	1996
34. Property and Equipment Acquired Under Capital Lease Obligations		$0
35. Property Acquired Under Long-Term Financing Arrangements		$0
36. Other Exchanges of Non-cash Assets or Liabilities		$0

The accompanying notes are an integral part of these statements.

The accompanying notes are an integral part of these statements.

JOINT LOGISTICS SYSTEMS CENTER

DEFENSE WORKING CAPITAL FUND

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Audit Opinion

JOINT LOGISTICS SYSTEMS CENTER DEFENSE WORKING CAPITAL FUND FINANCIAL OPERATIONS NOTES TO THE PRINCIPAL STATEMENTS AS OF SEPTEMBER 30, 1997

NOTE 1. Significant Accounting Policies:

A. Basis of Presentation:

These financial statements have been prepared to report the financial position, results of operations, and the cash flow of the Joint Logistics Systems Center activity group as required by the Chief Financial Officers (CFOs) Act, and other appropriate legislation. They have been prepared from the books and records of the activity group in accordance with Department of Defense (DoD) guidance on the form and content of financial statements. These statements are different from the financial reports that are used to monitor and control the activity group's use of budgetary resources.

B. Reporting Entity:

The Assistant Secretary of Defense for Production and Logistics (ASD(P&L)), directed that a Joint Logistics Systems Center (JLSC) be established effective December 31, 1991. The JLSC was established as a separate Defense Business Operations Fund (DBOF) business area. The JLSC implements integrated business process improvements by managing the development, integration, implementation and maintenance of the logistics business areas for Depot Maintenance and Supply Management.

The JLSC mission requires that it take a central role in the logistics functional area. The JLSC will facilitate, in conjunction with the functional communities, the identification of corporate business process improvements, and the appropriate application of Automated Information Systems (AIS) and related technologies to maximize operational effectiveness and achieve cost savings. The JLSC will employ data standardization to support corporate logistics systems design, development, integration, implementation and maintenance.

On August 18, 1997, the Acting Under Secretary of Defense (Comptroller) approved the final decisions and approved recommendations resulting from the Working Capital Fund Study Group. Among the decisions was one to terminate JLSC and begin to devolve its programs and responsibiliti to the individual Components no later than October 1, 1997. The decision included a prohibition of any new starts at JLSC, required the individual activity groups or Defense Working Capital Funds (DWCFs) to be responsible for financing the liquidation of any unfunded liabilities remaining at JLSC, and directed the return of any unneeded cash and financial assets not used for paying off program liabilities or program shutdown costs or not needed for the initial deployments of systems developed by JLSC.

The Defense Finance and Accounting Service - Denver Center uses the Departmental On-line Accounting and Reporting System (DOLARS) to consolidate and prepare JLSC's financial reports. DOLARS uses an Air Force unique general ledger structure.

C. Budgets and Budgetary Accounting:

(1) Budgets. JLSC business budgets are segregated into operating and capital budgets. Except for equipment costing more than $100,000 (during FY 1997) and used exclusively for the JLSC operations, all other equipment is expensed in the year of acquisition. Based on guidance from DoD(IG) (Report Number 94-147, Subject: JLSC Financial Statements for FY 1993), the JLSC has capitalized all of its equipment, meeting the capitalization criteria as established by DBOF Accounting Guidance (July 1992 letter) and accordingly depreciate all applicable equipment on a straight-line basis over a useful life of 5 years. This is properly reflected in the FY 1997 Financial Statements.

(2) Software Development Costs. The JLSC does not sell its software projects to its primary customers, the Depot Maintenance and Materiel Management business areas. Rather, PBD 426 directs a surcharge to these business areas within the Services and DLA for reimbursement of development and deployment back to the Defense Working Capital Fund (DWCF).

(3) Financial Constraints. Under the auspices of DoD and the federal government, the JLSC interacts with and is dependent on 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 JLSC as though it were a stand-alone entity.

D. Basis of Accounting:

The financial statements are presented in accordance with the accounting principles and reporting standards contained in the Department of Defense (DoD) Accounting Manual (DoD 7220.9-M) and DoD Financial Management Regulation (DoD 7000-14-R). The following are areas in which JLSC does not currently comply with existing DoD accounting standards:

(1) Chart of Accounts. JLSC has not implemented the standard DoD General Ledger chart of accounts.

(2) General Ledger. JLSC has not implemented a true transaction driven general ledger system to provide a consolidated source of financial management information for either management or financial statement purposes.

Transactions are recorded on the accrual basis of accounting as required by the DoD Accounting Manual. Under the accrual basis, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt for payment of cash. Presently JLSC does not purchase from or sell to DWCF activities; therefore, there are no interfund transactions that require elimination.

Presently, JLSC funds are accounted for as a DoD corporate fund using an Air Force stock fund chart of accounts. However, JLSC does not sell merchandise as do stock fund business activities. The JLSC's cost is recouped to the Defense Working Capital Fund (DWCF) through surcharge directed in PBD 426.

We were granted $10.1million Reimbursable Authority in FY 97. Of that, $1.3 million in customer orders were accepted. No earnings were generated in FY 97.

E. Revenues and Other Financing Sources:

JLSC is a DWCF business area. Its purpose is to develop logistics software programs for Supply Management and Depot Maintenance, two other DWCF areas. Under most circumstances DWCF areas use revolving funds whereby an initial appropriation, fund transfer, or capital transfer provides the beginning capital. Funds are replenished by the sales of goods or services.

JLSC, however, does not sell its software projects to the two previously mentioned business areas. Rather, it transfers the completed projects to the various DoD DWCF business areas with reimbursement through surcharges. It initially received a start up contribution from the Military Components and the Defense Logistics Agency of $10.1 million. Additional funding authority was received as follows:

		(Millions)	
Fiscal Year	**Operating**	**Capital**	**Total**
1992	$21.2	$282.8	$304.0
1993	37.1	423.7	460.8
1994	37.1	504.0	541.1
1995	33.9	297.0	330.9
1996	29.6	198.2	227.8
1997	29.6	132.9	162.5
Total	$188.5	$1,838.6	$2,027.1
	=====	======	========

During FY 1997, JLSC received $327.5 million by cash transfers from the military departments.

F. Accounting for Intra-governmental Activities: Not applicable.

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

The fund balances with Treasury are maintained at DLA.

H. Foreign Currency: Not applicable.

I. Accounts Receivable:

Accounts Receivable has an abnormal balance. The formula for net receivables includes undistributed collections. Since JLSC maintains no active accounts receivables, amounts recorded in undistributed collections causes an abnormal balance. Reference Note 5.

J. Loans Receivable: Not applicable.

K. Inventory: Not applicable.

L. Investments in U.S. Government Securities: Not applicable.

M. Property and Equipment:

Reference Note 15.

N. Prepaid and Deferred Charges: Not applicable.

O. Leases: Not applicable.

P. Contingencies: Not applicable.

Q. Accrued Leave:

The amount reported on the Statement of Financial Position, Line 4.b.(2)(b) for Annual Accrued Leave is $767.

R. Equity:

The Invested Capital balance stands at $1,615,241. The cumulative operating results is ($149,421), and future funding requirements is ($1,804). This leaves a net position balance of $1,464,016. (See Note 20).

S. Aircraft/Ship Crashes: Not applicable.

T. Treaties for Use of Foreign Bases: Not applicable.

U. Comparative Data:

Comparative data for FY 1996 and FY 1997 are presented to provide an understanding of changes in financial position and operations of the JLSC.

V. Undelivered Orders:

Undelivered Orders as reported on the SF133, Report on Budget Execution, amounted to $227,859 (DOD GLA 9411).

NOTE 2. Fund Balances with Treasury:

A. Fund and Account Balances:

	Funds Collected	Entity Assets Funds Disbursed	Cum Transfers
Beginning Balance	$0	$0	$0
Transfers of Cash to Others			0
Transfers of Cash from Others			162,161
Funds Collected:	692		
Funds Disbursed:		(266,141)	
Ending Balance	$692	($266,141)	$162,161

B. Other Information:

The fund balances with Treasury are maintained at DLA. Transfers of Cash from Others includes the 1996 ending balance of ($165,339) and cash transfers-in of $327,500.

The Treasury Balance, as reported on the AR(M)1307, breaks down as:

Funds Collected - Operating Program	$692
Funds Collected - Capital Program	0
Funds Disbursed - Operating Program	73,650
Funds Disbursed - Capital Program	(339,791)
Funds with Treasury - Operating Program	162,157
Funds with Treasury - Capital Program	0
Treasury Balance	($103,292)

NOTE 3. Cash, Foreign Currency and Other Monetary Assets: Not applicable.

NOTE 4. Investments: Not applicable.

NOTE 5. Accounts Receivable, Net:

	(1) Gross Amount Due	(2) Allowance For Estimated Uncollectibles	(3) Allowance Method Used	(4) Net Amount Due
A. Entity Receivables:				
Intragovernmental	($689)	$0	N/A	($689)
Governmental	0	0	N/A	0
B. Non-Entity Receivables:				
Intragovernmental	$0	$0	N/A	$0
Governmental	0	0	N/A	0

Accounts Receivables has an abnormal balance. The formula for net receivables includes undistributed collections. Since JLSC maintains no active accounts receivables, amounts recorded in undistributed collections causes an abnormal balance.

NOTE 6. Other Assets: Not applicable.

NOTE 7. Loans and Loan Guarantees, Non-Federal Borrowers: Not applicable.

NOTE 8. Inventory, Net: Not applicable.

NOTE 9. Work in Process: Not applicable.

NOTE 10. Operating Materials and Supplies (OM&S), Net: Not applicable.

NOTE 11. Stockpile Materials, Net: Not applicable.

NOTE 12. Seized Property: Not applicable.

NOTE 13. Forfeited Property, Net: Not applicable.

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

NOTE 15. Property, Plant and Equipment, Net:

	(1) Depreciation Method	(2) Service Life
Classes of Fixed Assets		
A. Land		
B. Structures, Facilities, & Leasehold Improvements	S/L	20
C. Military Equipment		
D. ADP Software	S/L	5
E. Equipment	S/L	5&10
F. Assets Under Capital Lease		
G. Other		
H. Natural Resources		
I. Construction-in-Progress		
Total		

	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
Classes of Fixed Assets			
A. Land	$0	$0	$0
B. Structures, Facilities, & Leasehold Improvements	0	0	0
C. Military Equipment	0	0	0
D. ADP Software	0	0	0
E. Equipment	2,776	(1,820)	956
F. Assets Under Capital Lease	0	0	0
G. Other	0	0	0
H. Natural Resources	0	0	0
I. Construction-in-Progress	1,592,919	0	1,592,919
Total	1,595,695	($1,820)	$1,593,875

*Keys:

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

The depreciation method for equipment is straight line and the service life is 5 to 10 years.

JLSC does not own land, buildings or equipment. The organization is a tenant on Wright Patterson Air Force Base and occupies portions of Buildings 15 and 167. JLSC reimburses Wright Patterson AFB for maintenance, police protection, refuse collection, utilities, and miscellaneous other services.

DoD-IG Draft Report No. 7FJ-2027, 10 Nov. 97, states the JLSC financial statements will remain materially overstated, until systems development costs are properly transferred to the appropriate organizations. It further recommends that Under Secretary of Defense (Comptroller) should provide guidance to the JLSC on how to equitably allocate the costs of systems development currently appearing in plant, property and equipment (Line 1.k.) of the JLSC Statement of Financial Position).

NOTE 16. Debt:

The JLSC reported no debt liability. Its proportionate share of public debt and related expenses of the federal government are not included in the financial statements. Debt incurred by the federal government and related interest are not apportioned to federal agencies. Consequently, JLSC's financial statements do not reflect any portion of the public debt or interest thereon, nor do the statements reflect the source of public financing.

NOTE 17. Other Liabilities: Not applicable.

NOTE 18. Leases: Not applicable.

NOTE 19. Pensions and Other Actuarial Liabilities:

A. Pensions:

This business area's civilian employees participate in the Civil Service Retirement System (CSRS), Federal Employee Retirement System (FERS), and Thrift Savings Plan (TSP), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security. JLSC finances a portion of pension benefits under these retirement systems, but does not disclose the assets or actuarial data on the accumulated plan benefits or unfunded liabilities of their employees. Reporting of these amounts is the responsibility of the Office of Personnel Management for CSRS, FERS, and TSP, and DoD for MRS. JLSC reports the revenue and expense for pensions (reference Notes 22 and 25).

B. Other Actuarial Liabilities:

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

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

The JLSC liability for FWC benefits is $1,804.

NOTE 20. Net Position:

	Revolving Funds	Trust Funds	Appro-priated Funds	Total
A. Unexpended Appropriations:				
(1) Unobligated,				
a. Available	$0	$0	$0	$0
b. Unavailable	0	0	0	0
(2) Undelivered Orders	0	0	0	0
B. Invested Capital	1,615,241	0	0	1,615,241
C. Cumulative Results of Operations	(149,421)	0	0	(149,421)
D. Other	0	0	0	0
E. Future Funding Requirements	(1,804)	0	0	(1,804)
F. Total	$1,464,016	$0	$0	$1,464,016

G. Other Information:

(1) Unexpended appropriations are not accounted for at the component level. JLSC is funded via cash transfer method from the military component's Defense Working Capital Fund.

(2) Future Funding Requirements ($1,804) is a contra related to the amount in Pensions and Other Actuarial Liabilities. (Reference Note 19).

(3) Invested Capital. A breakout of this account is furnished as follows:

(a) Assets Capitalized	$ -0-
(b) Liabilities Assumed	-0-
(c) Transfers, Net	1,615,241
Total	$1,615,241

NOTE 21. Taxes: Not applicable.

NOTE 22. Other Revenues and Financing Sources:

		1997	1996
A. Other Revenues and Financing Sources:			
Imputed Pension and Other Retirement Benefits		$1,628	$0
(a) CSRS/FERS Retirement	$1,144	0	0
(b) Health Benefits	482		
(c) Life Insurance	2	0	0
Total		$1,628	$0

B. Other Information:

The $1,628 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:

	1997	1996
A. Operating Expenses by Object Classification:		
(1) Personal Services and Benefits	$7,713	$17,311
(2) Travel and Transportation	1,257	1,241
(3) Rental, Communication and Utilities	308	652
(4) Printing and Reproduction	0	0
(5) Contractual Services	14,802	12,460
(6) Supplies and Materials	3,652	6,330
(7) Equipment not Capitalized	1	0
(8) Grants, Subsidies and Contributions	0	0
(9) Insurance Claims and Indemnities	0	0
(10) Other (describe):		
(a) Depreciation	0	0
(b) Bad Debt Writeoffs	0	0
(c) Other Expenses	0	0
(11) Total Expenses by Object Class	$27,733	$37,994

NOTE 24. Cost of Goods and Services Sold: Not applicable.

NOTE 25. Other Expenses:

		1997	1996
A. Other Expenses::			
Imputed Pension and Other Retirement Benefits		$1,628	$0
(a) CSRS/FERS Retirement	$1,144	0	0
(b) Health Benefits	482		
(c) Life Insurance	2	0	0
Total		$1,628	$0

B. Other Information:

The $1,628 represents the imputed expense 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 their financial statements while the employer discloses the imputed expenses. OPM actuaries provide the normal cost rates which are used to calculate the imputed expenses.

NOTE 26. Extraordinary Items: Not applicable.

NOTE 27. Prior Period Adjustments: Not applicable.

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

	1997	1996
A. Increases:		
(1) Transfers-In:		
(a) Cash Transfer	$327,500	$0
(b)__________	0	0
(c)__________	0	0
(2) Unexpended Appropriations	0	0
(3) Donations Received	0	0
(4) Other Increases	0	372,719
(5) Total Increases	$327,500	$372,719

	1997	1996
B. Decreases:		
(1) Transfers-Out:		
(a)__________	0	$0
(b)__________	0	0
(c)__________	0	0
(2) Donations	0	0
(3) Other Decreases	(1,749)	0
(4) Total Decreases	(1,749)	$0
C. Net Non-Operating Changes (Transfers):	$325,751	$372,719

D. Other Information:

Line B.(3) Other Decreases includes ($1,804) for the changes in reported unfunded liability for worker's compensation.

NOTE 29. Intrafund Eliminations:

JLSC does not purchase from or sell to other DWCF organizations; therefore, there are no transactions being reported.

NOTE 30. Contingencies: Not applicable.

NOTE 31. Other Disclosures:

A. Unmatched Disbursements, Negative Unliquidated Obligations, and Aged In-Transit Disbursements:

Joint Logistics Systems Center Funds	September 1996	September 1997	Change	Percent Change
Unmatched Disbursements	$3,664	$210	($3,454)	(94%)
Negative Unliquidated Obligations*	1,925	4,027	2,102	121%
Aged In-Transit Disbursements	0	3,714	3,714	Not reported in 1996
Totals	$5,589	$7,951	$2,362	27%

DFAS and customer making concerted effort to reduce problem disbursements.

B. Other Information:

A discrepancy exists between the AR(M)1307 and CFO Statements for Accrued Payroll and Benefits. The September AR(M)1307, Statement of Financial Position, Accrued Payroll and Benefits was overstated by $8,894 . (Salaries and Wages was overstated by $1,281, and Accrued Annual Leave was overstated by $7,613.) The overstatement was due to incorrect information given to the fund code manager. The CFO reflects the correct balances. The following lines on the CFO do not agree with the AR(M)1307 due to the overstatement:

	CFO	AR(M)1307	Difference
Statement of Financial Position:			
Line 4.b.(a) - Salaries and Wages	$ 211	$1,492	($1,281)
Line 4.b.(b) - Annual Accrued Leave	767	8,380	(7,613)
	978	9,872	(8,894)
Line 7.c. Cumulative Results of Operations	(149,421)	(158,315)	8,894
Statement of Operations and Changes in Net Position:			
Line 9 - Program or Operating Expenses	27,733	36,624	(8,891)
Statement of Cash Flows:			
Line 6 - Increase (Decrease) in Other Liabilities	(1,372)	5,717	(7,089)
Line 9 - Other Adjustments	(1,749)	53	(1,802)
	(3,121)	5,770	(8,891)

Audit Opinion

JOINT LOGISTICS SYSTEMS CENTER

DEFENSE WORKING CAPITAL FUND

AUDIT OPINION

Audit Opinion

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

February 27, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND THE CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
COMMANDER, JOINT LOGISTICS SYSTEMS CENTER

SUBJECT: Disclaimer of Opinion on the Joint Logistics Systems Center Working Capital Fund Financial Statements for FY 1997 (Project No. 8FJ-2001)

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 and prescribes the responsibility of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. Preparation of the Joint Logistics Systems Center (JLSC) Working Capital Fund financial statements is the joint responsibility of JLSC and the Defense Finance and Accounting Service (DFAS). JLSC and DFAS are also responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to JLSC financial accounting and reporting. Our responsibility is to render an opinion on the financial statements based on our work, and to determine whether internal controls are adequate and whether management complied with laws and regulations.

Before FY 1992, the DoD operated a significant number of 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). The Inspector General, DoD, was responsible for auditing and rendering an opinion on the DBOF Consolidated Financial Statements. In December 1996, the Under Secretary of Defense (Comptroller) restructured the DBOF into separate working capital funds, including the JLSC Working Capital Fund.

In September 1997, the Under Secretary of Defense (Comptroller) (the USD[C]) announced that JLSC would be terminated and directed JLSC to begin transferring its functions to the Military Departments on October 1, 1997.

Disclaimer of Opinion. We were unable to render an opinion on the FYs 1997 and 1996 JLSC Working Capital Fund Financial Statements because we did not perform sufficient work. We did not perform sufficient work because JLSC began terminating its operations in October 1997. However, our limited work indicated that because of significant deficiencies in the accounting systems and internal control structure, it was unlikely that the FYs 1997 and 1996 financial statements were reliable.

Accounting Principles. The DoD Consolidated Financial Statements for FYs 1997 and 1996 were to be prepared in accordance with Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as supplemented by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. These Bulletins incorporate the Statements of Federal Financial Accounting Concepts and Standards recommended by the Federal Accounting Standards Advisory Board, which are approved by the Secretary of the Treasury; the Director, OMB; and the Comptroller General of the United States. Footnote 1 of the DoD Consolidated Financial Statements discusses the significant accounting policies that DoD followed in preparing the financial statements. JLSC attempted to prepare its financial statements according to these standards.

Internal Controls. Internal controls were not adequate to ensure the accurate reporting of Property, Plant, and Equipment accounts, resulting in material overstatements on the FY 1997 JLSC Working Capital Fund Financial Statements. The JLSC inappropriately reported $1 billion in development costs for systems that were already in operation at various Working Capital Fund organizations, and $500 million in development costs for canceled systems. This occurred because the USD(C) did not provide adequate guidance to JLSC on how to equitably allocate the systems development costs to the depot maintenance and supply management organizations of the Working Capital Fund so that those organizations could capitalize and report the value of the assets received.

Compliance With Laws and Regulations. We identified one instances of noncompliance with regulations. JLSC did not fully comply with DoD accounting policy for capital assets. JLSC initially recorded systems development costs as Construction-in-Progress. However, when the systems were completed and installed, JLSC did not properly transfer the costs of development to the receiving Working Capital Fund organizations, as required by DoD policy.

Additional Report. This memorandum summarizes the major deficiencies affecting the portion of the FY 1997 JLSC Working Capital Fund Financial Statements we reviewed. A subsequent report will give more details on our work and the deficiencies identified.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Appendix D. Management and Legal Representation Letters

This appendix (a total of 5 pages) consists of the management and legal representation letters for the FY 1997 Financial Statements of the JLSC WCF.

JOINT LOGISTICS SYSTEMS CENTER
1864 Fourth Street, Suite 1, Building 15
WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433

JAN 27 1998

MEMORANDUM FOR OFFICE OF THE ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE
ATTN: MR. JOHN ISSEL
630 MORRISON ROAD, SUITE 310
GAHANNA OH 43230-5327

FROM: JLSC/CC
Building 15
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

SUBJECT: Representation Letters for the FY 1997 Joint Logistics Systems Center Working Capital Fund Financial Statements (Your Memo, 6 Jan 97)

1. The attached Management and Legal Representation Letters are submitted in accordance with the guidance provided in above referenced document. We have forward dated our Management Representation Letter, as you requested, to 27 Feb 98, to coincide with the auditor's opinion report. Should subsequent information or events arise, during the period from the date of this memo and 27 Feb 98, that would affect our management assurance, we will immediately and formally notify you. Please note that our legal counsel has elected to date their memorandum with their actual signature date. Should this pose a problem to you, please feel free to contact the signing acquisition attorney, Major Alvin Chase, USAF, DSN 785-5270, ext. 342.

2. Our point of contact is Mr. Dennis Kahn, JLSC/RMF. He may be contacted on (937) 255-0407 or DSN 785-0407.

David A. Herrelko

DAVID A. HERRELKO
Brig Gen, USAF
Commander

Attachments:
1. Management Representation Letter
2. Legal Representation Letter

JOINT LOGISTICS SYSTEMS CENTER
1864 Fourth Street, Suite 1, Building 15
WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433

27 Feb 98

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE
630 MORRISON ROAD, SUITE 310
GAHANNA OH 43230-55327

FROM: JLSC/CC

SUBJECT: Management Assurance Concerning FY 1997 Joint Logistics Systems Center Working Capital Fund Financial Statements

This is in regard to your audit of the Joint Logistics Systems Center (JLSC) Working Capital Fund Financial Statements as of 30 Sep 97, (Project No. 8FJ-2001). For the purpose of expressing an opinion as to whether the financial statements are presented fairly in accordance with pertinent regulations and governmental accounting standards, we confirm, to the best of our knowledge and belief, the following representations.

1) We acknowledge responsibility for the fair presentation of the FY 1997 JLSC Working Capital Fund's Financial Statements.

2) We have provided you with all available financial records and related data. However, the final version of the Chief Financial Officer (CFO) Financial Statements and associated Overview and Footnotes are not yet final as of the date of this letter. The Defense Finance and Accounting Service (DFAS) Denver is currently in the process of completing and assembling the final version for our review before going final. We do not believe however, that any material adjustments will be made from the current version.

3) We can provide reasonable assurance that the accounting and non-accounting systems used to produce the financial statements are reliable.

4) One of the recommendations of DoD-IG draft audit, Project No. 7FJ-2027 states the following: "We recommend that the Under Secretary of Defense Comptroller to provide guidance to the JLSC on how to equitably allocate the costs of system developments to the appropriate DoD Working Capital Fund organizations and direct that those organizations properly capitalize and report in their financial statements the costs incurred by the JLSC for systems developments." As a result of the audit we concurred with the finding in our response, 4 Dec 97. We are currently in the process of coordinating a procedure with Under Secretary of Defense (USD)-Comptroller Accounting Policy to transfer all pertinent system development costs to the receiving Components. These costs make up most of the cost portrayed in Plant, Property, and Equipment of the JLSC Statement of Financial Position. Subsequently, we will also write-off all remaining system development costs

that were not completed or designated for transfer. These adjustments will materially affect the carrying value of JLSC assets. Full disclosure will be provided in footnotes that are part of the CFO Statements. These CFO statements are still in draft form in the DFAS.

5) There have been no irregularities involving management and employees who have significant roles in the internal control structure. Additionally, there is no evidence of other employees involved in irregularities that could materially affect the financial statements.

6) The JLSC could not transfer system development costs to the Components as systems were delivered and installed at various Working Capital Funds (WCF) organizations because of lack of guidance from USD-Comptroller. Consequently, it did not comply with DoD 7000.14R, Vol. 11B which directs that the gaining organization will capitalize the asset when installed and in use, implying that JLSC would have transferred the asset at that time by removing it from its books. Consequently, the FY97 financial statements are materially overstated.

7) Although we acknowledge that regulatory guidance could not be followed as discussed in item 6 above, no violation of law exists.

8) Except as stated in item 4 above, we are not aware of any other material liabilities or loss contingencies that may need to be accrued.

9) There are no unasserted claims or assessments that our legal representatives have advised us must be disclosed.

10) The Department of Defense has satisfactory title to all assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged.

11) Two subsequent events occurred after the Balance Sheet date that may require adjustment to, or disclosure in the financial statements as follows:

a. The JLSC is terminated by the recommendations resulting from the Working Capital Fund Study Group.

b. The findings of DoD-IG Draft Report No. 7FJ-2027, 10 Nov 97, indicate that the JLSC will overstate its FY 1997 Financial Statements, as described in item 4 above.

12) JLSC has no reason to believe that any other account balances, except those within Account No. 17305, as described in item 6, are misstated.

13) We have no reason to believe that any adjustments made to our account balances lack full documentation. Additionally, we believe the financial reports follow applicable accounting standards.

David A. Herrick
Commander

Sherry Partee
JLSC Financial Officer

DEPARTMENT OF THE AIR FORCE
AIR FORCE MATERIEL COMMAND LAW OFFICE (AFMC)
WRIGHT-PATTERSON AIR FORCE BASE OHIO

23 Jan 98

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

FROM: AFMC LO/JANO
1864 Fourth St., Room 130A
Wright-Patterson AFB, OH 45433

SUBJECT: Legal Representation Letter--Joint Logistics Systems Center Working Capital Fund

1. This legal representation letter is provided pursuant to a request regarding the Audit of FY 1997 Joint Logistics Systems Center (JLSC) Working Capital Fund Financial Statements. This office has provided legal counsel and representation in acquisition matters to the JLSC on various contracts administered by Materiel Systems Group, Contracting (MSG/PK), Wright-Patterson Air Force Base. As we do not provide counsel and representation on contractual matters administered by other contracting activities, this representation letter only pertains to contracts administered by MSG/PK.

2. Review of our records indicates that on 30 September 1997 there existed no pending or threatened litigation, claims, and assessments in amounts material to the fund. Additionally, to the best of our knowledge, there are no pending or threatened litigation, claims, and assessments pertaining to the fund from 1 October 1997 to the date of this letter. Furthermore, there are no claims or assessments that we consider probable of assertion and which, if asserted, would have a reasonable possibility of an outcome unfavorable to the JLSC Working Capital Fund. We conclude there are no unasserted possible claims or assessments which, in our professional judgment, should be disclosed or considered for potential disclosure in the fund's financial statements in accordance with the applicable requirements of the Statement of Federal Financial Accounting Standard (SFFAS) No. 5 "Accounting for Contingencies," December 1995.

3. Should you have any questions regarding this matter, please contact the undersigned at DSN 785-5270 ext. 342.

Alvin Chase
ALVIN CHASE, Major, USAF
Acquisition Attorney
Operations Division
Directorate of Contract Law

cc:
JLSC/RMF (Attn: Mr. Dennis Kahn)

Appendix E. Laws and Regulations Reviewed

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

Public Law 103-356, "Government Management Reform Act of 1994," October 13, 1994 (Title IV may be cited as the "Federal Financial Management Act of 1994")

OMB Bulletin No. 98-04, "Addendum to OMB Bulletin No. 93-06," January 16, 1998

OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996

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

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

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

DoD 7000.14-R, "DoD Financial Management Regulation," volume 11B, "Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund," December 1994

Appendix F. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Commander, Joint Logistics Systems Center
Director, Defense Finance and Accounting Service

Non-Defense Federal Organizations and Individuals

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

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

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

Audit Team Members

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

F. Jay Lane
Salvatore D. Guli
James L. Kornides
John K. Issel
Walter J. Carney
Eric T. Thacker
Karen M. Bennett
Susanne B. Allen