Audit Report

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS FOR THE DOD CONSOLIDATED FINANCIAL STATEMENTS FOR FY 1997

Report No. 98-161 June 22, 1998

Office of the Inspector General
Department of Defense

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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
FFMIA	Federal Financial Management Improvement Act
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards
USC	United States Code
USD(C)	Under Secretary of Defense (Comptroller)
USGSGL	U.S. Government Standard General Ledger
WCF	Working Capital Fund

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June 22, 1998

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

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and Regulations for the DoD Consolidated Financial Statements for FY 1997 (Report No. 98-161)

We are providing this audit report for your information and use. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare annual financial statements. We conducted this audit in accordance with the requirements of Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. This bulletin requires the Inspector General, DoD, to render an opinion on the DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations. Because this report contains no findings or recommendations, no written comments were required and none were received.

We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1997 because the statements and the legal representation letter were not received in a timely manner. In addition, significant deficiencies in the accounting systems and the lack of sound internal controls prevented the preparation of accurate financial statements. Part I discusses material weaknesses in the internal controls and noncompliance with laws and regulations. Part II contains appendices for management's use.

We appreciate the courtesies extended to the audit staff. If you have any questions, please contact Mr. Richard B. Bird, at (703) 604-9175 (DSN 664-9175) or e-mail rbird@dodig.osd.mil or Mr. Jack Armstrong, at (317) 510-3846 (DSN 699-3846) or e-mail jarmstrong@dodig.osd.mil. See Part II, Appendix F, for the report distribution. A list of the audit team members is included on the inside of the back cover.

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Assistant Inspector General
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Office of the Inspector General, DoD

Report No. 98-161 **June 22, 1998**
(Project No. 7FI-2030.01)

Internal Controls and Compliance With Laws and Regulations for the DoD Consolidated Financial Statements for FY 1997

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare annual audited financial statements. The DoD Consolidated Financial Statements for FY 1997 consist of the financial statements of the Army, the Navy, and the Air Force General Funds; the Army, the Navy, and the Air Force Working Capital Funds; the Defense Logistics Agency, the Defense Information Systems Agency, the Defense Finance and Accounting Service, the Defense Commissary Agency, the U.S. Transportation Command, and the Joint Logistics Systems Center Working Capital Funds; the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; the U.S. Army Corps of Engineers (Civil Works) General Fund; and the Other Defense Organizations General Fund.* In FY 1997, DoD reported assets of $1.3 trillion and revenues of $270 billion.

Related Reports. This is the second in a series of reports related to the FY 1997 DoD Consolidated Financial Statements. Report No. 98-9008, "Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1997," February 27, 1998, summarized the reasons we were unable to render an opinion on the DoD Consolidated Financial Statements. We relied on audit work performed by the Military Department audit agencies (the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency). Our combined audit efforts provide a reasonable basis for our results. The report was included in the published financial statements transmitted by the Under Secretary of Defense (Comptroller) to the OMB. Copies of our opinion and the financial statements are included in Appendix C. At a later date, we will issue additional reports on issues identified during our review of the FY 1997 DoD Consolidated Financial Statements.

Audit Objectives. The primary audit objective was to determine whether the DoD Consolidated Financial Statements for FY 1997 were presented fairly in accordance with 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. Our objective was not to determine whether comparative data for FY 1996 was fairly presented. We determined

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*DoD did not prepare financial statements for the Other Defense Organizations General Fund; however, accounting data for that fund is part of the DoD Consolidated Financial Statements.

whether controls were adequate to ensure that the DoD consolidated financial statements were free of material error. We also assessed DoD compliance with laws and regulations for transactions and events that had a direct and material effect on the financial statements.

Review of Internal Controls. Although progress has been made, DoD internal controls were not adequate to ensure that resources were properly managed and accounted for, and that the financial statements were free of material misstatements. The DoD control environment was not conducive to the preparation of auditable and timely financial statements, and DoD accounting systems did not meet the requirements to interface with other financial management systems or to provide audit trails, general ledger controls, identification of eliminating entries, and valuation of inventory and property, plant, and equipment that were adequate. DoD and the Defense Finance and Accounting Service did not fully disclose management control weaknesses with respect to all accounting and related systems, and DoD accounting and related systems were not Year 2000-compliant.

In addition, control procedures were not adequate over adjusting entries and caused inaccurate and inconsistent reporting of Property, Plant, and Equipment (including Federal Mission Property, Plant, and Equipment); Pensions and Other Actuarial Liabilities; Other Liabilities; and footnotes to the principal statements. In the FY 1997 Annual Statements of Assurance, the Secretary of Defense and the Defense Finance and Accounting Service candidly identified the most significant conditions we found as material weaknesses. Part I, Section A, is our report on the internal controls.

Review of Compliance With Laws and Regulations. Instances of noncompliance with laws and regulations continued to exist in DoD accounting systems. Although required by Title 31, United States Code, the internal controls did not completely or accurately disclose the financial condition of DoD. The Department also was not fully compliant with the Federal Managers' Financial Integrity Act of 1982 and the Federal Financial Management Improvement Act of 1996.

In addition, DoD did not always comply with policies established within OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, 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, and Joint Financial Management Improvement Program guidance in areas such as Fund Balance with Treasury; Accounts Receivable; Inventory; Accounts Payable; and Revenues and Cost Recognition. Part I, Section B, is our report on compliance with laws and regulations. Part II, Appendix D, lists the laws and regulations we reviewed.

Summary of Recommendations. This report does not contain recommendations because the needed recommendations were made in other audit reports.

Management Comments. We provided a draft of this report on April 30, 1998. Written comments were not required and none were received. Therefore, we are publishing this report in final form.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 3

Part I. A. - Review of Internal Controls

Introduction 6
Control Environment 7
Accounting and Related Systems 9
Control Procedures 13

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

Introduction 20
Material Noncompliances 20

Part II - Additional Information

Appendix A. Audit Process 28
Appendix B. Prior Audit Reports 32
Appendix C. Financial Statements and Audit Opinion 49
Appendix D. Management and Legal Representation Letters 51
Appendix E. Laws and Regulations Reviewed 53
Appendix F. Report Distribution 58

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 the DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, to prepare Government-wide financial statements beginning in FY 1997. The DoD Consolidated Financial Statements for FY 1997 consist of the financial statements of the Army, the Navy, and the Air Force General Funds; the Army, the Navy, and the Air Force Working Capital Funds (WCF); the Defense Logistics Agency (DLA), the Defense Information Systems Agency, the Defense Finance and Accounting Service (DFAS), the Defense Commissary Agency, the U.S. Transportation Command, and the Joint Logistics Systems Center WCFs; the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; the U.S. Army Corps of Engineers (Civil Works); and the Other Defense Organizations General Fund.*

DoD did not include financial data for the Defense Security Assistance Agency in the DoD Consolidated Financial Statements, but will include this data in the DoD Consolidated Financial Statements for FY 1998. See Part I.A., Review of Internal Controls section for further discussion of this issue.

Accounting Functions and Responsibilities. DFAS performs accounting functions and prepares financial statements for DoD. DFAS operates under the control and direction of the Under Secretary of Defense (Comptroller) (USD[C]). The USD[C], as the Chief Financial Officer (CFO) of DoD, is responsible for overseeing the preparation of agency-wide financial statements. This responsibility includes segmenting the agency into reportable entities and determining which issues will be reported in the consolidated statements. DFAS is responsible for entering information from DoD entities into 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. The day-to-day operations of the reporting entities are the responsibilities of the Military Departments, the Defense agencies, and the DoD field activities.

Accounting Policy. The DoD Consolidated Financial Statements for FY 1997 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. Footnote 1 of the DoD Consolidated Financial Statements discusses the significant accounting policies followed in preparing the financial statements.

*DoD did not prepare financial statements for the Other Defense Organizations General Fund; however, accounting data for that fund is part of the DoD Consolidated Financial Statements.

Scope of DoD Operations. In employment and discretionary spending authority, DoD is the largest U.S. Government agency. In FY 1997, DoD employed about 2.2 million active-duty Service members and civilian personnel and had budget authority of about $258 billion, about 16 percent of the Federal budget. DoD employed 51 percent of the 4.26 million military and civilian employees in the Federal workforce and was responsible for 48 percent of the estimated $536 billion in discretionary Federal budget authority. DoD also employed about 886,000 reservists. In FY 1997, DoD reported assets of $1.3 trillion and revenues of $270 billion.

Disclaimer of Opinion. This is the second in a series of reports related to the DoD Consolidated Financial Statements for FY 1997. Report No. 98-9008, "Disclaimer of Opinion on the DoD Consolidated Financial Statements for FY 1997," February 27, 1998, was the first report and was published in the published financial statements transmitted by the USD(C) to the OMB. The reasons for why we were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1997 are summarized in Appendix A. Copies of our opinion and the financial statements are in appendix C.

Audit Objectives

The primary audit objective was to determine whether the DoD Consolidated Financial Statements for FY 1997 were presented fairly 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. We determined whether controls were adequate to ensure that the DoD Consolidated Financial Statements were free of material error. We also assessed DoD compliance with laws and regulations for transactions and events that had a direct and material effect on the financial statements. Part I.A. is our report on the internal controls, and Part I.B. is our report on compliance with laws and regulations. Part II, Appendix A, provides the audit scope and methodology, auditing standards, and accounting principles. Appendix A also discusses the assistance we received from the Military Department audit agencies.

Part I. A. - Review of Internal Controls

Introduction

Audit Responsibilities. Our audit objective was to determine whether controls were adequate to ensure that the FY 1997 DoD Consolidated Financial Statements were free of material error. We examined DoD internal controls for the year ended September 30, 1997, as those controls related to the consolidated financial statements. We obtained an understanding of the internal control policies and procedures and assessed the level of control risk relevant to significant cycles, classes of transactions, the consolidation process and account balances. We reviewed and tested the DoD's internal controls with respect to the DoD Consolidated Financial Statements. In addition, we relied on audit results supplied by the other Inspector General (IG), DoD, and Military Department audit agency audits. For areas relating to the DoD Consolidated Financial Statements where the 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. As the CFO, the USD(C) oversees all financial management activities relating to the programs and operations of DoD, including the accounting functions of DFAS. The Military Departments, Defense agencies, and DoD field activities are responsible for managing their operations. Establishing and maintaining internal controls appropriate to the entity is an important management responsibility. The objectives of the internal controls are to provide management with reasonable but not absolute assurance that:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation;
- 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
- transactions comply with any laws and regulations that OMB, DoD, or the IG, DoD, have identified as being significant and for which compliance can be objectively measured and evaluated.

Internal Control Elements. The purpose of our review of internal controls was not 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 policies 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 control and the emphasis placed on it within 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, that 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 reliable and accurate financial information for use in managing and evaluating operational performance. A material weakness is a reportable condition in which the design or operation of the internal controls 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 in a timely manner by employees in the normal course of performing their functions.

Material weaknesses in the internal controls added to the difficulty in producing timely, accurate, and fairly presented financial statements. Since DoD did not have adequate internal controls, we were not able to apply other auditing procedures to overcome these deficiencies and satisfy ourselves as to the fairness of data in the DoD Consolidated Financial Statements for FY 1997. Except as noted, the Secretary of Defense and DFAS identified, in the FY 1997 Annual Statements of Assurance, the material weaknesses we identified.

Conditions Noted in Each Area. Although progress has been made, material internal control weaknesses existed in the control environment; in accounting and related systems; and in control procedures for adjusting entries, Property, Plant, and Equipment (including Federal Mission Property, Plant, and Equipment), Pensions and Other Actuarial Liabilities, Other Liabilities, and the footnotes to the principal statements. In areas we did not review, internal controls should not be considered adequate until tests can be performed to determine whether those controls are established and working. Because of inadequate internal controls, we could not determine whether the amounts reflected all errors; therefore, we could not determine whether account balances were fair and reasonable.

Control Environment

The DoD control environment was not conducive to the preparation of auditable financial statements because the CFO did not provide timely guidance to the DoD Components. In addition, the CFO did not provide timely and auditable financial statements to the IG, DoD.

DoD Form and Content Guidance. The Deputy CFO; the Director, DFAS; and the IG, DoD, agreed to responsibilities for the presentation of audited financial statements in a Memorandum of Understanding, issued on June 6, 1997. Under the Memorandum of Understanding, the CFO was responsible for ensuring that DoD issued guidance on the form and content of the financial statements. This guidance would implement the requirements of OMB Bulletin No. 94-01, as supplemented by OMB Bulletin No. 97-01. The DoD guidance on form and content gives the DoD Components the requirements for reporting format and disclosure that they are to use in preparing their financial statements. The CFO did not issue the FY 1997 DoD form and content guidance until January 14, 1998, after the DoD Components had prepared Version 2 of the FY 1997 financial statements. As a result, the DoD Components lacked sufficient guidance. For example, the DoD Components did not consistently prepare the interagency elimination schedules in Note 29 of the Version 2 financial statements because sufficient DoD guidance was not available. In addition, the Army misclassified $4.6 billion of overseas real property assets as Assets Under Capital Lease because the CFO did not issue revised guidance in time for FY 1997 reporting.

Version 2 of Financial Statements Provided to DFAS Indianapolis Center. The DFAS Indianapolis Center is responsible for preparing the DoD Consolidated Financial Statements and footnotes. The DFAS Indianapolis Center did not receive Version 2 of all the necessary DoD Components' financial statements by December 12, 1997. Further, the Version 2 financial statements that the DFAS Indianapolis Center had received by December 12, 1997, were incomplete and were continually being revised. Therefore, the DFAS Indianapolis Center was unable to prepare Version 2 of the FY 1997 DoD Consolidated Financial Statements.

Version 2 of Financial Statements Provided to IG, DoD. The CFO is responsible for submitting financial statements to the auditors that are accurate and meaningful and contain an overview and footnotes. After providing the IG, DoD, with Version 2 of the financial statements, the DFAS continued to make material changes to subsequent versions of the financial statements. In addition, the IG, DoD, continued to receive revisions to Version 2 of the financial statements after DFAS had already supplied Version 2 financial statements for audit purposes. Thus, the Version 2 financial statements provided to the IG, DoD, for audit purposes were not the most current version and were unauditable.

For example, the IG, DoD, received the initial Version 2 of the DLA WCF financial statements on December 23, 1997. The IG, DoD, received a revised Version 2 of the DLA WCF financial statements on January 8, 1998. We identified the following material differences:

- assets increased by $1.6 billion (12.6 percent of total assets);

- liabilities increased by $738 million (5.9 percent of total assets);
- revenue increased by $2.0 billion (16.5 percent of total assets); and
- expenses increased by $2.5 billion (19.8 percent of total assets).

Preparation of DoD Consolidated Financial Statements. The CFO was to provide the IG, DoD, with Version 2 of the DoD Components' financial statements. The IG, DoD, was to recommend adjustments to Version 2 of the DoD Components' financial statements that DFAS would incorporate into Version 3 of the DoD Components' financial statements. Headquarters, DFAS, was to forward Version 2 of all DoD Components' financial statements to the DFAS Indianapolis Center for use in preparing Version 2 of the DoD Consolidated Financial Statements. The IG, DoD, was to recommend adjustments to Version 2 of the DoD Consolidated Financial Statements that DFAS would incorporate into Version 3 of the DoD Consolidated Financial Statements.

Because the CFO did not provide the DFAS Indianapolis Center with a complete Version 2 of the DoD Components' financial statements in a timely manner, the DFAS Indianapolis Center was unable to provide an unaudited Version 2 of the DoD Consolidated Financial Statements to the IG, DoD, by December 24, 1997. Consequently, the IG, DoD was unable to conduct adequate audit work to render an audit opinion by February 28, 1998. We cited the untimely preparation of the DoD Consolidated Financial Statements as one of several reasons we were unable to render an opinion on the DoD Consolidated Financial Statements.

Version 3 of DoD Consolidated Financial Statements. The CFO was to provide the final version of the DoD Consolidated Financial Statements for FY 1997 on February 7, 1998, to the IG, DoD. However, the CFO released Version 3 of the DoD Consolidated Financial Statements in segments. On February 12, 1998, the CFO submitted the DoD Consolidated Financial Statements without the Footnotes and the Overview. The footnotes were provided on February 13, 1998. The Overview was provided on March 13, 1998. We were not able to recommend adjustments to the DoD Consolidated Financial Statements for FY 1997 because the CFO did not provide the statements to us in a timely manner.

Accounting and Related Systems

DoD was unable to produce auditable and timely financial statements for FY 1997 primarily because the accounting and related systems were deficient. In the Annual Statements of Assurance for FY 1997, required by the "Federal Managers' Financial Integrity Act of 1982," DoD did disclose management control weaknesses in accounting and related systems.

However, DoD did not adequately disclose management control weaknesses in its feeder systems.* In addition, DoD accounting and related systems were not Year 2000-compliant and will have to be reprogrammed to avoid miscalculations beginning with the Year 2000. As a result, the financial condition of DoD and its operating results for FY 1997 were not verifiable, and DoD has no assurance that it is properly managing its resources.

The primary deficiencies were that most DoD accounting systems:

- did not use a transaction-driven general ledger to account for and manage resources;
- did not have audit trails to trace general ledger account balances back to supporting documentation or specific accounting transactions back to the general ledger;
- did not have a process for accurately identifying and reporting transactions that should be eliminated during the financial statements consolidation process; and
- did not accurately value Inventory and Property, Plant, and Equipment.

Transaction-Driven General Ledger. DoD did not use a transaction-driven, integrated accounting system that was based on the U.S. Government Standard General Ledger (USGSGL). A transaction-driven system controls accounting data from the point of entry to presentation on the financial statements, and ensures that all affected accounts are accurately posted. A standard general ledger ensures that each entity uses the same accounts to record and summarize accounting transactions. Lacking these controls, DoD relied on a variety of sources to obtain financial information and then crosswalked that information to a general ledger format to prepare financial statements.

Consequently, $65.4 billion of expenses reported by the Army could not be audited because Army accounting systems did not produce subsidiary ledgers showing the transactions that made up the summary amounts reported in the Army financial statements. The Navy could not accurately report the value of assets and liabilities, including the status of funds appropriated, because it lacks a transaction-driven standard general ledger accounting system. The Navy War Reserve balance of $54.5 billion was understated by $8.5 billion, and the Navy Property, Plant, and Equipment balance of $293 billion was understated by at least $10.8 billion. The Air Force's lack of a transaction-driven general ledger was one reason that the acquisition cost of Air Force assets, valued at $293 billion, could not be verified.

* Military Department systems that provide financial information to the DFAS core or primary financial systems used in the preparation of DoD financial statements.

In addition, because the Navy lacked a transaction-driven general ledger accounting system, it relied on data calls that were error prone and systems that did not have account-based subsidiary general ledgers. Consequently, the Navy reported that $17.7 billion of Government Property Held by Contractors could not be supported by data documented through data calls.

On July 30, 1997, the Principal Deputy USD(C) issued a memorandum stating that the USGSGL is mandated for use throughout DoD in all systems that originate information that ultimately is used in, or passed to, financial systems. This includes financial, nonfinancial, and mixed systems that process financial information. The Office of the Deputy Chief Financial Officer, in conjunction with the Director, DFAS, has undertaken an effort to implement the USGSGL throughout DoD.

Audit Trails. The DoD accounting systems used to consolidate data did not always have audit trails for verifying the $294.8 billion of DoD expenses reported in FY 1997. An adequate audit trail allows transactions to be traced from the source document to the resulting accounting record or report. An adequate audit trail also allows summary accounting data to be traced back through subsidiary ledgers to the source document. Audit trails are critical for the financial statements because those statements comprise data that originates with base-level transactions from locations worldwide. Without adequate audit trails, account balances cannot be traced to source documents through successive levels of summarization to the financial statements. This process is necessary to ensure that all transactions are properly recorded and supported.

Eliminating Entries. Because of inadequate accounting systems, we were unable to substantiate $230.6 billion of eliminating entries for Accounts Receivable, Accounts Payable, Revenues, Expenses, Unearned Revenue, Advances, Collections, and Disbursements. DoD presented sales or services between DoD reporting entities according to the amounts reported for Accounts Receivable, Revenue, Unearned Revenue, and Collections. It was DoD's understanding that equal amounts of Accounts Payable, Expenses, Advances, and Disbursements were entered on the accounting records of the purchasing activity. Currently, most agencies do not reconcile differences with their transaction partners and no effective mechanism exists for such reconciliations. Thus, we were unable to apply auditing procedures to satisfy ourselves as to the fairness of the $230.6 billion of eliminating entries presented in the DoD Consolidated Financial Statements for FY 1997.

Neither DFAS nor the DoD Components performed critical checks to validate the reporting of eliminating entries of $230.6 billion by reconciling Note 29, Schedules C and D, with the related line items in the financial statements. Because DFAS and DoD did not reconcile Note 29 with the related line items at the DoD Component level, we identified $10.5 billion in differences between the amounts reported in Note 29 for Accounts Receivable, Revenues, and Unearned Revenues, and the amounts reported on related line items of the financial statements. Advances, Prepayment, Accounts Payable, and Expenses would also be misstated by $10.5 billion for the same reason. In addition,

because DFAS did not perform the necessary reconciliations at the DoD Consolidated level, the DoD Consolidated Statement of Operations and Changes in Net Position, Line 2b (Revenues from Sales of Goods and Services, Intragovernmental), was overstated by $11.8 billion and Line 4 (Interest, Federal), was understated by $11.8 billion. Because our audit work was limited, we could not determine whether the differences were caused by the incorrect reporting of amounts on the financial statements or the incorrect reporting of amounts in Note 29, or both.

Valuation of Inventory. Accounting and related system deficiencies prevented the DoD from fully complying with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." For example, the Air Force financial accounting systems did not maintain supporting subsidiary records for WCF inventory shipments to and from contractor repair facilities and inventory in-transit between contractors and Air Force installations. Consequently, $11 billion of Air Force WCF inventory could not be validated. In addition, the Air Force did not value operating materials and supplies at their historical cost because the accounting system did not accumulate, account for, and report historical costs. Consequently, the $40.3 billion of Operating Materials and Supplies included in the financial statements as War Reserves and Inventory is unreliable.

Valuation of Property, Plant, and Equipment. Accounting and related system deficiencies prevented DoD from accurately valuing Property, Plant, and Equipment. The Army was unable to adequately value $132.0 billion of Property, Plant, and Equipment because prices used to value the equipment weren't current, reported values didn't include the value of items accepted at contractors' plants but not yet received by the using unit, contractor reports weren't accurate or complete, and the Army values its Military Equipment at latest acquisition cost or standard prices, rather than actual cost. The Navy understated its Military Equipment balance by at least $10.8 billion because of reporting misunderstandings and because FY 1996 data was used to report the number of stricken aircraft, materials procured by fleet commanders, and satellites. In addition, the auditors were unable to verify the Navy's $17.7 billion of Government Property Held by Contractors because the data was not available in the Contract Property Management System. The Air Force inventory systems used to track Military Equipment applied standard values instead of acquisition costs to value the assets. Consequently, $182 billion of Air Force Military Equipment included in the financial statements as Property, Plant, and Equipment may be materially misstated.

National Defense Property, Plant, and Equipment (Mission Assets). The General Accounting Office and the IG, DoD, performed a coordinated review of DoD mission assets during the FY 1997 CFO audit. Mission assets, more properly referred to as National Defense Property, Plant, and Equipment, are weapon systems and other equipment used in the performance of actual military operations. Examples would be aircraft, ships, trucks and jet engines. The purpose of the joint effort was to test mission assets for completeness of reporting and existence of assets. Based on a rigorous sampling methodology designed to result in a pass/fail conclusion on the categories of the items

sampled, the Army and Air Force passed, while the Navy failed in three of the eleven categories.*

Annual Statements of Assurance. In the Annual Statement of Assurance required by the Federal Managers' Financial Integrity Act of 1982, DoD did not fully disclose management control weaknesses in accounting and related systems. The FY 1997 Annual Statements of Assurance prepared by DoD and the DFAS did not adequately identify the number of DoD Components' feeder systems that affect financial reporting. In addition, the Annual Statement of Assurance did not specifically identify all material control weaknesses in the DoD Components' feeder systems. DoD acknowledged that it should fully disclose the significant number of feeder systems and their management control weaknesses in its Annual Statements of Assurance. Ongoing efforts to identify and disclose all critical financial management systems in DFAS should allow for a more adequate disclosure in the FY 1998 Annual Statements of Assurance. The OMB is aware of the inadequate disclosure in the DoD and DFAS Annual Statements of Assurance, and is also aware that DoD is working to correct the inadequate disclosure of material management control weaknesses.

Year 2000 Compliance. In its FY 1997 Annual Statement of Assurance, DoD reported accounting and related systems that were not Year 2000-compliant. The Year 2000 problem is caused by the way automated systems use the last two digits of the year in order to conserve data storage. Computers are unable to distinguish year 1900 from 2000, as a result systems that use dates to calculate and compare information will generate incorrect results. DFAS reported to OMB that 123 (77 percent) of its 160 systems were noncompliant. However, DFAS reports on Year 2000 efforts were unreliable and did not accurately report its progress of solving Year 2000 problems. Specifically, the DFAS did not perform adequate assessments of systems reported in the renovation phase and did not meet all requirements for making systems Year 2000-compliant. The Year 2000 problem has the potential to affect all financial areas in DoD

Control Procedures

Control procedures throughout DoD were not adequate to properly report balances on the financial statements. DoD allowed unsupported adjusting entries to be made; Property, Plant, and Equipment to be inaccurately reported; Pensions and Other Actuarial Liabilities to be inadequately supported; Other Liabilities to be understated and unreliable; and the Notes to the Principal Statements to be inconsistently reported. In addition, inadequate DoD guidance caused the financial statements to be misstated.

Adjusting Entries. Controls throughout DoD were not adequate to ensure that $906.4 billion (absolute value) in adjustments were accurate and properly

* The verification was performed on a pass or fail basis, two or more errors in a category would equal a failure in that category.

supported before being entered into accounting systems. Specifically, the DFAS Indianapolis Center made adjustments of $350 billion to change Army general ledger accounts to match certified status data. However, the DFAS Indianapolis Center did not attempt to reconcile the differences between the general ledger and the certified status reports. The DFAS Cleveland Center made adjustments to Navy general ledger accounts totaling $459 billion. Controls over the manual journal voucher process at the DFAS Cleveland Center needed improvement in areas such as supervisory reviews, posting, consistency between appropriations, and supporting audit trails. In addition, the DFAS Indianapolis Center could not provide supporting documentation for adjustments of $97.4 billion to the Other Defense Organizations financial data; those adjustments made the general ledger accounts agree with the certified budget reports. As a result, the DoD Consolidated Financial Statements were subject to higher risk of material misstatement.

Property, Plant, and Equipment. Inadequate control procedures prevented DoD from accurately reporting at least $38.1 billion of Property, Plant, and Equipment on the DoD Consolidated Financial Statements. Specifically, the Army understated its Property, Plant, and Equipment by $11.4 billion because unit prices had not been updated. The Navy and the Air Force understated Property, Plant, and Equipment balances by $10.8 billion and $14.3 billion, respectively, because of incomplete reporting of assets. In addition, DoD financial policy requires that capital assets acquired by the Joint Logistics Systems Center and installed at WCF activities are to be capitalized in the financial records of each receiving organization. The Joint Logistics Systems Center did not properly transfer $1.6 billion in systems development costs to the receiving organizations for capitalization. In addition, about $500 million in development costs spent on canceled systems were still reflected on the Joint Logistics Systems Center financial records as construction-in-process.

Pensions and Other Actuarial Liabilities. DoD did not adequately support its $218 billion of Unfunded Actuarial Liability for Military Retirees' Medical Benefits. Actuarial estimates of unfunded liability were not based on complete data. According to the actuarial contractor who developed the unfunded liability, the normal cost percentages and unfunded actuarial liability were uncertain because a large portion of the data on claims was not readily available; and only two-thirds of the data on medical expenses was available by age and sponsor group. Until the data are complete, the unfunded liability costs will vary widely from year to year and remain unreliable.

Other Liabilities. DoD did not report reliable amounts for Other Liabilities. Specifically, the Navy understated the WCF Other Federal (Intragovernmental) Liabilities by $2.3 billion because the reported amount contained net balances for undistributed amounts that should have been transferred to Accounts Receivable and Payable and also contained undetected errors. In addition, because DoD had weak controls and used systems that

were not designed for financial reporting, the $27.7 billion of Other Non-Federal Liabilities reported by the Army were not reliable.

Footnotes to the Principal Statements. The Footnotes to the Principal Statements contained inconsistencies and incorrect classifications. We identified a total of $55.2 billion in inconsistencies between the Notes and line items, and between Notes. These problems occurred primarily because DFAS did not perform the necessary cross-checks between the Notes and related line items in the Financial Statements, and because DoD guidance did not give adequate instructions for preparing the Notes. As a result, the financial statements were often misleading or not fully informative.

Consistency With Line Items. DoD did not ensure that the Notes agreed with line items. As a result, inconsistencies appeared in the financial statements of DoD reporting entities, and DoD did not address those nconsistencies when preparing the DoD Consolidated Financial Statements. For example:

Note 15, Property, Plant, and Equipment. The Navy reported in Note 15 of its financial statements that it had understated the FY 1996 Military Equipment account balance by $20.1 billion and that the $20.1 billion was included in the FY 1997 account balance for Military Equipment. However, the Navy did not make a prior-period adjustment to the FY 1996 amount so that the FYs 1996 and 1997 financial statements and footnotes would show comparable data.

Note 17, Other Liabilities. DoD did not consistently report all environmental cleanup costs. The Army reported $15.1 billion of Environmental Cleanup Costs and $10.5 billion of Chemical Demilitarization Costs under the subcategory "Other" instead of "Environmental Cleanup Costs" in Note 17 of the Army General Fund Financial Statements. The DFAS Indianapolis Center identified the $15.1 billion of Army Environmental Cleanup Costs in a note to Note 17 in the DoD Consolidated Financial Statements. However, the DFAS Indianapolis Center did not recognize as Environmental Cleanup Costs the additional $10.5 billion of Chemical Demilitarization Costs that were misreported by the Army. Thus, DoD reported a total of $27.8 billion of Environmental Cleanup Costs. We concluded that DoD should have reported a total of $38.3 billion of Environmental Cleanup Costs. This understatement at the DoD level caused the Environmental Liabilities line on the "1997 Consolidated Financial Statements of the United States" to be understated by $10.5 billion.

Note 24, Cost of Goods Sold. DoD did not divide the Cost of Goods Sold between the Public and Intragovernmental. The Note reported only the total Cost of Goods Sold and stated that the amount was prorated between the Cost of Goods Sold, Public and Cost of Goods Sold, Intragovernmental, based on revenues generated.

Note 25, Other Expenses. Material differences existed between the Other Expenses disclosed in Note 25 and related line items in the financial statements. In preparing Note 25, DoD used $4.1 billion of Other Expenses for the Military Retirement Trust Fund. However, in consolidating the DoD

Components' financial statements, DoD used $15.9 billion of Other Expenses for the Military Retirement Trust Fund. The $11.8 billion difference appeared to be caused by an intragovernmental revenue amount that was misclassified and mistakenly eliminated at the DoD level instead of the Federal level.

Note 29, Intrafund Eliminations. Material differences existed between the amounts disclosed in Note 29 and related line items in the financial statements. For example, the $17.4 billion of revenue identified in Note 29 did not agree with the related revenue line items in the Statement of Operations and Changes in Net Position, which showed $23.3 billion. DoD did not explain the $5.9 billion difference.

Because DoD did not consistently report information in the financial statements and the Notes, the financial statements were misleading. For example, readers may believe that DoD had $27.8 billion of Environmental Cleanup Costs, instead of $38.3 billion. Also, the financial statements did not clearly and consistently support the cost of goods sold and other expenses and did not show readers the extent of intragovernmental account balances.

Consistency Between Notes. The Notes were not always consistent with information in other Notes. For example, Note 1, Summary of Significant Accounting Policies, stated that DoD valued its $61.3 billion of Inventory at a standard sales price; however, Note 24, Cost of Goods Sold, reported that Inventory was valued at the latest acquisition cost. In addition, Note 17, Other Liabilities, reported total advances and unearned revenues of $2.7 billion; however, Note 29, Intrafund Eliminations, reported $161 million in total advances and unearned revenues.

Inconsistencies in explanatory notes to the financial statements can confuse readers and lead to a lack of credibility. In the examples given, readers could question the ability of DoD to accurately report the results of operations and value of assets.

Classification of Assets and Liabilities. The Notes did not always classify assets and liabilities correctly. For example, Note 17 included $341.4 million of Accounts Receivable, although that Note should have included only Other Liabilities. This misclassification overstated the Other Liabilities (Intragovernmental) Covered by Budgetary Resources that DoD reported by $312.0 million and understated the Other Liabilities (Governmental) Covered by Budgetary Resources that DoD reported by $29.4 million.

DoD Guidance. DoD financial management guidance prohibits DoD from reporting foreign military sales revenues and expenses, except for those applicable to surcharges, in the financial statements of the Foreign Military Sales Trust Fund. Therefore, DoD did not report approximately $14.5 billion of revenues and expenses for foreign military sales in the Defense Security Assistance Agency's financial statements for FY 1997, causing the revenues and expenses to be understated.

Also, the DoD did not include financial data for the Defense Security Assistance Agency in the DoD Consolidated Financial Statements. The Defense Security Assistance Agency did not account for revenues and expenses of approximately $15.1 billion each. Accounts receivable were overstated and inventories were unrecorded. We do not agree with the exclusion of the Defense Security Assistance Agency's financial data from the FY 1997 DoD Consolidated Financial Statements; we included this issue as a reason for our disclaimer.

In addition, DoD financial management guidance did not require the Military Departments to report to DFAS the amount of inventory that was purchased with foreign military sales funds under the Cooperative Logistics Supply Support Agreement program. Thus, the Defense Security Assistance Agency's financial statements for FY 1997 understated inventory and total assets by at least $459 million, which was the amount of inventory purchased with foreign military sales funds for sale to foreign customers.

Conclusions

Although progress has been made, the DoD internal controls were not adequate to ensure that resources were properly managed and accounted for and that financial statements were free of material misstatements. The DoD control environment was not conducive to the preparation of auditable financial statements. DoD accounting and related systems did not produce reliable and verifiable data and did not provide adequate documentation, audit trails, and general ledger control. In addition, DoD did not disclose all management control weaknesses in the accounting and related systems in its FY 1997 Annual Statements of Assurance, and DoD reported accounting and related systems that were not Year 2000-compliant.

Weak control procedures allowed unsupported adjusting entries; questionable reporting of Property, Plant, and Equipment; Pensions, Other Actuarial Liabilities; and Other Liabilities; and inconsistent reporting of Notes to the Principal Statements. Until control procedures are strengthened, DoD will continue to produce unreliable, unverifiable, and inaccurate financial statements.

Recurring Issues in the DoD Consolidation Process. Unsupported adjustments, unreconciled eliminating entries, and inconsistency between the footnotes and the financial statements are recurring issues in the DoD Consolidated Financial Statements. For FY 1996, DoD reported at least $217.5 billion of unsupported adjustments, at least $52.1 billion of inaccurate eliminating entries, and material inconsistencies between footnotes and between various footnotes and related line items. For FY 1997, DoD reported at least $893.4 billion of unsupported or questionable adjustments and at least $44.6 billion of inaccurate eliminating entries, and continued to report material inconsistencies between footnotes and between footnotes and related line items. We believe that these issues continue because DoD financial reporting guidance is not timely and the process of consolidating the financial statements is cumbersome.

DoD Position on Systems. DoD acknowledged that its financial management systems have significant procedural and systemic deficiencies, including noncompliance with the Year 2000 requirements, and included a discussion of those deficiencies in the FY 1997 Annual Statements of Assurance and the management representation letter for the DoD Consolidated Financial Statements (see Appendix D). The management representation letter stated that DoD systems did not always generate reliable accounting data to produce financial statements. The DFAS continues to consolidate and modernize all migratory, interim migratory, and legacy accounting systems in order to improve DoD's financial reporting and comply with applicable laws and regulations. We believe that full cooperation from all stakeholders and system owners is critical.

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

Introduction

As part of the audit of the DoD Consolidated Financial Statements for FY 1997, we tested compliance with laws and regulations that directly and materially affected those financial statements. We performed these tests, which are required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, to obtain reasonable assurance that the principal statements were free of material misstatements. Our objective, however, was not to render an opinion on DoD compliance with laws and regulations. The USD(C) is responsible for compliance with laws and regulations applicable to the DoD Consolidated Financial Statements.

Because of weak internal controls and a lack of audit trails, we were unable to perform all the tests necessary to determine compliance with laws and regulations. However, except as described in this report, results of the tests we performed indicate that, with respect to the items tested, DoD complied, in all material respects, with the laws and regulations listed in Part II, Appendix E. For the items not tested, nothing came to our attention to cause us to believe that DoD had not complied, in all material respects, with those laws and regulations.

Material Noncompliances

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

DoD did not comply with several laws and regulations related to the DoD Consolidated Financial Statements for FY 1997. Material instances of noncompliance included inadequate accounting systems, improper accounting, and inadequate disclosure in the financial statements. Because many of these instances of noncompliance were related to basic financial requirements, we were unable to fully evaluate DoD compliance with laws and regulations. Also because of the noncompliance, DoD financial statements are of limited use to DoD and other Government managers.

Except for issues related to the consolidated financial statements, the instances of noncompliance discussed here have been reported previously by the IG, DoD, the Military Department audit agencies, or the General Accounting Office. DoD has also candidly reported many of the issues in previous Annual Statements of Assurance. While many noncompliance issues apply to the financial statements of DoD reporting entities, some apply only at the consolidated level**Title 31, United States Code (U.S.C.) Section 501, Chief Financial Officers Act of 1990.** The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare audited financial statements and submit them to OMB no later than March 1, 1998. DoD did not prepare and issue financial statements for FY 1997 in time for us to accomplish sufficient work and render an opinion. The statements were delayed, and

consequently unauditable, primarily because DoD had inadequate accounting systems and control procedures. We cited the untimely preparation of the DoD Consolidated Financial Statements and deficiencies in accounting systems and control procedures as a reason we were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1997. Those deficiencies prevented DoD from completely and accurately disclosing timely financial results; obtaining the financial information needed for managing; and using accounting results to prepare and support budget requests, control the budget, and provide adequate financial information for preparation of the President's budget.

Title 31, U.S.C. Section 65, Federal Managers' Financial Integrity Act of 1982. The Federal Managers' Financial Integrity Act of 1982 requires DoD to evaluate its systems of internal accounting and administrative controls to determine whether such systems can comply with the Act, and to prepare an Annual Statement of Assurance for the President and the Congress stating whether DoD systems of internal accounting and administrative control are in compliance with Act. In addition, DoD and DFAS identified accounting and related systems that were not compliant with OMB Circular A-127 and were not Year 2000-compliant

Title 31, U.S.C. Section 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 each Federal agency to implement and maintain: financial management systems that comply substantially with Federal requirements, applicable Federal accounting standards, and the USGSGL at the transaction level. The FFMIA also requires that the IG, DoD, report on agency compliance with these requirements. These requirements for financial management systems, accounting standards, and the USGSGL are already well-established in the following Federal policy documents

- OMB Circular A-127, "Financial Management Systems," July 23, 1993;
- OMB Circular A-134, "Financial Accounting Principles and Standards," May 20, 1993; and
- Joint Financial Management Improvement Program (JFMIP), Part II, Appendix D, of this report, lists all JFMIP publications.

As part of our audit to obtain reasonable assurance about whether the DoD Consolidated Financial Statements for FY 1997 were free of material misstatement, we performed tests of compliance with certain provisions of laws and regulations when noncompliance with these laws and regulations could have a direct and material effect on the determining the amounts in the financial statements. We also

tested compliance with certain other laws and regulations specified in OMB Bulletin No. 93-06, as supplemented by OMB Bulletin No. 98-04, "Addendum to OMB Bulletin No. 93-06." In planning and performing our tests of compliance, we considered the implementation guidance issued by OMB on September 9, 1997, relating to the FFMIA.

For FY 1997, the financial management systems that supported the DoD Consolidated Financial Statements were not in substantial compliance with the requirements of the FFMIA. DoD financial management systems were unable to produce auditable and timely financial statements for FY 1997 primarily because the accounting and related systems were not designed for financial reporting. DoD financial management systems comprised multiple finance, accounting, and feeder systems that were the responsibility of DFAS, the Military Departments, and the Defense agencies. As a result, the financial condition of DoD and its operating results for FY 1997 were not verifiable, and DoD had no assurance that it was properly managing its resources.

DoD Deficiencies. DoD has acknowledged that its financial management systems have significant procedural and systemic deficiencies, and has included a discussion of those deficiencies in previous Annual Statements of Assurance and the management representation letter for the FY 1997 DoD Consolidated Financial Statements (see Appendix D). The management representation letter stated that DoD systems did not always generate reliable accounting data to produce financial statements. The primary deficiencies were that most DoD accounting systems:

- did not use a transaction-driven general ledger to account for and manage resources;
- did not have audit trails to trace general ledger account balances back to supporting documentation or to trace specific accounting transactions to the general ledger; and
- did not have adequate internal controls.

Specifically, the DoD financial management systems were not in substantial compliance with the requirements of the FFMIA because:

- The financial management systems did not meet the requirements published in the "Federal Financial Management System Requirements" of the JFMIP.

- Multiple instances of noncompliance with Federal Generally Accepted Accounting Principles existed that prevented the proper reporting of material line items such as Fund Balance With Treasury; Accounts Receivable; Inventory; Accounts Payable; and Revenue and Cost recognition. The financial management systems did not incorporate the USGSGL at the transaction level.

- Accounting systems did not have a process for accurately identifying and reporting transactions that should be eliminated during the financial statement consolidation process.

Management Actions. The DFAS continues to consolidate and modernize all migratory, interim migratory, and legacy accounting systems. The goals of that office are to comply with applicable laws and regulations and improve DoD financial reporting.

DFAS did not report on the systems owned by the Military Departments in its Annual Statements of Assurance for FY 1997. DFAS is identifying systems and developing an inventory of Military Department-owned systems and plans to report on these systems for FY 1998. The Program Management Office has notified OMB that DFAS will not report on the Military Department-owned systems for FY 1997.

OMB Circular No. A-127, "Financial Management Systems." OMB Circular No. A-127 establishes Government policy for developing, evaluating, and reporting on financial management systems. Financial management systems must provide complete, reliable, consistent, timely, and useful information. To achieve this goal, DoD and other Federal agencies must establish and maintain a single, integrated financial management system, using the USGSGL. DoD financial management systems did not comply with the requirements of OMB Circular No. A-127. DoD had multiple, nonintegrated financial systems that did not use the USGSGL. The general ledger used by DoD did not control all financial transactions and account balances and was not the only source of information for financial reports.

OMB Circular No. A-134, "Financial Accounting Principles and Standards." OMB Circular A-134 establishes policies and procedures for approving and publishing financial accounting principles and standards. It also establishes the policies that Executive branch agencies and OMB follow in seeking and providing interpretations and other advice related to the standards.

JFMIP Federal Financial Management System Requirements. The 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." Part II of this report, Appendix E lists all the "Federal Financial Management System Requirements" published by JFMIP.

The "Core Financial System Requirements," September 1995, which are part of the JFMIP's "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. This includes the ability to:

- collect accurate, timely, complete, reliable, and consistent information;
- provide for adequate agency management reporting;
- support government-wide and agency-level policy decisions;
- support the preparation and execution of agency budgets;
- facilitate the preparation of financial statements, and other financial reports in accordance with federal accounting and reporting standards;
- provide information to central agencies for budgeting, analysis, and government-wide reporting, including consolidated financial statements; and
- provide a complete audit trail to facilitate audits.

Further, the requirements state that integrated financial management systems must be designed with effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems.

DoD financial management systems did not assure the integrity of information for decision-making and measuring performance because the systems did not assure reliable and timely collection and reporting of financial data and did not provide a complete audit trail.

OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements." DoD did not always follow the accounting principles in OMB Bulletin No. 94-01, as supplemented by OMB Bulletin 97-01, when accounting for resources and preparing the Overview and the Footnotes to the Principal Statements. We identified at least $52.7 billion in material noncompliance with the accounting principles. These noncompliance issues included the methods used to account for Fund Balance With Treasury, Accounts Receivable, Inventory, Accounts Payable, Environmental Costs associated with weapons systems, and Revenue and Cost Recognition.

- **Fund Balance With Treasury.** DoD did not fully comply with OMB Bulletin No. 94-01, which requires entities to disclose any differences between Fund Balance With Treasury in the entity's records and the corresponding account balances reported by the U.S. Treasury. DoD failed to disclose at least $1.4 billion of unresolved differences between U.S. Treasury records and the records of the Army's disbursing office.

- **Accounts Receivable.** DoD did not fully comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 1, "Accounting for Selected Assets and Liabilities." DoD was unable to support at least $7.3 billion of Accounts Receivable amounts reported. In addition, DoD misclassified Accounts Receivable because requests to foreign military sales customers for advance payments were recorded as accounts receivable. As a result of the misclassification, Accounts Receivable and total assets were overstated by at least $1.9 billion. As previously stated, DoD did not include financial data for the Defense Security Assistance Agency in the DoD Consolidated Financial Statements.

- **Inventory.** DoD did not fully comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Because of improper reporting of inventory held for repair, Government furnished material, and inventory in transit, $10.2 billion of Army WCF Inventory was unreliable. Air Force systems did not maintain supporting subsidiary records for $11 billion of inventory shipments to and from contractor repair facilities, and inventory in-transit between contractors or Air Force installations. In addition, DLA did not properly value or present inactive stock in its inventory. Consequently, at least $21.2 billion of inventory could not be validated.

- **Accounts Payable.** DoD was unable to record Accounts Payable in accordance with SFFAS No. 1. Specifically, DoD did not record Accounts Payable when goods were received or services were completed; did not recognize Accounts Payable for bills not yet paid; and did not record progress payment holdbacks as Accounts Payable. Consequently, at least $2.3 billion of Accounts Payable reported by the Army was unreliable and the Navy understated Accounts Payable by $415 million.

- **Environmental Costs.** Although SFFAS No. 5, "Accounting for Liabilities of the Federal Government," was effective beginning with FY 1997, DoD has not established a policy to implement this federal accounting standard. Consequently, the DoD Consolidated Financial Statements for FY 1997 do not recognize and report environmental costs associated with weapons systems, such as aircraft disposal costs.

- **Revenue and Cost Recognition.** DoD did not fully comply with SFFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting. Consequently, the Air Force was unable to match revenues of $1.8 billion and costs of $1.9 billion. In addition, the DoD Consolidated Financial Statements for FY 1997 did not include approximately $14.5 billion of revenues and expenses for foreign military sales from the Defense Security Assistance Agency's Financial Statements, causing the revenues and expenses to be understated.

For FY 1997, DoD improved the Overview portion of its financial statements. For FY 1996, DoD limited the Overview portion of its financial statements to a discussion of organizational structure. DoD did not disclose how well it accomplished its mission or what improvements were needed in program or financial performance. For FY 1997, the Overview summarized financial performance measures required under Public Law 103-62, the Government Performance and Results Act of 1993, August 3, 1993.

Conclusion

Noncompliance with fundamental requirements affected the DoD Consolidated Financial Statements for FY 1997. Although many noncompliance issues related to deficient financial systems are not expected to be corrected for years, others can and must be resolved earlier. Through policy changes and improved planning, DoD can correct some instances of noncompliance, such as failure to use the USGSGL and improper reporting of Fund Balance With Treasury, Accounts Receivable, Inventory, Accounts Payable, environmental costs associated with weapons systems, and Revenue and Cost Recognition. Those improvements would lead to better financial statements and audit opinions.

Part II. - Additional Information

Appendix A. Audit Process

Scope

Statements Reviewed. We examined the Principal Statements, the Footnotes to the Principal Statements, and the Overview in the DoD Consolidated Financial Statements for FY 1997. On February 12, 1998, the CFO submitted the DoD Consolidated Financial Statements without Footnotes and the Overview. The footnotes were provided on February 13, 1998. The Overview was provided March 13, 1998. Therefore, we were unable to conduct adequate work to render an opinion on the financial statements by February 28, 1998. The Principal Statements included the Consolidated and the Consolidating Statements of Financial Position and the Statements of Operations and Changes in Net Position.

To report on the internal controls and compliance with laws and regulations, we relied on audit work conducted by the Military Department audit agencies (the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency). Our combined audit efforts provide a reasonable basis for our results.

Scope Limitations. We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1997. The DoD Consolidated Financial Statements were not received in a timely manner, and a legal representation letter was not prepared until April 8, 1998. Although progress continues, significant deficiencies in the accounting systems and the lack of sound internal controls prevented the preparation of accurate financial statements. The accounting data were not reliable, and we were unable to satisfy ourselves that the data were accurate and complete. We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1996, and as such we did not determine if comparative data for FY 1996 was fairly presented on the FY 1997 statements.

Our disclaimer was partially based on work performed by the Military Department audit agencies. The Army Audit Agency could not verify the accuracy of approximately $27.7 billion reported for non-Federal liabilities not covered by budgetary resources. The Naval Audit Service determined that property, plant, and equipment was understated by at least $10.8 billion. The Air Force Audit Agency could not verify the accuracy of $24.5 billion in inventory.

Because of accounting system and internal control deficiencies and significant scope limitations, the scope of our work was not sufficient to allow us to render an opinion on the FY 1997 DoD Consolidated Financial Statements.

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 for approval

by the Director, OMB; the Secretary of the Treasury; and the Comptroller General. The Director, OMB, and the Comptroller General issue the standards after approval. To date, seven accounting standards and two accounting concepts have been published in final form. Accounting SFFAS 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 SFFAS No. 6 and No. 8. These standards and concepts constitute generally accepted accounting principles for the Federal government. OMB Bulletin No. 94-01, as supplemented 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 SFFAS 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 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 has issued an exposure draft, "Amendments to Accounting for Property, Plant, and Equipment," 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 supplemented 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;
- form and content requirements of OMB Bulletin No. 94-01 as supplemented 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.

Review of Internal Controls. We examined DoD internal controls for FY 1997, as related to the DoD Consolidated Financial Statements. We obtained an understanding of the internal control policies and procedures and assessed the level of control risk relevant to all significant cycles, all classes of transactions, the consolidation process, and account balances. We reviewed and tested the DoD control environment, accounting and related systems, and control procedures for the DoD Consolidated financial statements. We also relied on other audits conducted by the GAO, the IG, DoD, and the Military Department audit agencies. The scope of our review was limited to the internal controls for the DoD Consolidated Financial Statements and issues reported in other related audits.

DoD Directive 5010,38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls. Because DoD did not have sound internal controls, we revised our audit approach to focus on specific internal controls. We obtained an understanding of management's process for evaluating and reporting on the internal controls and accounting systems and compared the material weaknesses in financial reporting, as reported in the entity's Annual Statement of Assurance, to the material weaknesses and reportable conditions we found. A copy of this report will be provided to the USD(C), who is the senior official in charge of management controls for DoD.

Review of Compliance With Laws and Regulations. We reviewed and tested DoD compliance with laws and regulations designated by OMB with respect to the DoD Consolidated Financial Statements. We also relied on other audits conducted by the GAO, the IG, DoD, and the Military Department audit agencies. The scope of our review was limited to compliance as related to the DoD Consolidated Financial Statements and compliance issues reported in other audits mentioned. See Part II, Appendix E, for a list of laws and regulations we reviewed.

Methodology

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

Audit Assistance. The Military Department audit agencies assisted us by auditing various reporting entities and accounts. Except for deficiencies unique to the consolidation process, the information in this report is a summary of the most significant deficiencies reported by the IG, DoD, and the Military Department audit agencies. Refer to the IG, DoD, audit reports and the Military Department audit reports listed in Part II, Appendix B, for explanations of the findings summarized in this report.

Computer-Processed Data. We could not rely on the computer-processed data used to prepare the FY 1997 DoD Consolidated Financial Statements. DoD accounting and related systems were unreliable and as such the financial statements were unauditable. DoD has candidly addressed deficiencies in its financial management systems in the Annual Statement of Assurance and the management representation letter for FY 1997. Although the unreliable computer processed data was used in the preparation of the financial statements and this report, this was the only financial data available. We continue to review the adequacy of existing and proposed financial management systems.

Statistical Sampling Methods. We relied on information contained in audit reports and summaries and information published in management reports. We did not use statistical sampling methods.

Audit Period and Locations. We conducted the audit from August 1997 through April 1998 at various DoD activities, including DFAS and the Military Departments.

Representation Letters. We received a management representation letter from the USD(C). The letter acknowledged that significant procedural and systemic deficiencies exist in DoD, and discussed internal control weaknesses and compliance problems for many accounts. See Part II, Appendix D, for the management and legal representation letter. The DoD did not provide a legal representation letter regarding the FY 1997 DoD Consolidated Financial Statements until April 8, 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

General Accounting Office

Report No.	Title	Date
GAO/AIMD-98-40	Financial Management: Seven DoD Initiatives That Affect the Contract Payment Process	January 30, 1998
GAO/AIMD-98-35	Defense Computers: Air Force Needs to Strengthen Year 2000 Oversight	January 16, 1998
GAO/AIMD-98-32	DoD's Liability for the Disposal of Conventional Ammunition Can Be Estimated (OSD Case No. 1491)	December 19, 1997
GAO/AIMD-98-25	Financial Management: Issues to Be Considered by DoD in Developing Guidance for Disclosing Deferred Maintenance Aircraft	December 30, 1997
GAO/AIMD-98-16	Financial Reporting: DoD's Fiscal Year 1996 Financial Statements Inventory Reporting Does Not Meet Standards	December 24, 1997
GAO/AIMD-98-9	Financial Management: DoD's Liability for Aircraft Disposal Can Be Estimated (OSD Case No 1476)	November 20, 1997
GAO/AIMD-97-150	Financial Management: DoD's Approach to Financial Control Over Property Needs Structure	September 30, 1997
AIMD-97-117	Defense Computers: DFAS Faces Challenges in Solving the Year 2000 Problem	August 11, 1997
GAO/NSIAD-97-71	Defense Logistics: Much of the Inventory Exceeds Current Needs	February 28, 1997

AIMD/NSIAD-97-61	Financial Management: An Overview of Finance and Accounting Activities in DoD (OSD Case No. 1270)	February 19, 1997
AIMD-97-45	Financial Management: Improved Management Needed for DoD Disbursement Process Reforms (OSD Case No. 1300)	March 31, 1997
AIMD-97-29	Financial Management: DoD Inventory of Financial Management Systems Is Incomplete (OSD Case No. 1273)	January 31, 1997
AIMD-96-99	DoD Accounting Systems: Efforts to Improve System for Navy Need Overall Structure (OSD Case No. 1210)	September 30, 1996
AIMD-96-94	Navy Financial Management: Improved Management of Operating Materials and Supplies Could Yield Significant Savings (OSD Case No. 1168)	August 16, 1996
AIMD-96-65	CFO Act Financial Audits: Navy Plant Property Accounting and Reporting Is Unreliable (OSD Case No. 1050-D)	July 8, 1996
AIMD-96-54	Defense Business Operations Fund (DBOF): DoD Is Experiencing Difficulty in Managing the Fund's Cash (OSD Case No. 1109)	April 10, 1996
AIMD-94-12	Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (OSD Case No. 9276-D)	December 22, 1993

AIMD-94-9	Financial Management: Army Real Property Accounting and Reporting Weaknesses Impede Management Decision-Making (OSD Case No. 9276-B)	November 2, 1993

Inspector General, Department of Defense

98-9015	Disclaimer of Opinion on the Defense Security Assistance Agency Financial Statements for FY 1997	February 27, 1998
98-9014	Disclaimer of Opinion on the National Defense Stockpile Transaction Fund Financial Statements for FY 1997	February 27, 1998
98-9013	Disclaimer of Opinion on the Defense Commissary Agency Financial Statements for FY 1997	February 27, 1998
98-9012	Disclaimer of Opinion on the Defense Information Systems Agency Defense-Wide Working Capital Fund Financial Statements for FY 1997	February 27, 1998
98-9011	Disclaimer of Opinion on the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1997	February 27, 1998
98-9010	Disclaimer of Opinion on the Joint Logistics Systems Center Working Capital Fund Financial Statements for FY 1997	February 27, 1998
98-9009	Audit Opinion on the Defense Logistics Agency Working Capital Fund Financial Statements for FY 1997	February 27, 1998
98-9008	Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1997	February 27, 1998

98-9007	Endorsement of the Disclaimer of Opinion on the FY 1997 Department of the Air Force Working Capital Fund Financial Statements	February 27, 1998
98-9006	Endorsement of the Disclaimer of Opinion on the FY 1997 Department of the Air Force General Fund Financial Statements	February 27, 1998
98-9005	Endorsement of the Disclaimer of Opinion on the FY 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements	February 27, 1998
98-9004	Endorsement of the Disclaimer of Opinion on the FY 1997 Department of the Navy General Fund Financial Statements	February 27, 1998
98-9003	Endorsement of the Disclaimer of Opinion on the FY 1997 Department of the Army Working Capital Fund Financial Statements	February 27, 1998
98-9002	Endorsement of the Disclaimer of Opinion on the FY 1997 U.S. Army Corps of Engineers, Civil Works Program, Financial Statements	February 27, 1998
98-9001	Endorsement of the Disclaimer of Opinion on the FY 1997 Army General Fund Financial Statements	February 27, 1998
98-077	Year 2000 Computing Problems Reports: August 1997 Report	February 18, 1998
98-073	Defense Finance and Accounting Service Work on the Navy General Fund FY 1996 Financial Statements	February 12, 1998

Appendix B. Prior Audit Coverage

98-062	Compilation of the FY 1996 Financial Statements for Other Defense Organizations	February 4, 1998
98-060	Joint Logistics Systems Center Reporting of Systems Development Costs	February 3, 1998
98-059	Financial Accounting for the Defense Investigative Service	February 3, 1998
98-058	Payroll Expenses Reported in FY 1996 for the Office of the Secretary of Defense	February 2, 1998
98-056	Controls Over Presenting Expense Account Line Items on the FY 1996 Statement of Operations for the Air Force Supply Management Business Area	January 27, 1998
98-054	Compilation of FY 1996 Air Force Consolidated Financial Statements at the Defense Finance and Accounting Service Denver Center	January 23, 1998
98-052	Defense Logistics Agency Past Due Federal Accounts Receivable	January 22, 1998
98-050	Defense Business Operations Fund Adjustments at the Defense Finance and Accounting Service Denver Center	January 20, 1998
98-048	Travel and Transportation Expenditures Reported on the Consolidated FY 1996 Financial Statements of the "Other Defense Organizations" Receiving Department 97 Appropriations	January 16, 1998
98-046	Military Traffic Management Command Financial Reporting of Property, Plant, and Equipment	January 14, 1998
98-042	Financial Reporting by Selected Defense Agencies of Government Property in the Custody of Contractors	December 16, 1997

98-040	Air National Guard Financial Reports on the National Guard and Reserve Equipment Appropriation	December 16, 1997
98-039	Cash Management in the Defense Working Capital Funds	December 15, 1997
98-028	Personal Services and Benefits Expenses in the FY 1996 Statement of Operations and Changes in Net Position of the "Other Defense Organizations"	December 2, 1997
98-027	Comprehensivness of the FY 1996 "Other Defense Organizations" Financial Statements	November 28, 1997
98-022	Reporting of Contract Holdbacks on the DoD Financial Statements	November 17, 1997
98-019	Inventory Record Accuracy and Management Controls at the Defense Logistics Agency Distribution Depots	November 10, 1997
98-014	The Working Capital Funds Interim Migratory Accounting Strategy	October 24, 1997
98-008	Financial Reporting of Defense Business Operations Fund FY 1996 Property, Plant, and Equipment	October 9, 1997
98-002	A Status Report on the Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund for FY 1996	October 3, 1997
97-227	Foreign Military Sales Administrative Surcharge Fund	September 30, 1997
97-225	Major Deficiencies Preventing Favorable Audit Opinions on the FY 1996 DoD General Fund Financial Statements	September 30, 1997

97-224	Presentation of Accrued Leave in the FY 1996 Defense Agency Financial Statements of the Defense Business Operations Fund	September 30, 1997
97-223	Recording and Reporting Expenses of the Defense Commissary Agency	September 30, 1997
97-215	Reporting of Accounts Payable for the National Guard and Reserve Equipment Appropriation on the "Other Defense Organizations" Portion of the FY 1996 Financial Statements	September 18, 1997
97-212	FY 1996 DoD Superfund Financial Transactions	September 4, 1997
97-206	Defense Finance and Accounting Service Acquisition Strategy for a Joint Account System Initiative	August 22, 1997
97-202	Financial Reporting of Government Property in the Custody of Contractors	August 4, 1997
97-201	Navy and Marine Corps Reserve Financial Reports on the National Guard and Reserve Equipment Appropriation	July 30, 1997
97-194	Evaluation of Management Controls at the Disbursing Office, Naval Surface Warfare Center, Dahlgren, Virginia	July 23, 1997
97-183	Uncataloged Material at Research, Development, Test, and Evaluation Installations	June 30, 1997
97-178	Internal Controls and Compliance with Laws and Regulations for the Defense Business Operations Fund Consolidated Financial Statements for FY 1996	June 26, 1997

97-177	Internal Controls and Compliance with Laws and Regulations for the DoD Military Retirement Trust Fund Financial Statements for FY 1996	June 25, 1997
97-176	Internal Controls and Compliance with Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996	June 25, 1997
97-171	Internal Controls and Compliance with Laws and Regulations for the FY 1996 Financial Statements of the Defense Security Assistance Agency	June 19, 1997
97-163	Financing Computer Systems and Other Equipment at the Defense Contract Management Command	June 16, 1997
97-160	Financial Accounting for the Chemical Agents and Munitions Destruction, Defense Appropriation	June 13, 1997
97-159	Inventory Accuracy at the Defense Depot, Susquehanna, Pennsylvania	June 12, 1997
97-155	Internal Controls and Compliance with Laws and Regulations for the FY 1996 Financial Statements of the "Other Defense Organizations" Receiving Department 97 Appropriations	June 11, 1997
97-151	The Fund Balance With Treasury Account for the Research, Development, Test and Evaluation Appropriation, Department 97	June 4, 1997
97-148	Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting	May 29, 1997

97-141	Financial Management at the Uniformed Services University of the Health Sciences	May 9, 1997
97-140	Financial Management at the American Forces Information Service	May 7, 1997
97-131	Financial Management at the Department of Defense Education Activity	April 17, 1997
97-129	Financial Accounting at the On-Site Inspection Agency	April 15, 1997
97-125	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the US Army Corps of Engineers, Civil Works Program, FY 1996 Financial Statements	April 10, 1997
97-124	Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Fiscal Year 1996 Navy General Fund	April 10, 1997
97-123	Inspector General, DoD, Oversight of the Army Audit Agency Audit of the Army Financial Statements for Fiscal Years 1996 and 1995	April 10, 1997
97-122	Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 1996 Air Force Consolidated Financial Statements	April 10, 1997
97-9009	Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1996	May 14, 1997
97-9008	Internal Controls and Compliance With Laws and Regulations for the DoD Military Retirement Trust Fund Financial Statements for FY 1996	May 5, 1997

97-9007	Disclaimer of Opinion on the Defense Business Operations Fund Consolidated Financial Statements for FY 1996	March 1, 1997
97-9006	Endorsement of the Disclaimer of Opinion on the FY 1996 U.S. Army Corps of Engineers, Civil Works Program, Statement of Operations and Changes in Net Position	March 1, 1997
97-9005	Endorsement of the Disclaimer of Opinion on the Department of Navy FY 1996 Statement of Financial Position	March 1, 1997
97-9004	Endorsement of the Disclaimer of Opinion on the FY 1996 Air Force Consolidated Financial Statements	March 1, 1997
97-9003	Audit Opinion on the National Defense Stockpile Transaction Fund Financial Statements for FY 1996	March 1, 1997
97-9002	Endorsement of the Disclaimer of Opinion on the FYs 1996 and 1995 Army Principal Financial Statements	March 1, 1997
97-9001	Disclaimer of Opinion on the Defense Security Assistance Agency Consolidated Financial Statements for FY 1996	February 21, 1997
97-117	Eliminating Entries	March 31, 1997
97-116	Allegations of Improper Accounting for the National Guard and Reserve Equipment Appropriation at the Army National Guard	March 31, 1997
97-112	Air Mobility Command Financial Reporting of Property, Plant, and Equipment	March 19, 1997

97-110	Material Accounting and Management Control Weaknesses in the Defense Agencies' FYs 1995 and 1996 Financial Information	March 17, 1997
97-107	Defense Contract Management Command Capitalization of Fixed Assets	March 10, 1997
97-100	Asset Presentation on Military Department General Fund Financial Statements	February 25, 1997
97-073	Reliability of the FY 1995 Financial Statements for the Defense Logistics Agency General Fund	January 15, 1997
97-051	Corps of Engineers Financial Management System	December 18, 1996
97-047	Consolidated Financial Report on the National Guard and Reserve Equipment Appropriation for the Army National Guard	December 13, 1996
97-044	Army National Guard Military Equipment	December 11, 1996
97-026	Major Deficiencies Preventing Auditors From Rendering Audit Opinions on FY 1995 DoD General Fund Financial Statements	November 19, 1996
97-025	Consolidated Financial Report on the National Guard and Reserve Equipment Appropriation for the Army Reserve	November 19, 1996
97-020	Capitalization of Defense Technology Security Administration Equipment	November 4, 1996
97-017	Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations	October 31, 1996

97-008	Summary Report on the FY 1994 Financial Statement Audits of Defense Agencies	October 25, 1996
97-006	Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995	October 15, 1996
96-161	Compilation of FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service, Indianapolis Center	June 13, 1996
95-301	Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements	August 29, 1995
95-294	Major Accounting Deficiencies in the DBOF in FY 1994	August 18, 1995
95-267	DBOF Consolidated Statement of Financial Position for FY 1994	June 30, 1995

Army Audit Agency

AA 98-124	Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Report on Internal Controls and Compliance With Laws and Regulations	March 19, 1998
AA 98-112	U.S. Army Corps of Engineers, Civil Works: FY 1997 Opinion Report	February 19, 1998
AA 98-111	Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Auditor's Report	February 13, 1998
AA-98-104	Army's Principal Financial Statements for Fiscal Years 1997 and 1996: Auditor's Report	February 13, 1998

AA-98-91	Recommended Adjustments to Draft Financial Statements, Audit of Army Working Capital Fund FY 97 Financial Statements	January 23, 1998
AA 98-79	Army Working Capital Fund FY 1997 Financial Statements: U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey	January 23, 1998
AA 98-60	Army Working Capital Fund FY 1997 Financial Statements: Work In Process	January 21, 1998
AA 98-46	Army Working Capital Fund Supply Management FY 1997 Statement of Financial Position: U.S. Army Air Defense Artillery Center and Fort Bliss	December 17, 1997
AA 98-32	Army Working Capital Fund FY 1997 Financial Statements: Crane Army Ammunition Activity, Crane, Indiana	November 17, 1997
AA 98-12	Army Working Capital Fund FY 1997 Financial Statements: Anniston Army Depot, Anniston, Alabama	October 20, 1997
AA 97-293	Army Working Capital Fund FY 1997 Financial Statements: Rock Island Arsenal, Rock Island, Illinois	September 26, 1997
AA 97-283	Army Working Capital Fund Supply Management, FY 1997 Financial Statements: U.S. Army Missile Command	August 25, 1997
AA 97-188	FY 96 Army Defense Business Operations Fund Financial statements	May 16, 1997
AA-97-147	Financial Reporting of Asset Values	July 28, 1997

AA-97-146	Financial Reporting of Wholesale Asset Balances	June 23, 1997
AA- 97-145	Report on Internal Controls and Compliance with Laws and Regulations	June 30, 1997
AA-97-144	Proposed Adjustments and Comments Regarding Army's FY 96 Annual Financial Report	June 13, 1997
AA 97-136	FY 96 Financial Statements: U.S. Army Corps of Engineers, Civil Works	February 28, 1997
AA 97-133	Army's Principal Financial Statements for FYs 1996 and 1995	February 21, 1997
AA 96-155	Financial Reporting of Wholesale Munitions	April 19, 1996
AA 96-154	Examinations of the Army's Financial Statements for Fiscal Years 1995 and 1994: Report on Internal Controls and Compliance With Laws and Regulations	July 11, 1986
AA 96-152	Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994: Auditor's Report	March 15, 1996
AA 96-73	DBOF, FY 95 Financial Statements--Supply Management, Revenues and Expenses: U.S. Army Missile Command	February 15, 1996

Naval Audit Service

024-98	Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund	February 27, 1998

025-98	Department of the Navy Principle Statements for Fiscal Years 1997 and 1996: Report on Auditor's Opinion	February 27, 1998
022-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Auditor's Opinion	March 1, 1997
029-97	FY 1996 Annual Financial Report: Report on Internal Controls and Compliance with Laws and Regulations	April 15, 1997
035-97	Auditor General Advisory: Trends in Department of the Navy Financial Audits	May 12, 1997
040-97	Fiscal Year 1996 Consolidating Financial Statements of the Department of the Navy Defense Business Operations Fund	June 16, 1997
045-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Accounts Receivable, Net	August 12, 1997
046-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Government Furnished Property Held by Contractors	August 14, 1997

Air Force Audit Agency

97068043	Opinion on Fiscal Year 1997 Air Force Working Capital Fund Financial Statements	February 27, 1998
97053012	Contingent Liabilities, FY 1996 Air Force Consolidated Financial Statements	April 10, 1997

97053011	Eliminating Entries and Nonoperating Changes, FY 1996 Air Force Consolidated Financial Statements	April 15, 1997
97053009	Opinion on Fiscal Year 1997 Air Force Consolidated Financial Statements	February 27, 1998
96053019	Real Property and Nonmilitary Equipment, FY 1996 Air Force Consolidated Financial Statements	February 11, 1997
96053015	Military Pay, FY 1996 Air Force Consolidated Financial Statements	April 15, 1997
96053005	Operating Materials and Supplies, FY 1996 Air Force Consolidated Financial Statements	January 30, 1997
96053004	Civilian Pay, FY 1996 Air Force Consolidated Financial Statements	April 17, 1997
96053003	Fund Control Process, FY 1996 Air Force Consolidated Financial Statements	February 7, 1997
96053002	Federal Mission Property, Plant and Equipment FY 1996 Air Force Consolidated Financial Statements	February 3, 1997
96053001	Opinion on FY 1996 Air Force Consolidated Financial Statements	March 1, 1997

Appendix C. Financial Statements and Audit Opinion

This appendix (a total of 54 pages) consists of the DoD Consolidated Financial Statements for FY 1997 and the audit opinion. These and the individual DoD Component financial statements for FY 1997 are available on the internet at http://www.dtic.mil/comptroller/97afs/.

DEPARTMENT OF DEFENSE

AGENCY-WIDE FINANCIAL STATEMENTS

FOR FY 1997 FINANCIAL ACTIVITY

February 27, 1998

DEPARTMENT OF DEFENSE

AGENCY-WIDE FINANCIAL STATEMENTS

PRINCIPAL STATEMENTS

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Department of Defense
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)	$169,287,308	$184,244,796
(2) Investments, Net (Note 4)	140,856,719	132,776,006
(3) Accounts Receivable, Net (Note 5)	5,542,903	7,607,765
(4) Interest Receivable	4,258,395	4,202,116
(5) Advances and Prepayments	(1,530,399)	(704,752)
(6) Other Federal (Intragovernmental) (Note 6)	415,021	941,882
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	297
(2) Accounts Receivable, Net (Note 5)	6,152,092	7,475,327
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0
(4) Interest Receivable, Net	543	28,296
(5) Advances and Prepayments	16,130,693	8,654,608
(6) Other Non-Federal (Governmental) (Note 6)	1,354,377	37,560
c. Cash and Other Monetary Assets (Note 3)	27,839	113,973
d. Inventory, Net (Note 8)	61,289,500	66,029,264
e. Work in Process (Note 9)	2,411,333	2,531,554
f. Operating Materials/Supplies, Net (Note 10)	1,475,518	1,546,695
g. Stockpile Materials, Net (Note 11)	3,320,087	3,696,491
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)	777,032,816	772,884,804
l. War Reserves	140,057,700	111,529,701
m. Other Entity Assets	919,269	7,113,685
n. Total Entity Assets	$1,329,001,714	$1,310,710,068
2. Non-Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$165,983	($583,053)
(2) Accounts Receivable, Net (Note 5)	30,768	118,917
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	393,512	375,620

The accompanying notes are an integral part of these statements

Department of Defense
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)	$98,961	$539,546
(2) Interest Receivable, Net	14,906	52,674
(3) Other (Note 6)	48,249	7,851
c. Cash and Other Monetary Assets (Note 3)	439,071	277,305
d. Other Non-Entity Assets	65,966	38,362
e. Total Non-Entity Assets	$1,257,416	$827,222
3. Total Assets	$1,330,259,130	$1,311,537,290
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$1,073,307	$5,838,587
(2) Interest Payable	0	0
(3) Debt (Note 16)	1,308,077	1,382,763
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	4,304,819	6,300,591
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	14,973,184	15,132,961
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	5,483,640	4,592,069
(b) Annual Accrued Leave	1,079,654	978,934
(c) Severance Pay and Separation Allowance	792,548	751,198
(3) Interest Payable	1	251
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	3,622
(6) Pensions and Other Actuarial Liabilities (Note 19)	142,150,555	132,787,893
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	4,012,618	3,970,143
c. Total Liabilities Covered by Budgetary Resources:	$175,178,403	$171,739,012

The accompanying notes are an integral part of these statements

Department of Defense
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	$210,920	($48,917)
(2) Debt (Note 16)	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	7,103,420	770,760
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	2,301,880	5,254
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	124,273	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	726,352,927	421,930,934
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	37,555,670	24,239,647
c. Total Liabilities Not Covered by Budgetary Resources	$773,649,090	$446,897,678
6. Total Liabilities	$948,827,493	$618,636,690
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$158,944,492	$171,465,546
b. Invested Capital	1,038,951,433	1,005,978,667
c. Cumulative Results of Operations	(42,090,233)	(31,026,936)
d. Other	(724,965)	(6,618,999)
e. Future Funding Requirements	(773,649,090)	(446,897,678)
f. Total Net Position	$381,431,637	$692,900,600
8. Total Liabilities and Net Position	$1,330,259,130	$1,311,537,290

The accompanying notes are an integral part of these statements

Department of Defense
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	$226,175,336	$212,942,585
2. Revenues from Sales of Goods and Services		
a. To the Public	8,474,679	8,556,044
b. Intragovernmental	23,100,003	44,997,100
3. Interest and Penalties, Non-Federal	4,689	9,564
4. Interest, Federal	167,409	11,385,085
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	13,337,939	24,657,414
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	(890,267)	(651,633)
8. Total Revenues and Financing Sources	$270,369,788	$301,896,159
EXPENSES		
9. Program or Operating Expenses (Note 23)	$239,224,197	$257,418,065
10. Cost of Goods Sold (Note 24)		
a. To the Public	8,127,453	7,730,102
b. Intragovernmental	19,642,292	31,266,410
11. Depreciation and Amortization	2,088,022	1,558,173
12. Bad Debts and Writeoffs	124,181	122,485
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	86,770	0
b. Federal Securities	0	0
c. Other	34,624	6,509
14. Other Expenses (Note 25)	25,514,154	23,024,177
15. Total Expenses	$294,841,693	$321,125,921
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	(24,471,905)	(19,229,762)
17. Plus (Minus) Extraordinary Items (Note 26)	(595,331)	428,252
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($25,067,236)	($18,801,510)

The accompanying notes are an integral part of these statements

Department of Defense
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	$692,900,600	$726,220,581
20. Adjustments (Note 27)	(312,801,322)	(9,001,015)
21. Net Position, Beginning Balance, as Restated	$380,099,278	$717,219,566
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(25,067,236)	(18,801,510)
23. Plus (Minus) Non Operating Changes (Note 28)	26,399,595	(5,517,456)
24. Net Position, Ending Balance	$381,431,637	$692,900,600

The accompanying notes are an integral part of these statements

The accompanying notes are an integral part of these statements

DEPARTMENT OF DEFENSE

AGENCY-WIDE FINANCIAL STATEMENTS

FOOTNOTES TO THE PRINCIPAL STATEMENTS

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NOTES TO THE DEPARTMENT OF DEFENSE PRINCIPAL STATEMENTS

Note 1. Summary of Significant Accounting Policies:

A. Basis of Presentation:

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense, as required by the Chief Financial Officers (CFO) Act, and other appropriate legislation. They have been prepared from the books and records of DoD Agencies in accordance with DoD guidance on the form and content of financial statements as adopted from Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," and subsequent issues. Consequently, these statements are different from the financial reports, also prepared by the DoD Agencies pursuant to OMB directives, that are used to monitor and control DoD's use of budgetary resources.

These financial statements are prepared from a consolidation of accounting information reported from multiple field level and departmental level accounting systems. DoD Agency general ledger account balances have been verified to the year-end departmental budget execution reports. Other methods, to include feeder reports, must be used to verify the accuracy of general ledger balances in those instances where budget execution and expenditure reports don't contain the proprietary information - for example, "Government Furnished Property." Budget execution reports are prepared from field level reports that are certified for accuracy and completeness by the individual responsible for the allotment of funds.

B. Reporting Entity:

Fiscal year 1997 represents the second year the Department of Defense prepared and has audited, an agency-wide set of financial statements. The reporting entities within the Department have been changed to facilitate this new reporting requirement. Auditors will be issuing reports on the financial statements of the following reporting entities: 1) Army; 2) Navy; 3) Air Force; 4) Army Working Capital Fund; 5) Navy Working Capital Fund; 6) Air Force Working Capital Fund; 7) Defense Logistics Agency Working Capital Fund; 8) Defense Finance and Accounting Service Working Capital Fund; 9) Defense Commissary Agency Working Capital Fund; 10) Joint Logistics Systems Center Working Capital Fund; 11) U.S. Transportation Command Working Capital Fund; 12) Defense Information Systems Agency Working Capital Fund; 13) DoD Military Retirement Trust Fund; 14) National Defense Stockpile Transaction Fund; and 15) U.S. Army Corps of Engineers (Civil Works). In addition to the preceding fifteen entities, the reporting entities "Working Capital Fund Component Adjustments" and "Other Defense Organizations" have been added to incorporate all remaining DoD agencies.

Auditors will not issue a separate report on the "Other Defense Organizations" but will be issuing reports on selected agencies within this reporting entity group. Consequently, since all of

the DoD reporting entities comprising the DoD Consolidated Report have separate audit reports - with the exception of "Working Capital Fund Component Adjustments" and "Other Defense Organizations" - readers of this consolidated report may refer back to the underlying CFO Report for more specific financial statement presentations and disclosures. These consolidated statements account for all funds for which the Department of Defense is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that the information is no longer classified.

The accounts used to prepare the principal statements are classified as entity/non-entity and by type of fund. Entity accounts consist of resources that the agency has the authority to decide how to use, or where management is legally obligated to use funds to meet entity obligations. Non-entity accounts are assets that are held by an entity but are not available for use in operations.

C. Budgets and Budgetary Accounting:

Funds are distributed by appropriation directors to the entities responsible for accomplishing the diverse missions for which the Department of Defense is responsible. As missions are performed, reporting entities record obligations and disbursements against the applicable appropriations. The DoD appropriations are divided into the general, revolving, trust, special and deposit funds. These accounts are used to fund and report how the resources have been used in the course of executing the DoD's missions.

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

Revolving funds receive their initial working capital through an appropriation or a transfer of resources from existing appropriations of funds and use those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations is generated by the acceptance of customer orders.

Trust funds are used to record the receipt of funds held in trust for the government.

Special funds are comprised of receipt and expenditure accounts that can only be used in accordance with specific provisions of law.

Deposit funds generally are used to hold assets that are awaiting legal determination or for which the DoD acts as agent or custodian. These accounts may also be used for unidentified remittances.

D. Basis of Accounting:

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

E. Revenues and Other Financing Sources:

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

Appropriations are, when authorized, supplemented by revenues generated by sales of goods or services through a reimbursable order process. Revenue is recognized to the extent the revenue is payable to the DoD from other federal agencies and the public as a result of costs incurred or services performed on their behalf. Revenue is recognized when earned under the reimbursable process.

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

F. Accounting for Intragovernmental Activities:

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

The DoD's proportionate share of public debt and related expenses of the federal government are not included in these financial statements. Debt incurred by the federal government and the related interest are not apportioned to federal agencies.

These financial statements do not reflect any portion of the public debt or interest thereon, nor do the statements reflect the source of public financing (e.g. debt issuance, tax revenues).

The related interest costs incurred in the construction of DoD facilities are also not capitalized since Treasury does not allocate interest costs to the benefiting agencies.

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

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

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

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

The DoD also contributes to the FERS Thrift Savings Plan on behalf of its participating employees. The following contributions listed below were made to the retirement plans and FERS Thrift Savings Plan (TSP) for the Military Departments.

Retirement Contributions
(Thousands)

CSRS	$1,599,840
FERS	1,847,098
MRS	9,989,102
Social Security	2,748,367
Total	$16,184,407
TSP	$511,478

The DoD funds a portion of the pension benefits under these retirement plans. No amounts relating to the civilian workforce are reported as assets or liabilities in the financial statements because the funds are maintained and reported by the Office of Personnel Management for CSRS and FERS. However, assets and liabilities relating to the military workforce are included in these statements through reporting by the Military Retirement Trust Fund.

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

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

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

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

H. Foreign Currency:

The Department conducts a significant portion of its operations overseas. Gains and losses from foreign currency transactions for four general fund appropriations (operation and maintenance, military construction, family housing operation and maintenance, and family housing construction) are recognized and reported in the statement of operations. Similar gains and losses from other appropriations are not recognized in the Statement of Operations and Changes in Net Position. They are absorbed by budgetary transactions in which obligations are increased or decreased to reflect foreign currency fluctuations. Gains and losses from foreign currency transactions are computed as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of the fiscal year.

I. Accounts Receivable, Net:

As presented in the Statement of Financial Position, accounts receivable includes accounts, claims, and refunds receivable from other entities. Allowances for uncollectible accounts are based on an analysis of collection experience by fund type. Accounts Receivable that were established under accounts that have been canceled are included in the Department's financial statements where material. See Note 5, "Accounts Receivable, Net."

J. Loans Receivable:

Loans are accounted for as receivables after funds have been disbursed. For loans obligated prior to October 1, 1991, loan principal, interest, and penalties receivable are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience, present market conditions, and an analysis of outstanding balances. For loans obligated on or after October 1, 1991, the loans receivable are reduced by an allowance equal to the present value of the subsidy costs (due to the interest rate differential between the loans and U.S. Treasury borrowing, the estimated delinquencies and defaults net of recoveries, the offset from fees, and other estimated cash flows) associated with these loans.

K. Inventory, Net:

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

L. Investments in U.S. Government Securities:

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

M. Property, Plant and Equipment, Net:

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

Valuations for weapons systems are to be based on historical procurement costs, however, most of the Department's tracking systems were not designed to record and perpetuate individual acquisition costs. Instead they assign standard costs to like items. Standard cost is normally the latest acquisition costs for specific Federal stock categories. Engineering and modification costs incurred subsequent to approval of the basic procurement contracts are valued at the contract

price of the engineering change order, value engineering, or modification which extends the life of the asset or capability of the system, and any other cost of materials or services not included in the contract cost.

Land and facilities are valued at cost. Buildings are capitalized when constructed or at the date of acquisition. Significant improvements to land and buildings normally are capitalized and depreciated over their remaining useful life. Audits of the Department's financial statements have shown that documentation to support the recorded acquisition cost of many older properties is no longer available. Obtaining appraisals for older property for which original acquisition records are no longer available is not cost effective, especially considering the number and age of many of the Department's real property assets. As a reasonable solution to this dilemma, recorded valuation of property is permitted for financial statement purposes in cases where original records supporting the property acquisition cost are no longer available. The DoD has requested that the Federal Accounting Standards Advisory Board endorse the above policy until such time as other applicable accounting standards are issued by the Board.

Routine maintenance and repair costs are expensed when incurred. Depreciation of property and equipment - required for revolving funds - is calculated on a straight line basis. Depreciation is not required for general fund equipment and buildings.

N. Prepaid and Deferred Charges:

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

O. Leases:

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

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

P. Contingencies:

At any given time, the Department may be a party to various legal and administrative actions, and claims brought against it. These relate primarily to tort claims resulting from aircraft, ship, and vehicle accidents, medical malpractice, property and environmental damages resulting from Departmental activities, and contract disputes. Most legal actions, other than contract claims, to which the department may be a named party are covered by the provisions of the federal tort claims act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Either because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the Department's appropriations or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the DoD's operations or financial position.

Q. Accrued Leave:

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

R. Equity:

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

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

S. Aircraft/Ship Crashes:

An operating loss of $1.1 billion has been recognized in fiscal year 1997 for aircraft/ships which were either destroyed or damaged beyond repair due to aviation/navigation mishaps. No loss has been separately recognized for aircraft/ships that were damaged by accidents but were

repairable. Costs associated with repair of such aircraft/ships are recorded as operating expenses and generally funded from operation and maintenance appropriations.

T. Treaties for Use of Foreign Bases:

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

U. Comparative Data:

This is the first year comparative data from FY 1996 has been presented on the DoD Agency-wide FY 97 Principal Statements. The Department's financial statements, however, will continue to reflect restatements and reclassifications of prior year data due to the evolving nature of federal accounting standards and the development of new reporting financial systems.

V. Undelivered Orders:

DoD was obligated to pay for goods and services that have been ordered but not yet received. No liability for payment has been recognized in the financial statements because goods/services have yet to be delivered. As of September, 30, 1997, the following undelivered orders were reported:

(Billions)

Army	Air Force	Navy	Defense Agencies	Working Capital Fund
$28.1	$34.8	$45.0	$25.9	$15.1

Note 2. Fund Balances with Treasury (in thousands):

This account represents the aggregate of all Defense appropriations. The schedule below identifies, by fund type, the status of the resources maintained in the Treasury accounts. Amounts that have been restricted by Congress, OMB, Treasury or DoD have been separately identified. Special, Deposit, and Receipt account balances have been consolidated into "Other Fund Types."

The aggregate fund balances of canceled and closed accounts that have been reopened for processing of accounting adjustments is $17.7 billion. Balances related to the reopened canceled and closed accounts have no effect on these financial statements and have been disclosed for information purposes only.

Closed/Reopened

(Billions)

Army	Navy	Air Force	Other Defense Agencies
$3.5	$ 7.5	$6.0	$.7

A. Fund and Account Balances

	Entity Assets				
	Trust Funds	Revolving Funds	Appro-priated Funds	Other Fund Types	Total
Unobligated Balance Available:					
Available	$162,475	$1,914,736	$27,503,856	$185,758	$29,766,825
Restricted	14,836	68,341	3,951,432	0	4,034,609
Reserve For Anticipated Resources	0	(30,684)	0	0	(30,684)
Obligated (but not expensed)	706,152	2,321,111	129,886,039	171,160	133,084,462
Unfunded Contract Authority	0	$0	(122,999)	0	(122,999)
Unused Borrowing Authority	0	$0	0	0	0
WCF Fund Balance	0	2,555,095	0	0	2,555,095
Treasury Balance	$883,463	$6,828,599	$161,218,328	$356,918	$169,287,308

B. Working Capital Fund Activities:

	Entity Assets		
	Funds Collected	Funds Disbursed	Total
Beginning Balance	$14,703,273	$10,515,949	$4,187,324
Transfers of Cash to Others	(1,774,353)	992,746	(2,767,099)
Transfers of Cash from Others	708,454	1,887,895	2,596,349
Funds Collected	38,319,746	0	38,319,746
Funds Disbursed	0	39,781,225	(39,781,225)
Ending Balance	$51,957,120	$53,177,815	$2,555,095

C. All Funds and Accounts:

	Non-Entity Assets		
	Funds Collected	Funds Disbursed	Total
Beginning Balance	($535,429)	$152,961	($688,390)
Funds Collected	30,370,295	0	30,370,295
Funds Disbursed	0	29,515,922	(29,515,922)
Ending Balance	$29,834,866	$29,668,883	$165,983

Note 3. Cash, Foreign Currency, and Other Monetary Assets (in thousands):

	Entity Assets	Non-Entity Assets
A. Cash	$8,405	$394,710
B. Foreign Currency	18,747	44,361
C. Other Monetary Assets:	687	0
D. Total Cash, Foreign Currency and Other Monetary Assets	$27,839	$439,071

Other Information: None

Note 4. Investments (in thousands):

	(1) Cost	(2) Market Value	(3) Amortization Method	(4) Amortized Premium/ (Discount)	(5) Investments Net
A. Intragovernmental Securities:					
(1) Marketable	$1,833,840	$0		$0	$1,833,840
(2) Non-Marketable Par Value	8,626	0		(16)	8,610
(3) Non-Marketable Market Based	145,479,816	157,029,135	EI*	(6,465,547)	139,014,269
Subtotal	$147,322,282	$157,029,135		($6,465,563)	$140,856,719

	(1) Cost	(2) Market Value	(3) Amortization Method	(4) Amortized Premium/ (Discount)	(5) Investments Net
B. Governmental Securities:					
(1) Commercial Paper	$0	$0		$0	$0
Subtotal	$0	$0		$0	$0
Total	$147,322,282	$157,029,135		($6,465,563)	$140,856,719

* EI = Effective Interest

C. Other Information: The majority of the Department of Defense entity investments of $ 145.5 billion are non-marketable/market based securities invested for the DoD Military Retirement Trust Fund. The Fund uses the same method that conforms to the prevailing practice in the financial community to determine amount amortized, book value of investments currently held and the related Effective Interest (i.e. EI) yield on investments. These calculated yields match up with yields in published security tables of U. S. Treasury securities. Also there was approximately $1.5 billion in invested marketable securities reported by Other Defense Organizations; with an additional $8.6 million investments in non-marketable securities reported by the varied Military Departments Trust funds. These types of investments are normally recorded at cost, and if applicable, net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment. It is the intent of the Departments to hold their trust fund investments to maturity unless they are needed to finance claims or otherwise sustain operations. Therefore, no provisions are made for unrealized gains or losses on these securities.

Note 5. Accounts Receivable (in thousands):

	(1) Gross Amount Due	(2) Allowance For Estimated Uncollectibles	(3) Allowance Method Used	(4) Net Amount Due
A. Entity Receivables:				
Intragovernmental	$11,039,443	$16,589	See Item C	$11,022,854 *
Governmental	6,357,659	200,105	See Item C	6,152,092
B. Non-Entity Receivables:				
Intragovernmental	$30,768	$0	N/A	$30,768
Governmental	106,652	7,691	N/A	98,961

C. Other Information: Accounts Receivable represent all receivables due from federal and non-federal sources, net of allowance for estimated uncollectible accounts. The accounts receivable values include reimbursables and refund receivables such as out-of-service debts from former service members, contractor debt, and unused travel tickets.

*"Intragovernmental , Net" differs from line 1.a.(3) of the Statement of Financial Position by the amount of intra-DoD receivables that must be eliminated as shown in Note 29, Schedule C (Column A).

The method of calculating the allowance for estimated uncollectibles varies for each department and agency. For example, the allowance for uncollectible accounts, in some instances is based on an analysis of collection experience by fund type for current and noncurrent receivables. In another case, the departmental allowance for entity public receivables is computed each year, based on the average percent of write-offs to outstanding public accounts receivable for the last five years.

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

A. Other Entity Assets

1. Federal (Intragovernmental)	
(a) Assets Returned for Credits	$50,868
(b) Other	364,153
(c)_____	0
Total	$415,021
2. Non-Federal (Governmental)	
(a) FFB Loan Principal for APF-N Ships	$1,164,026
(b) Other	190,351
Total	$1,354,377

B. Other Information.

C. Other Non-entity Assets

1. Federal (Intragovernmental)	
(a) IMRL Equipment	$393,512
(b)_____	0
Total	$393,512
2. Non-Federal (Governmental)	
(a) Cash Advances to Contractors and Travel Advanc	$48,249
(b) Other	0
(c)_____	0
Total	$48,249

D. Other Information: The majority of "Other Assets" was reported by the Working Capital Funds. The $393,512 in Note 6.C.1(a) above reflects the FY 1997 gross value of Individual Material Readiness List (IMRL) Equipment for the Department of Navy. Naval Audit Service has questioned the inclusion of these items as Non-Entity Assets. USD(C) will be issuing clarifying guidance on the appropriate financial statement treatment for these items.

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

Note 8. Inventory, Net (in thousands):

	(1) Inventory Amount	(2) Allowance For Losses	(3) Inventory, Net	(4) Valuation Method
A. Inventory Categories:				
(1) Held for Current Sale	$56,665,152	$20,126,728	$36,538,424	a, c
(2) Held in Reserve for Future Sale	1,818,463	0	1,818,463	
(3) War Reserve Material	1,055,696	84,556	971,140	a
(4) Excess, Obsolete and Unserviceable	81,762	0	81,762	d, e
(5) Held for Repair	23,892,552	2,012,841	21,879,711	a, e
Total	$83,513,625	$22,224,125	$61,289,500	

B. Restrictions on Inventory Use, Sale, or Disposition: Effective with the FY 1997 DoD Form and Content guidance, significant changes for reporting values on the Inventory, Net line on the Statement of Financial Position occurred. The FY 1996 financial statements included War Reserve Material as a component of Inventory, however, current guidance now requires that War Reserve Material be reported separately in the Statement of Financial Position. This change in classification accounts for the significant decrease of the FY 1997 Inventory line over last year's reported values. The $1.1 billion reported as War Reserve Material is attributed to Working Capital Fund activities which continue to reflect these values as a component of Inventory.

C. Other Information: The majority of the Inventories held for Current Sale, $55.1 billion is attributed to Working Capital Fund activities and includes an allowance account value of approximately $20.1 billion. The residual values reported for this category by the other military departments are insignificant in amount.

Note 9. Work in Process (in thousands):

	(1) Work In Process Amount	(2) Valuation Method
A. Work in Process:		
1. In House	$1,832,121	a, c
2. Contractor	530,943	
3. Other Government Activities	48,269	
4. Government Furnished Materials	0	
Total	$2,411,333	

B. Other Information: Work in Process represents labor, material, and overhead cost incurred during the period but not recognized as revenue. The Working Capital Fund activities reported $2.4 billion dollars of the total balance.

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

	(1) OM&S Amount	(2) Allowance For Losses	(3) OM&S, Net	(4) Valuation Method
A. OM&S Categories:				
(1) Held for Use	$1,464,123	$27,412	$1,436,711	c, e
(2) Held in Reserve for Future Use	37,888	0	37,888	
(3) Excess, Obsolete and Unserviceable	919	0	919	e
Total	$1,502,930	$27,412	$1,475,518	

B. Other Information: Navy and Air Force Working Capital Funds have the majority of the OM&S assets. The valuations are primarily derived from use of the Latest Acquisition Cost and Weighted Average methods.

Note 11. Stockpile Materials Net (in thousands):

A. Stockpile Materials:

Stockpile materials are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. The Defense National Stockpile Transaction Fund is the only DoD agency involved in the reporting of this asset category.

	(1) Stockpile Materials Amount	(2) Allowance For Losses	(3) Stockpile Materials Net	(4) Valuation Method
A. Stockpile Materials:				
(1) Held for Sale *	$1,404,419	$0	$1,404,419	e
(2) Held in Reserve for Future Sale	1,915,668	0	1,915,668	e
Total	$3,320,087	$0	$3,320,087	

* Not held for sale in the ordinary course of business.

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

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

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

C. Other Information: The estimated market value of the total inventory as of 30 September 1997 is $5.4 billion. The financial statements report the recorded historical cost in accordance with the lower of cost or market principle.

Note 12. Seized Property: Not applicable

Note 13. Forfeited Property: Not applicable

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

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

	(1) Depreciation Method	(2) Service Life	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
Classes of Fixed Assets					
A. Land	N/A		$9,407,531	$0	$9,407,531
B. Structures, Facilities, & Leasehold Improvements	SL		143,724,260	12,295,187	131,429,073
C. Military Equipment	SL		589,289,357	1,560,629	587,728,728
D. ADP Software	SL		1,302,539	643,069	659,470
E. Equipment	SL		21,037,005	4,765,807	16,271,198
F. Assets Under Capital Lease	SL		4,811,873	956	4,810,917
G. Other	SL		130,317	25,175	105,142
H. Natural Resources	N/A		245,431	0	245,431
I. Construction-in-Progress	N/A		26,375,326	0	26,375,326
Total			$796,323,639	$19,290,823	$777,032,816

*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)	

Other Information: Approximately $5.0 billion of the Capital Lease balance represents real property assets at overseas locations. These assets do not represent "true" capital leases and are classified as such to segregate overseas assets (which are subject to the agreements made with the host country) from those assets that are located within the jurisdiction of the United States. Since these overseas assets don't fit the criteria for capital lease treatment, no offsetting lease liability has been established.

The increase in capitalization criteria from $50,000 to $100,000, as required by the Department of Defense Appropriation Act of 1996, resulted in "decapitalization" of various property, plant, and equipment assets. Consequently, items of property and equipment failing to meet the new $100,000 capitalization threshold are no longer reflected in the Statement of Financial Position. Depreciation of property and equipment is calculated on the straight line basis.

Note 16. Debt (in thousands):

Liabilities Covered by Budgetary Resources	Beginning Balance	New Borrowings	Repay-ments	Ending Balance	Re-financing
A. Intragovermental Debt:					
(1) Borrowing from the Treasury	$0	$0	$0	$0	$0
(2) Borrowing from Federal Financing Bank	1,382,763	0	74,686	1,308,077	0
(3) Borrowing from Other Federal Agencies	0	0	0	0	0
Total Intragovern-mental Debt	$1,382,763	$0	$74,686	$1,308,077	$0
Liabilities Not Covered by Budgetary Resources					
B. (1) Public Debt:					
(a) Held by Government Accounts	$0	$0	$0	$0	$0
(b) Held by the public	0	0	0	0	0
(c) Total Public Debt	$0	$0	$0	$0	$0
(2) Agency Debt:					
(a) Held by Government Accounts	$0	$0	$0	$0	$0
(b) Held by the public	0	0	0	0	0
(c) Total Agency Debt	$0	$0	$0	$0	$0
C. Total Liabilities For Debt Not Covered by Budgetary Resources	$0	$0	$0	$0	$0
D. Total Debt	$1,382,763	$0	$74,686	$1,308,077	$0

E. Other Information: The majority of the balance, $1.2 billion, was reported by the Navy Working Capital Fund (Navy Transportation - Military Sealift Command) and represents the outstanding principal balance on the Maritime Prepositioning Ships (MPS) equipment. The MPS program provided ships for time charter to Military Sealift Command (MSC) to meet requirements not available in the marketplace. The program was approved by the Congress. The ships were built/converted by private Interim Vessel Owners using private, non-government

financing obtained from various banking institutions. No payments were made by the government during the building/conversion phase. The interim financing was replaced by permanent financing, and vessel ownership was transferred to the permanent vessel owners (a trust company acting for the benefit of equity investors). The ships were financed with approximately 30% equity investments and 70% debt borrowings. The debt is in the form of loans from the Federal Financing Bank (FFB) to the vessel owners. The Time Charter Party requires MSC to make semi-annual payments to cover the repayment of the interest and principal on the FFB loans.

Note 17. Other Liabilities (in thousands):

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

A. Other Liabilities Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
1. Intragovernmental*			
(a) Unearned Revenue	$0	$1,996,116	$1,996,116
(b) Treasury Cash Advances to Disbursing Officers	0	661,372	661,372
(c) Deposit Fund Liabilities	0	577,974	577,974
(d) Unearned Revenue, Intra-DoD	0	11,369	11,369
(e) Liability for Property Furnished by Others	0	576,564	576,564
(f) Progress Billings to Others	0	1,335,052	1,335,052
(g) Entity Accounts Receivable	271,046	0	271,046
(h) Non-entity Accounts Receivable	39,162	1,784	40,946
(i) Miscellaneous	1,044,053	74,923	1,118,976
(j) Cancelled Budget Authority	0	0	0
(k) Budget Clearing Account	0	(308,531)	(308,531)
(l) Advances-Government	66,449	678,407	744,856
(m) Advances-Loans	0	(1,453)	(1,453)
(n) Military Labor	0	64,984	64,984
(o) Undistributed Cash Disbursements	0	(1,328,950)	(1,328,950)
(p) Accrued Reserve Revenue	0	141,650	141,650
(q) Contingent Liabilities	0	97,847	97,847
Total	$1,420,710	$4,579,108	$5,999,818

	Noncurrent Liability	Current Liability	Total
2. Governmental			
(a) Unearned Revenue	$0	$298,381	$298,381
(b) Deferred Credits	56,574	67,992	124,566
(c) Entity Accounts Receivable	(24,242)	0	(24,242)
(d) Non-entity Accounts Receivable	(9,393)	4,209	(5,184)
(e) Deposit Fund Liabilities	0	62,070	62,070
(f) Contract Holdbacks	0	21,090	21,090
(g) Miscellaneous	(186)	113,852	113,666
(h) Advances-Other	0	310,066	310,066
(i) Accrued Expenses-Other	0	2,888,875	2,888,875
(j) Progress Payments-Contractor	0	0	0
(k) Claims	0	3,570	3,570
(l) Other Liabilities	0	219,760	219,760
Total	$22,753	$3,989,865	$4,012,618

B. Other Information:

*Intragovernmental, Net differs from line 4.a. (4) of the Statement of Financial Position by the amount of intra-DoD other liabilities that must be eliminated as shown in Note 29, Schedule C (Column C).

C. Other Liabilities Not Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
1. Intragovernmental			
(a) Cancelled Budget Authority	$0	$0	$0
(b) Employer Share of Fringe Benefits	0	337,434	337,434
(c) Environmental Cleanup Costs	5,462,000	608,000	6,070,000
(d) Accrued Closed Years Accounts Payable	0	125,214	125,214
(e) Unemployment Benefits	32,879	8,519	41,398
(f) Workers' Comp Reimbursements to Department of Labor	145,233	116,141	261,374
(g) Voluntary Separation Incentive Cost	223,300	44,700	268,000
Total	$5,863,412	$1,240,008	$7,103,420
2. Governmental			
(a) Cancelled Budget Authority	$0	($128,075)	($128,075)
(b) Accrued Annual Leave, Military Unfunded	0	2,248,063	2,248,063
(c) Accrued Annual Leave, Civilian Unfunded	136,304	1,371,986	1,508,290
(d) Accrued Closed Years Accounts Payable	0	293,485	293,485
(e) Accrued Environmental Cleanup Costs	6,025,308	640,403	6,665,711
(f) Other	118	26,968,078	26,968,196
Total	$6,161,730	$31,393,940	$37,555,670

D. Other Information: Part C.2(f) includes $15.1 billion of estimated environmental clean-up costs reported by Army.

Note 18. Leases (in thousands):

The following schedules reported by the Army pertain to Operating and Capital Leases for Section 801 family housing leases (privately owned housing leased by the Army).

A. ENTITY AS LESSEE

Capital Leases

Summary of Assets Under Capital Lease:

Land and Buildings	$0
Machinery and Equipment	$0
Other	$0
Accumulated Amortization	$0

Description of Lease Arrangements:

Future Payments Due

	Asset Category			
Fiscal Year	(1)	(2)	(3)	Totals
Year 1	$20,785	$0	$0	$20,785
Year 2	20,785	0	0	20,785
Year 3	20,785	0	0	20,785
Year 4	20,785	0	0	20,785
Year 5	20,785	0	0	20,785
After 5 Years	128,620	0	0	128,620
Total Future Lease Payments	$232,545	$0	$0	$232,545
Less: Imputed Interest	68,518	0	0	68,518
Executory Costs (e.g., taxes)	39,754	0	0	39,754
Total Capital Lease Liability	$124,273	$0	$0	$124,273
			Funded	$0
			Unfunded	$124,273

Operating Leases

Description of Lease Arrangements

Future Payments Due

	Asset Category			
Fiscal Year	(1)	(2)	(3)	Totals
Year 1	$16,369,424	$0	$0	$16,369,424
Year 2	16,369,424	0	0	16,369,424
Year 3	16,369,424	0	0	16,369,424
Year 4	16,369,424	0	0	16,369,424
Year 5	16,369,424	0	0	16,369,424
After 5 Years	97,948,049	0	0	97,948,049
Total Future Lease Payments	$179,795,169	$0	$0	$179,795,169

B. ENTITY AS LESSOR

Capital Leases

Description of Lease Arrangements

Future Projected Receipts

	Asset Category			
Fiscal Year	(1)	(2)	(3)	Totals
Year 1	$0	$0	$0	$0
Year 2	0	0	0	0
Year 3	0	0	0	0
Year 4	0	0	0	0
Year 5	0	0	0	0
After 5 Years	0	0	0	0
Total Future Capital Lease Receivables	$0	$0	$0	$0

Operating Leases

Description of Lease Arrangements

Future Projected Receipts

	Asset Category			
Fiscal Year	(1)	(2)	(3)	Totals
Year 1	$0	$0	$0	$0
Year 2	0	0	0	0
Year 3	0	0	0	0
Year 4	0	0	0	0
Year 5	0	0	0	0
After 5 Years	0	0	0	0
Total Future Operating Lease Receivables	$0	$0	$0	$0

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

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

Major Program Activities	(1) Actuarial Present Value of Projected Plan Benefits	(2) Assumed Interest Rate (%)	(3) Assets Available to Pay Benefits	(4) Unfunded Actuarial Liability
A. Pensions and Health Plans	$859,742,072	0.00%	$140,640,969	$719,101,103
B. Insurance/Annuity Programs:				
(1) Voluntary Separation Incentive Benefits	$1,801,000	6.75%	$947,269	$853,731
(2) Workmen's Comp	1,044,007	0.00%	0	1,044,007
(3)_____	0	0.00%	0	0
Total	$2,845,007		$947,269	$1,897,738
C. Other:				
(1) Workmen's Comp	$3,655,966	6.40%	0	$3,655,966
(2) DoD Educ Benefits	727,568	6.10%	555,705	171,863
(3) Unfunded FECA	1,482,069	0.00%	0	1,482,069
(4) Other	50,800	0.00%	6,612	44,188
Total	$5,916,403		$562,317	$5,354,086
D. Total Lines A+B+C	$868,503,482		$142,150,555	$726,352,927

Other Information: Approximately $501.1 billion in unfunded actuarial liability for the DoD Military Retirement is included in line A., Pensions and Health Plans, column 4. The Military Retirement System is a single-employer plan that is classified as a "Defined Benefit Plan." Administrative costs are not borne by the plan. The actuarial cost method used is the aggregate entry-age-normal. Projected revenues, as authorized by PL98-94, are to be paid into the "Fund" at the beginning of each fiscal year by the Secretary of the Treasury as certified by the Secretary of Defense. This permanent indefinite appropriation, determined by the Board of Actuaries, represents the unfunded liability for service performed prior to October 1, 1984.

Accounting Method: Starting in FY 1997 and future years, the Military Retirement Trust Fund financial statements will present the unfunded actuarial liability determined as of the end of the fiscal year. This is a change from prior year reporting, which presented the beginning of year liability. This figure is approximate because of the lengthy time required to develop an accurate end of year actuarial estimate and the accelerated deadlines for financial statements.

Actuarial Cost Method: The Military Retirement Trust Fund financial statements present the actuarial liability as of the end of the fiscal year using the "projected benefit obligation" (PBO)

required by the Office of Management and Budget (OMB) Statement of Federal Financial Accounting Standards Number 5., "Accounting for Liabilities of the Federal Government." This is a change from prior year reporting, which presented the beginning of the year "accumulated benefit obligation" (ABO), which assumes no future salary increases

Approximately $218 billion in unfunded actuarial liability for the DoD military health benefits is also included in line A., Pensions and Health Plans, column 4. The FY 97 actuarial liability for post-retirement medical benefits is calculated under the aggregate entry age normal funding method. As is required under the Statement of Federal Financial Accounting Standards (SFFSA) No. 5, liabilities are spread over years of service, rather than over payroll. Because payroll is expected to increase, liabilities under SFFAS No. 5 will be higher than those calculated using a level percentage of payroll. SFFAS No. 5 will be higher than those calculated using a level percentage of payroll. Where appropriate, assumptions followed those used in the September 30, 1995 Valuation of the Military Retirement System, including a 6.75% assumed interest rate.

The FY 97 liability is based on medical counts and claims through FY 94, projected to the end of FY 97 using medical trend assumptions. Population data as of September 30, 1995 projected to the end of FY 97, is also used. This is the first time the SFFAS No. 5 post-retirement medical liability has been reported, hence the relative timing for these data and calculations may or may not be followed in future statements.

Data limitations and the difficulty of projecting medical costs make the estimated liability for post-retirement medical benefits less certain than the corresponding estimate for pension benefits. In addition, DoD is undergoing a transition to a new program called Tricare which will change the delivery system of health care. However, Tricare is in its infancy, and no data was available for the program at that time, thus no explicit adjustment has been made for Tricare for FY 97 liability estimate. Due to our difficulty in getting the desired data for the new format of health care, we were forced to rely on less recent data.

Legal actions brought by employees of DoD for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the Department of Labor (DOL). DOL bills DoD annually as DOL claims are paid. However, payment on these bills is deferred two years to allow for funding through the budget process. Using actuarial estimates provided by DOL, DoD has recorded FECA liabilities for balances billed to DoD by DOL, and for estimates of the present values related to cases on hand at the end of the fiscal year. The amount of unfunded FECA liability (i.e. Workmen's Comp) accrued as of September 30, 1997 was $6.2 billion. A corresponding amount has been established as a future funding requirement.

Note 20. Net Position (in thousands):

	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended Appropriations:				
(1) Unobligated,				
a. Available	$697,801	$143,600	$26,910,851	$27,752,252
b. Unavailable	(256,123)	14,747	5,737,226	5,495,850
(2) Undelivered Orders	3,965,047	26,255	121,705,088	125,696,390
B. Invested Capital	119,304,286	1,113,493	918,533,654	1,038,951,433
C. Cumulative Results of Operations	(42,184,202)	688,552	(594,583)	(42,090,233)
D. Other	(748,726)	2,044	21,717	(724,965)
E. Future Funding Requirements	(2,366,528)	(502,099,815)	(269,182,747)	(773,649,090)
Total	$78,411,555	($500,111,124)	$803,131,206	$381,431,637

G. Other Information: Within DoD $501.1 billion pertains to the future funding requirements of the Military Retirement Trust Funds and $218 billion pertains to military health benefits.

Net Position is comprised of the following components:

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

Invested capital - represents the net investment of the Government in the DoD. Includes the initial investment and subsequent appropriations to finance program activities. Also included is the net balance of assets and liabilities that have been transferred in and out to DoD Components or other U.S. Government Agencies without reimbursement.

Cumulative results of operations - represents the cumulative net difference between (1) expenses and losses and (2) financing sources to include appropriations, revenues and gains.

Other - represents other components of net position not specifically identified above.

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

Note 21. Taxes: Not applicable

Note 22. Other Revenue and Financing Sources (in thousands):

	1997	1996
A. Other Revenues and Financing Sources:		
(1) Inventory Gains	$0	$457,944
(2) Investment Gains	0	212
(3) Cost Contributions from Services	0	11,174,163
(4) Unfunded Liability Payment from Treasury	0	10,699,000
(5) Miscellaneous Reimbursements	3,833,470	1,169,388
(6) Other Miscellaneous Gains	12,358	103,518
(7) Benefit Program Revenue	7,025,382	397,902
(8) Gain on Disposition of Assets	1,637	5,566
(9) Donations	2,488	2,257
(10) Other Revenues	2,462,604	647,464
Total	$13,337,939	$24,657,414

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

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

Other revenues and financing sources also include miscellaneous receipts, donated revenue and inventory and other gains. Miscellaneous receipts, which are unavailable for agency use and are returned to Treasury, consist of license, fees, fines, penalties and general fund receipts.

Note 23. Program or Operating Expenses (in thousands):

	1997	1996
A. Operating Expenses by Object Classification:		
(1) Personal Services and Benefits	$96,266,616	$102,079,103
(2) Travel and Transportation	8,083,839	8,751,248
(3) Rental, Communication and Utilities	4,807,057	4,385,373
(4) Printing and Reproduction	279,205	254,578
(5) Contractual Services	83,932,388	81,732,984
(6) Supplies and Materials	16,492,006	12,797,033
(7) Equipment not Capitalized	6,198,152	4,175,490
(8) Grants, Subsidies and Contributions	1,336,785	504,683
(9) Insurance Claims and Indemnities	4,125,490	29,139,922
(10) Other	17,702,659	13,597,799
(11) Total Expenses by Object Class	$239,224,197	$257,418,213

	1997	1996
B. Operating Expenses by Program:		
(1) Revolving Fund	$506,278	$615,954
(2) General Fund	156,528,353	152,980,046
(3) Trust Fund	544,200	548,431
(4) Special Fund	673	494
(5) Unallocated Expense	0	0
Totals	$157,579,504	$154,144,925

C. Other Information: FY 96 Total Expenses differ from prior year published figures by $148 thousand as a result of reclassifying MSSO/CIM Program and Operating Expenses, Line 9, to Depreciation expense, Line 11.

Note 24. Cost of Goods Sold (in thousands):

A. Cost of Goods Sold:	
(1) Beginning Work-in-Process	$2,531,553
(2) Plus: Operating Expenses	51,448,481
(3) Minus: Ending Work-in-Process	2,411,333
(4) Minus: Completed Work for Activity Retention	46,313
Cost of Services Sold	$51,522,388
B. Cost of Goods Sold from Inventory (using Latest Acquisition Cost):	
(1) Beginning Inventory - L.A.C.	$81,378,904
(2) Less: Beginning Allowance for Unrealized Holding Gains (Losses)	21,073,009
(3) Plus: Purchases at Cost	30,736,972
(4) Plus: Customer Returns - Credit Given	3,823,834
(5) Plus: DLR Exchange Credits	2,604,399
(6) Less: Inventory Losses Realized	7,967,224
(7) Less: Ending Inventory - L.A.C.	80,202,641
(8) Plus: Ending Allowance for Unrealized Holding Gains (Losses)	22,188,109
(9) Less: Equity Transfers of Inventory to Others	969,544
(10) Plus: Equity Transfers of Inventory from Others	2,644,613
(11) Plus: Other	
a. Repair Cost adjustment	1,119,092
b. Beginning Allowance Adjustment from Prior Year	3,903,967
(12) Equals: Cost of Goods Sold from Inventory	$38,187,472
C. Cost of Goods Sold from Inventory (using Historical Cost):	
(1) Beginning Inventory	$3,696,491
(a) Plus: Purchases at Cost	0
(b) Plus: Inventory Gains	431
(c) Minus: Inventory Losses	3,352
(2) Less: Ending Inventory	3,320,087
D. Intra eliminations	
WCF	8,288,204
DoD Wide Consolidated	54,025,394
E. Cost of Goods Sold	$27,769,745

F. Other Information: Beginning and ending inventories are shown at latest acquisition less the potential excess inventory to calculate the cost of goods sold. The break-out between Cost of Goods Sold to the Public and the Cost of Goods, Intragovernmental was calculated by proration based on revenues generated.

Note 25. Other Expenses (in thousands):

	1997	1996
A. Other Expenses:		
(1) Inventory Losses or Adjustments	$8,692,824	$8,234,769
(2) Transfer to Property Disposal	2,339,600	2,494,835
(3) Potential Excess Inventory Loss	(357,484)	(331,966)
(4) Shrinkage, Fire, Theft, Losses, Etc.	805,541	378,178
(5) Payroll Variances	(17,422)	4,171
(6) Accrued Annual Leave	223,375	136,350
(7) Real Property Maintenance	60	0
(8) Losses on Sale of Fixed Assets	803	21,382
(9) Discounts on Material Returns	2,211	2,945
(10) Environmental Clean-Up	6,070,000	0
(11) Prior Year Expense Adjustment	0	(2,113)
(12) Supply	0	(2,814,889)
(13) Sum of USD(C) Model Entries	(2,870,670)	(3,868,016)
(14) Depot Maintenance	32,485	45,837
(15) Operating Materials and Supplies Variance	(8,884)	(93)
(16) Losses on Disposition of Assets	21,196	0
(17) Other Expenses	2,088,478	218,881
(18) Changes in Actuarial Liabilities	4,368,163	18,595,615
(19) Other Miscellaneous Losses	982,870	(91,709)
(20) Pension, Health, and Life Insurance Benefits	3,201,018	0
(21) Estimated Losses on Foreign Currency Transactions	1,013	0
(22) DLR Advance Credit	(61,023)	0
Total Other Expenses	$25,514,154	$23,024,177

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

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

Other revenues and financing sources also include miscellaneous receipts, donated revenue and inventory and other gains. Miscellaneous receipts, which are unavailable for agency use and are returned to Treasury, consist of license, fees, fines, penalties and general fund receipts.

Note 26. Extraordinary Items (in thousands):

A. Extraordinary Items:

(1) Inventory losses from fire and theft	$0
(2) Surcharges	(566,639)
(3) Extraordinary Current Year Expense	1,984
(4) Passthroughs	0
(5) Military Labor Variance	(5,198)
(6) Reserve Balancing	(1,969)
(7) Fixed Asset Adjustment	0
(8) Litigation over Sale of Tanks	(825)
(9) Depot Maintenance	0
(10) BRAC	(22,684)
Total	($595,331)

Note 27. Prior Period Adjustments (in thousands):

A. Prior Period Adjustments:	
(1) Accounting Changes	$100,539
(2) Adjustments to Operating Materials and Supplies	0
(3) Adjustments to Property & Equipment	(29,898)
(4) Adjustments to future funding requirements	(2,008,612)
(5) Adjustments to reclassify account balances	0
(6) Prior year contract adjustments	(18,510)
(7) Write-off of prior year accounts payable and receivables	0
(8) Inventory adjustments	(1,518,730)
(9) Other adjustments	(311,334,044)
(10) BRAC Costs	62,852
(11) USD(C) Model Prior Period AOR Adjustment	2,131,132
(12) Accounts Payable Transfer to Equity	(52,986)
(13) Prior Period AOR Adjustment	951,399
(14) Reparable Support Division Adjustment	(738,772)
(15) Cumulative Results of Operations	(8,712)
(16) Overstated Accounts Payable	(145)
(17) BOP Fund Balance Error	(11)
(18) Collections & Disbursements	10,965
(19) Salaries & Wages	390
(20) Unit Repair Cost Error	(18,177)
(21) WIP Correction	(6,937)
(22) Bad Debts Correction	2,585
(23) Plant Increment Income	(852,458)
(24) SWD Audit Adjustments	880,569
(25) COEMIS Adjustments	(353,761)
Total	($312,801,322)

The amount reflected in line (9), "Other Adjustments." is comprised of $218 billion in unfunded actuarial liability for the DoD military health benefits, a $78.1 billion "Change in Actuarial Liability" reported by the Military Retirement Trust Fund and $15.1 billion reported by Army in accordance with Statement of Federal Financial Accounting Standard Number 6, "Property, Plant, and Equipment" which requires that the offsetting charges against liabilities recognized for environmental cleanup costs be recorded as a prior period adjustment.

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

A. Increases:	1997	1996
(1) Transfers-In	$46,058,938	$3,667,568
(2) Unexpended Appropriations	75,717,045	82,609,261
(3) Donations Received	263,988	35,136
(4) Other Increases	278,436,309	24,601,013
(5) Total Increases	$400,476,280	$110,912,978

B. Decreases:	1997	1996
(1) Transfers-Out	$50,087,558	$20,080,374
(2) Donations	622,731	0
(3) Other Decreases	323,366,396	96,350,060
(4) Total Decreases	$374,076,685	$116,430,434

C. Net Non-Operating Changes (Transfers):	$26,399,595	($5,517,456)

Note 29. Intrafund Eliminations (in thousands):

Schedules A, B, are not applicable to the DoD-Wide consolidated financial statements. Schedule C presents the totals of the transactions that were eliminated from the Statement of Financial Position and Statement of Operations (and Changes in Net Position) since they represent activity between DoD entities. Schedule D shows the sales or services activity between the Department of Defense and other U.S. Government entities.

Schedule A: Not applicable.

Schedule B: Not applicable.

Schedule C: Presents the sales or services between DoD reporting entities according to general ledger amounts for accounts receivable, revenue, unearned revenue, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity. DoD continues efforts to identify and report seller activity for eliminating entries required to prepare the DoD consolidated statements.

Selling Activity:	Column A Accounts Receivable	Column B Revenue	Column C Unearned Revenue	Column D Collections
Department of the Army	$632,650	$6,451,382	$0	$5,737,533
Department of the Navy	1,415,621	3,520,376	0	3,506,396
Department of the Air Force	642,696	1,885,059	0	2,126,137
Army WCF	199,109	6,426,642	0	6,299,686
Navy WCF	0	15,798,978	0	15,798,978
Air Force WCF	456,038	7,723,860	0	7,267,822
DLA WCF	625,900	11,926,063	0	11,923,071
DISA WCF	325,594	2,087,881	0	2,051,867
DFAS WCF	10,646	1,737,855	0	1,767,587
DeCA WCF	6,532	31,303	0	38,563
JLSC WCF	0	0	0	0
U.S. TRANSCOM WCF	571,501	3,818,314	0	4,156,212
OTHER WCF	6,942	0	0	0
DoD Military Retirement Trust Fund	0	26,252,570	0	26,252,570
National Defense Stockpile	0	0	0	0
U.S. Army Corps of Engineers	0	0	0	0
Other Defense Organizations	586,722	4,425,362	0	4,310,098
Unearned Revenue	0	0	1,694,999	0
Total	$5,479,951	$92,085,645	$1,694,999	$91,236,520

Customer Activity:	Column A Accounts Payable	Column B Expenses	Column C Advances	Column D Disbursements
Department of the Army	$518,610	$15,475,668	$0	$13,924,401
Department of the Navy	423,745	24,599,488	0	23,970,559
Department of the Air Force	946,228	18,517,000	0	16,133,422
Army WCF	31,499	356,437	0	358,490
Navy WCF	41,558	241,293	0	235,807
Air Force WCF	291,624	1,423,432	0	1,450,141
DLA WCF	66,684	570,393	0	404,548
DISA WCF	8,263	23,126	0	24,460
DFAS WCF	43,890	137,037	0	152,668
DeCA WCF	77,576	348,543	0	60,115
JLSC WCF	7,453	12,937	0	6,007
U.S. TRANSCOM WCF	2,976	31,198	0	40,236
OTHER WCF	142,699	743,098	0	741,576
DoD Military Retirement Trust Fund	0	0	0	0
National Defense Stockpile	0	0	0	0
U.S. Army Corps of Engineers	19,057	53,536	0	47,713
Other Defense Organizations	2,858,089	29,552,459	0	33,686,377
Advances	0	0	1,694,999	0
Total	$5,479,951	$92,085,645	$1,694,999	$91,236,520

Schedule D: This schedule presents the value of sales and services between the Department of Defense and other U.S. Government entities. This information is needed by the Department of the Treasury to prepare U.S. Government-wide consolidated financial statements. The transactions are based on the accounting records of the Department of Defense. It is presumed

that an equal amount of accounts payable, expenses, advances, and disbursements have been entered on the accounting records of the purchasing entity.

	Accounts Receivable	Revenue	Unearned Revenue	Collections
Department of the Army	$227,687	$322,705	$0	$198,967
Department of the Navy	523,239	695,609	0	286,440
Department of the Air Force	402,126	1,021,710	0	782,791
Army WCF	7,862	11,713	0	0
Navy WCF	0	646,614	0	681,746
Air Force WCF	99,474	1,103,599	0	1,004,125
DLA WCF	77,747	164,273	0	168,418
DISA WCF	200,475	359,558	0	368,965
DFAS WCF	19,129	44,975	0	46,965
DeCA WCF	698	3,603	0	3,461
JLSC WCF	0	0	0	0
U.S. TRANSCOM WCF	1,243	12,696	0	98,434
OTHER WCF	7	0	0	0
DoD Military Retirement Trust Fund	4,228,139	11,807,681	0	11,807,681
National Defense Stockpile	0	21,276	0	21,276
U.S. Army Corps of Engineers	0	0	0	0
Other Defense Organizations	212,003	1,135,369	0	1,106,988
Unearned Revenue	0	0	161,001	0
Total	$5,999,829	$17,351,381	$161,001	$16,576,257

Customer Activity:	Column A	Column B	Column C	Column D
	Accounts Payable	Expenses	Advances	Disbursements
Department of Agriculture	$38,865	$25,963	$0	$22,812
Department of Commerce	1,934	528	0	493
Department of Interior	7,932	5,435	0	5,526
Department of Justice	11,334	21,452	0	19,538
Department of Labor	15	18	0	11
Department of State	14,514	269,645	0	265,559
Department of the Treasury	4,237,443	11,843,579	0	11,845,271
Office of Personnel Management	0	0	0	0
U.S. Nuclear Regulatory Commission	170	427	0	380
Department of Veterans Affairs	3,863	6,747	0	4,451
General Service Administration	152,294	342,241	0	246,276
National Science Foundation	0	0	0	0
Federal Emergency Management Agency	4,669	(708)	0	767
Environmental Protection Agency	554	1,465	0	1,772
Department of Transportation	18,212	268,968	0	261,992
Agency for International Development	0	0	0	0
Small Business Administration	0	0	0	0
Department of Health and Human Services	4,106	4,715	0	5,673
National Aeronautics and Space Administration	64,610	286,415	0	334,302
Department of Housing and Urban Development	822	888	0	72
Department of Energy	713	2,284	0	2,138
Department of Education	0	0	0	0
Government Printing Office	0	0	0	0
Executive Office of the President/	2,389	9,967	0	2,284
Defense Security Assistance Agency	321,039	1,011,625	0	734,097
Miscellaneous Government Departments	1,126,220	3,106,931	0	2,668,178
Unknown/Unidentifiable	(11,869)	142,796	0	154,665
Advances	0	0	161,001	0

Other information:

DoD continues efforts to specifically identify sales to other U.S. government agencies and to separately report in Schedule D eliminating amounts needed to prepare U.S. government wide consolidated financial statements.

Note 30. Contingencies:

The DoD canceled all merged year and expiring account appropriations. The DoD may still be responsible for obligations related to the canceled appropriations.

The DoD is responsible for costs associated with environmental cleanup. Navy estimates possible environmental cleanup costs at $6.0 billion for FY 97. The total estimated cost to the Air Force and Army to complete environmental cleanup is $6.3 billion and $15.1 billion, respectively. These liabilities have been included in the financial statements and are reflected in line 5.b(5) as Other Non-Federal (Governmental) Liabilities as a part of Liabilities Not Covered by Budgetary Resources on the statement of financial position and in line 7.e, Future Funding Requirements on the statement of financial position. A prior period adjustment was recorded in the applicable statements for the same amounts to recognize the liability in accordance with Statement of Federal Financial Accounting Standard Number 6, "Property, Plant, and Equipment".

The DoD is subject to various asserted contract claims for over $100 million. These claims are in various phases ranging from investigation to appeal. While no opinion has been expressed regarding the likely outcome for specific claims or possible associated loss, experience indicates that many such claims are settled for less than claimed, dismissed altogether, or the possibility of the contingency materializing is remote. Contractor claims are funded primarily from DoD appropriations. As of September 30, 1997 Air Force was a party to 224 contract appeals. The total dollar value of these claims was approximately $630.7 million. Similarly, Navy was a party to several contract appeals with an approximate total of $1.7 billion.

It is uncertain that these claims will ever accrue to the DoD and thus are not reflected in the financial statements. In addition to the fact that many cases simply lack merit, most claims, even if successful, will not be paid from DoD accounts. Rather, judgments are ordinarily paid from the GAO Judgment Fund. In many cases involving attorney fees, the amounts are not known until the last appeal is taken.

Note 31. Other Disclosures (in thousands):

A. Problem Disbursements:

Problem disbursements represent disbursements of DoD funds that have been reported by a Treasury Disbursing Station Symbol Number (DSSN) to Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursement. Problem disbursements represent a significant financial management concern because: (1) the accuracy of accounting reports is affected; (2) available funding picture is distorted; and (3) the research and resolution process can be very labor intensive. Initiatives such as prevalidation of payments, are well underway to reduce or eliminate problem disbursements. In the case of prevalidation efforts, entitlement personnel and accountants are now required to jointly ensure that an obligation of funds sufficient to cover the amount of the proposed disbursement has been recorded in the accounting records. This validation must be done for all payments exceeding a specified threshold. Eventually, all payments will be prevalidated prior to the disbursement of funds. The following chart shows the balances reported by the military departments and Working Capital Funds. Negative Unliquidated Disbursements represent disbursements in excess of the obligations against which the disbursements are posted.

	September 1996	September 1997	Change	Percent Change
Unmatched Disbursements	$8,087,959	$5,886,788	($2,201,171)	-27.22%
Negative Unliquidated Obligations	3,261,640	3,106,046	(155,594)	-4.77%
Totals:	$11,349,599	$8,992,834	($2,356,765)	-20.77%

B. Canceled Balances: All unliquidated balances associated with the closed accounts have been canceled in accordance with Public Law 101-510. Canceled accrued expenditures unpaid are reflected in the financial statements as unfunded liabilities. Canceled undelivered orders outstanding are not included in the financial statements; however, these orders may result in future expenditures.

DEPARTMENT OF DEFENSE

AGENCY-WIDE FINANCIAL STATEMENTS

AUDIT OPINION

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

February 27, 1998

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

SUBJECT: Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1997 (Project No. 7FI-2030)

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 responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. As the Chief Financial Officer of DoD, the Under Secretary of Defense (Comptroller) is responsible for establishing and maintaining internal controls and for complying with laws and regulations applicable to DoD financial accounting and reporting. Our responsibility is to render an opinion on the financial statements based on our audit, and to determine whether internal controls were adequate and whether DoD complied with laws and regulations. We delegated to the Military Department audit agencies the audits of the Departments of Army, Navy and Air Force financial statements.

Disclaimer of Opinion. We were unable to render an opinion on the DoD Consolidated Financial Statements for FYs 1997 and 1996. The DoD Consolidated Financial Statements were not received in a timely manner, and management and legal representation letters were not provided. Although progress continues, significant deficiencies in the accounting systems and the lack of sound internal controls prevented the preparation of accurate financial statements. The accounting data were not reliable, and we were unable to satisfy ourselves that the data were accurate and complete. For example, the Defense Security Assistance Agency financial statements did not include accounting data on approximately $15.1 billion of transactions. Also, we could not verify the accuracy of approximately $218 billion reported for military retirees' medical benefits.

Our disclaimer was partially based on work performed by the Military Department audit agencies. The Army Audit Agency could not verify the accuracy of approximately $27.7 billion reported for non-Federal liabilities not covered by budgetary resources. The Naval Audit Service determined that property, plant, and equipment was understated by at least $10.8 billion. The Air Force Audit Agency could not verify the accuracy of $24.5 billion in inventory.

Because of accounting system and internal control deficiencies and significant scope limitations, the scope of our work was not sufficient to allow us to render an opinion on the FYs 1997 and 1996 DoD Consolidated Financial Statements.

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.

Internal Controls. We reviewed the internal controls for the reporting entities included in the DoD Consolidated Financial Statements for FY 1997. The internal controls consist of the overall control environment, accounting systems, and control procedures that provide reasonable assurance that accounting data are accumulated, recorded, and reported properly by management and that assets are safeguarded. We performed applicable tests of the internal controls to determine whether the controls were effective and working as designed.

The DoD internal controls were not adequate to ensure that resources were properly managed and accounted for and that the financial statements were free of material misstatements. In the FY 1997 Annual Statements of Assurance for DoD and the Defense Finance and Accounting Service, the most significant conditions we found were also acknowledged as material weaknesses. The DoD accounting systems were not integrated, and DoD did not provide adequate documentation, audit trails, and general ledger controls. Control procedures over assets were inadequate and caused inaccurate reporting of real and personal property, Government-furnished property, inventory, and foreign military sales.

Compliance With Laws and Regulations. We assessed compliance with laws and regulations related to the DoD Consolidated Financial Statements. Accounting systems and internal controls did not completely or accurately disclose the financial condition of DoD as required by title 31, United States Code. DoD did not always comply with OMB Bulletin No. 94-01 in areas such as Operating Materials and Supplies, Inventory, Capital Leases, and Contingent Liabilities. Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements for Federal Financial Statements," January 16, 1998, our work disclosed that financial management systems did not comply with Federal financial management system requirements; applicable Federal accounting standards; and the United States Government Standard General Ledger at the transaction level.

Additional Reports. This is the first in a series of reports related to the DoD Consolidated Financial Statements for FY 1997. This report briefly summarizes the major deficiencies affecting DoD. Later reports will discuss internal controls and laws and regulations in more detail.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Appendix D. Management and Legal Representation Letters

This appendix (a total of 7 pages) consists of the management and legal representation letters for the DoD Consolidated Financial Statements for FY 1997.

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

FEB 11 1998

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, OFFICE OF THE INSPECTOR GENERAL, DOD

SUBJECT: Management Representation Letter for the FY 1997 DoD-wide Consolidated Financial Statements

This is in regard to your audit of the DoD Consolidated Financial Statements as of September 30, 1997, (Project No. 7FI-2030). For the purpose of expressing an opinion as to whether those statements are presented fairly and in accordance with the other comprehensive basis of accounting described in Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, and applicable portions of OMB Bulletin 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, we confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

1) I am responsible for the fair presentation of the FY 1997 DoD Consolidated Financial Statements in accordance with OMB Bulletin 94-01 and applicable portions of OMB Bulletin 97-01.

2) To the best of my knowledge, all financial records and related data have been made available to you.

3) I cannot provide reasonable assurance that all of the accounting and nonaccounting systems used to produce the financial statements are reliable.

4) I have no plans or intentions, other than those previously disclosed to you, that may materially affect the carrying value or classification of assets and liabilities.

5) I know of no irregularities involving management personnel or employees who have significant roles in the internal control structure that are not a matter of public record.

6) I have no knowledge of other employees being involved in irregularities that could materially affect the financial statements that are not a matter of public record.

7) I have not received communications from regulatory agencies or auditors concerning noncompliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial statements that are not a matter of public record.

8) I have no knowledge of violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, that are not a matter of public record.

9) I have no knowledge of other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Federal Financial Accounting Standards (SFFAS) No. 5, "Accounting for Liabilities of the Federal Government," December 1995 that are not a matter of public record.

10) I have no knowledge of unasserted claims or assessments that our legal representatives have advised us are probable of assertion and must be disclosed in accordance with SFFAS No. 5, beyond those that may be reported in the legal representation letter for the DoD-wide Consolidated Financial Statements that will be furnished shortly to you by the General Counsel of the Department of Defense.

11) I have no knowledge of material transactions that have not been properly recorded in the accounting records underlying the financial statements that are not a matter of public record.

12) To my knowledge, the Department of Defense has satisfactory title to all reported assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

13) I have no knowledge of events that have occurred after the balance sheet date that would require adjustment to, or disclosure in, the financial statements that have not been previously identified on the statements.

14) I cannot attest to the accuracy of all the various account balances provided by various DoD Components or the Defense Finance and Accounting Service (DFAS) and used to prepare financial statements.

15) Some adjustments made to account balances by the DoD Components, the DFAS, or the Corps of Engineers, may not have been fully documented, or made in accordance with applicable accounting standards.

With respect to the procedural and systemic deficiencies that may prevent an auditor from expressing an unqualified opinion on the financial statements, the Department is committed to implementing the associated corrective actions. Information on the plans for correcting these deficiencies can be found in the Department's financial management improvement plans, such as the 5-Year Plan.

My staff contact for this matter is Mr. Henry Bezold. He may be reached at e-mail: bezoldh@ousdc.osd.mil or by telephone at (703) 614-3523.

William J. Lynn

GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
1600 DEFENSE PENTAGON
WASHINGTON, D. C. 20301-1600

GENERAL COUNSEL

April 8, 1998

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: LEGAL REPRESENTATION LETTER FOR AUDITORS CONCERNING THE DEPARTMENT OF DEFENSE FISCAL YEAR 1997 DEFENSE-WIDE CONSOLIDATED FINANCIAL STATEMENTS

REFERENCES:

(a) USD(C) Memorandum dated February 9, 1998, Subject: Request for Legal Representation Letter for the FY 1997 DoD-Wide Consolidated Financial Statements

(b) DoD Directive 5145.1, dated December 15, 1989, "General Counsel, Department of Defense"

(c) DoD Directive 5145.4, dated December 15, 1989, "Defense Legal Services Agency"

(d) Statement of Federal Financial Accounting Standard No. 5, "Accounting for Liabilities of the Federal Government," September 30, 1996

(e) Department of the Army General Counsel Memorandum to the Auditor General, Department of the Army, dated January 15, 1998, Subject: Legal Representation Letter, Fiscal Year 1997, Army Litigation and Contingencies

(f) Department of the Navy General Counsel Memorandum to the Auditor General, Department of the Navy, dated January 21, 1998, Subject: Legal Representation Letter for the Fiscal Year 1997 Year-End Department of the Navy-Wide Fund Financial Audit

(g) Department of the Navy General Counsel Memorandum to the Auditor General, Department of the Navy, dated January 21, 1998, Subject: Legal Representation Letter for the Fiscal Year 1997 Year-End Department of the Navy Working Capital Fund Financial Audit

(h) Department of the Air Force General Counsel Memorandum to the Auditor General, Department of the Air Force, dated February 12, 1998, Subject: Air Force Audit Agency Audit of the Air Force Fiscal

Year (FY) 1997 Financial Statement

(i) Defense Logistics Agency General Counsel Memorandum to the Assistant Inspector General for Auditing, Office of the Inspector General, Department of Defense, dated March 1, 1998, Subject: Defense Logistics Agency Working Capital Fund for FY 1997

(j) Defense Logistics Agency General Counsel Memorandum to the Assistant Inspector General for Auditing, Office of the Inspector General, Department of Defense, dated March 1, 1998, Subject: National Defense Stockpile Transaction Fund Financial Statement Audit FY 1997

(k) Defense Security Assistance Agency General Counsel Memorandum to the Assistant Inspector General for Auditing, Department of Defense, dated January 29, 1998, Subject: Legal Representation Letter

(l) Defense Finance and Accounting Service General Counsel Memorandum to the Assistant Inspector General for Auditing, Department of Defense, dated January 20, 1998, Subject: Audit of the FY 1997 Financial Statements of the Defense Finance and Accounting Service Working Capital Fund

(m) Defense Commissary Agency General Counsel Memorandum to the General Counsel, Department of Defense, dated February 27, 1998, Subject: Inspector General, Department of Defense, Audit of FY 1997 Defense Commissary Agency Working Capital Fund Financial Statements (Project No. 7FH-2042)

(n) Defense Information Systems Agency General Counsel Letter to the Office of the Assistant Inspector General for Auditing, Department of Defense, dated February 27, 1998, concerning the DODIG audit of the FY 1997 Defense Information Systems Agency Working Capital Fund financial statements

(o) Air Force Materiel Command Law Office Memorandum to the Assistant Inspector General for Auditing, Department of Defense, dated January 23, 1998, Subject: Legal Representation Letter--Joint Logistics Systems Center Working Capital Fund

(p) Department of Defense General Counsel Memorandum to the Assistant Inspector General for Auditing, Department of Defense,

Subject: Legal Representation Letter for Auditors Concerning the Department of Defense Fiscal Year 1997 Military Retirement Trust Fund Financial Statements

(q) American Bar Association Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (December 1975)

This memorandum responds to reference (a) which requests that my office provide information concerning "all known litigations, claims, and assessments of $100 million or more" involving legal claims of the DoD Components for the fiscal year ended September 30, 1997 and from the period September 30, 1997 through February 6, 1998 with respect to the DoD-Wide Consolidated Financial Statements. Reference (a) further requests information concerning unasserted claims and assessments and requests confirmation that Department legal counsel are disclosing material loss contingencies as defined in reference (d).

Known Litigation, Claims and Assessments

As you are aware, the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements covers those items which are the subject of the legal representation memoranda covered by references (e) through (p). References (e) through (o) have been submitted previously by the Military Departments, as well as by various components of the Department of Defense and should form the basis for the required representations and evaluations for the matters covered by those memoranda. Reference (p) is being submitted to your Office contemporaneously with this memorandum and should form the basis for the required representations and evaluations for the matters covered by those memoranda. Collectively, references (e) through (p) should form the basis for the required representations and evaluations covered by all of the memoranda.

As General Counsel of the Department of Defense, I have supervisory authority only with respect to claims and litigation made against the Department of Defense and its Agencies and Field Activities (References (b) and (c)). I have obtained copies of each of the legal representation memoranda identified in references (e) through (o) and have signed the legal representation memoranda identified in reference (p) in response to a separate request for the financial statement addressed in that reference. Collectively, and subject to the time periods and other qualifications addressed in each of the legal representation memoranda, they constitute the legal representation memoranda for the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements.

With respect to those elements of the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements pertaining to matters which are administered by the Military Departments, over whose legal staffs I exercise no supervisory responsibility with respect to the subject matter of reference (a), I expressly disclaim any responsibility for the accuracy or completeness of any information reported by the legal advisors to the Military Departments.

Copies of each of the foregoing references are attached and are considered to constitute the totality of legal representation matters pertaining to the subject matter covered by the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements of the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements.

Unasserted Claims and Assessments

Reference (a) requests information concerning unasserted claims and assessments which this office considers probable of assertion and, if asserted, would have a reasonable possibility of an unfavorable outcome. I have interpreted this request to refer to unasserted claims and assessments which, if asserted, have a reasonable possibility of resulting in a material unfavorable outcome where materiality is defined as $100 million or more.

Subject to the limitations on my authority stated in references (b) and (c), to Paragraph 5, clause (a) of reference (q), and to the last paragraph of this memorandum, and the information contained in references (e) through (p), I advise you that neither I nor any of the lawyers over whom I exercise legal supervision have given substantive attention to, or provided representation in any matter covered by the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements in connection with any unasserted claims or assessments which, if asserted, would constitute a material loss contingency within the scope of clause (a) of Paragraph 5 of reference (q).

Representation Concerning Disclosure

Subject to the limitations on my authority in references (b) and (c) and to the last paragraph of this memorandum, and consistent with the last sentence of Paragraph 6 of reference (q), this will confirm that whenever, in the course of performing legal services for the Department of Defense, its Agencies or Field Activities with respect to a matter recognized to involve an unasserted possible material claim or assessment in any matter covered by the Fiscal Year 1997 Defense-Wide Consolidated Financial Statements that may call for financial statement disclosure, I or one of the lawyers over whom I exercise general legal supervision have formed a professional conclusion that the Department must disclose, or consider disclosure, concerning such possible claim or assessment, the lawyer forming such professional conclusion will so advise the Department and will consult with the Department's financial managers concerning the question of such disclosure and the applicable requirements of reference (d).

Limitation on This Response

This response is limited by, and made in accordance with, the ABA Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (December 1975) (reference (q)). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (paragraphs 2 and 7)) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of reference (q) and the accompanying Commentary

(which is an integral part of this Statement). In addition, we do not interpret reference (a) to require or authorize the release of information subject to the attorney-client privilege or the work product doctrine, and in responding to reference (a) we have provided no information subject to that privilege or doctrine. Moreover, except as otherwise indicated in references (e) through (p), the information set forth herein is as of March 30, 1998, and covers matters that existed as of September 30, 1997 and for the period September 30, 1997 to February 6, 1998, and I expressly disclaim any undertaking to advise you of changes which may be brought to my attention or to the attention of the lawyers over whom I exercise general legal supervision after March 30, 1998. Finally, information reported herein relating to the Military Departments is reported as a courtesy and I hereby disclaim any responsibility for the accuracy or completeness of any information reported by the legal advisers of the Military Departments.

Judith A. Miller

Appendix E. Laws and Regulations Reviewed

Subtitle III, "Financial Management," Title 31, United States Code (U.S.C.), including the requirements for accounting and accounting systems and information in 31 U.S.C. 3511, 3512, 3513, and 3514; and the financial statement requirements in 31 U.S.C. 3515

Subtitle II, "The Budget Process," Title 31, U.S.C., including the Antideficiency Act provisions found in 31 U.S.C. 1341, "Limitations on Expending and Obligating Amounts;" and 31 U.S.C. 1517, "Prohibited Obligations and Expenditures"

Historical and Statutory Notes to Title 10, U.S.C. 2208, "Working Capital Funds"

Public Law 104-208, "Federal Financial Management Improvement Act of 1996," September 30, 1996

Public Law 104-134, "Debt Collection and Improvement Act of 1996," April 26, 1996

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

Public Law 103-62, "Government Performance and Results Act of 1993," August 3, 1993

Public Law 101-647, "Federal Debt Collection Procedures Act of 1990," November 29, 1990

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

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

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

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

Public Law 96-510, "Comprehensive Environmental Response, Compensation, and Liability Act," as amended by Public Law 99-499

Public Law 96-427, "Federal Employees' Group Life Insurance Act of 1980," October 10, 1980

Public Law 95-454, "Civil Service Reform Act of 1978," October 13, 1978

Public Law 90-269, "Arms Export Control Act," October 22, 1968

Public Law 86-382, "Federal Employees' Health Benefits Act of 1959," September 28, 1959

"Budget and Accounting Procedures Act of 1950," chapter 946

"Fair Labor Standards Act of 1938" (as amended in 29 U.S.C. 22201-219)

"Civil Service Retirement Act of 1930," as renumbered July 31, 1956, Title IV, (codified as amended in Title 5, U.S.C. Sections 1308, 3323, and 8331-8348)

"Federal Employees' Compensation Act" (as amended in various sections of Title 5, U.S.C.)

National Defense Authorization Act for FY 1996

National Defense Authorization Act for FY 1995

DoD Appropriations Act of 1993

Federal Acquisition Regulation

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. 93-18, "Audited Financial Statements," June 25, 1993

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

OMB Circular No. A-11, "Preparation and Submission of Budget Estimates," June 13, 1996

OMB Circular No. A-34 (Revised), "Instructions on Budget Execution," December 1995

OMB Circular No. A-123, "Management Accountability and Control," June 21, 1995

OMB Circular No. A-134, "Financial Accounting Principles and Standards," May 20, 1993

OMB Circular No. A-125 (Revised), "Prompt Payment," December 12, 1989

OMB Circular No. A-127, "Financial Management Systems," July 23, 1993

Accounting Principles Board Opinion 22, "Disclosure of Accounting Policies"

Overview of Federal Accounting Concepts and Standards, Reporting Relevant Financial Information, December 31, 1996

Statements of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," September 2, 1993

Statements of Federal Financial Accounting Concepts No. 2, "Entity and Display," June 6, 1995

Statements of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993

Statements of Federal Financial Accounting Standards No. 2, "Accounting for Direct Loan and Loan Guarantees," August 23, 1993

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

Statements of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government ," July 31, 1995

Statements of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," December 20, 1995

Statements of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," November 30, 1995

Statements of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources," May 10, 1996

Statements of Federal Financial Accounting Standards No. 8, "Supplementary Stewardship Reporting," June 11, 1996

Joint Financial Management Improvement Program, "Framework for Federal Financial Management Systems," January 1995

Joint Financial Management Improvement Program, "Core Financial Systems Requirements," September 1995

Joint Financial Management Improvement Program, "Personnel/Payroll System Requirements," May 1990

Joint Financial Management Improvement Program, "Travel System Requirements," January 1991

Joint Financial Management Improvement Program, "Seized/Forfeited Asset System Requirements," March 1993

Joint Financial Management Improvement Program, "Direct Loan System Requirements," December 1993

Joint Financial Management Improvement Program, "Guaranteed Loan System Requirements," December 1993

Joint Financial Management Improvement Program, "Inventory System Requirements," June 1995

Treasury Financial Manual, Volume 1, "Instructions for Disbursing Officer's Reports"

Under Secretary of Defense (Comptroller), "Revenue Recognition Policy for the Air Force Working Capital Fund Depot Maintenance Business Area," February 18, 1997

DoD Directive 5010.38, "Management Control Program," August 26, 1996

DoD Directive 5000.1, "Defense Acquisition," March 15, 1996

DoD Regulation 5000.2-R, "Mandatory Procedures for Major Defense Acquisition Programs and Major Automated Information System Acquisition Programs," March 15, 1996

DoD Directive 7200.1, "Administrative Control of Appropriations," May 4, 1995

DoD Directive 7410.13, "Stock Fund Operations"

DoD Directive 4140.31, "Defense Inactive Item Program"

DoD Directive 5010.40, "Management Control Program Procedures," August 28, 1996

DoD Instruction 7000.14, "DoD Financial Management Policy and Procedures," November 15, 1992

DoD Instruction 4140.39, "Storage"

DoD Instruction 4140.35, "Physical Inventory Control for DoD Wholesale Supply System Material"

DoD Manual 5105.38-M, "Security Assistance Management Manual," October 1988, as amended

DoD Manual 7200.10-M, "Report of Survey"

DoD 7000.14-R, "Financial Management Regulation"

DoD 7220.9-M, "DoD Accounting Manual," as amended June 17, 1991

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
  Deputy Under Secretary of Defense (Logistics)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller) and Chief Financial Officer
  Deputy Chief Financial Officer
    Director, Accounting Policy
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Personnel and Readiness)
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence)
Assistant Secretary of Defense (Public Affairs)

Department of the Army

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

Department of the Navy

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

Department of the Air Force

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

Unified Commands

Commander-in-Chief, US Transportation Command

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Washington Headquarters Service
Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Information Systems Agency
Director, Defense Logistics Agency
Director, National Security Agency
Director, Defense Security and Assistance Agency
Commander, Joint Logistics Systems Center

Non-Defense Federal Organizations

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

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