

A *udit*



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INSPECTOR GENERAL, DOD, OVERSIGHT
OF THE ARMY AUDIT AGENCY AUDIT
OF THE FY 2000 U.S. ARMY CORPS OF ENGINEERS,
CIVIL WORKS PROGRAM, FINANCIAL STATEMENTS

Report No. D-2001-067

February 28, 2001

Office of the Inspector General
Department of Defense

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Acronym

AAA Army Audit Agency



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

February 28, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
COMMANDER AND CHIEF OF ENGINEERS, U.S.
ARMY CORPS OF ENGINEERS
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, Financial Statements (Report No. D-2001-067)

We are providing this report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Army Audit Agency disclaimer of opinion on the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements, along with excerpts from the Army Audit Agency report, "FY 00 Financial Statements: U.S. Army Corps of Engineers, Civil Works," February 14, 2001. An audit of the U.S. Army Corps of Engineers, Civil Works Program, financial statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Because this report contains no findings or recommendations, written comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Richard B. Bird at (703) 604-9159 (DSN 664-9159) (rbird@dodig.osd.mil) or Ms. Addie M. Beima at (703) 604-8912 (DSN 664-8912) (abeima@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Acting Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-067
(Project No. D2001FI-0034)

February 28, 2001

Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, Financial Statements

Executive Summary

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 DoD to prepare annual audited U.S. Army Corps of Engineers, Civil Works Program, financial statements. Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, establishes the minimum requirements for audits of these financial statements. This Bulletin requires the Inspector General, DoD, to express an opinion on the DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations. We delegated the audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements to the Army Audit Agency. This report discusses the work performed on the oversight of the Army Audit Agency audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements.

Objectives. Our objectives were to oversee the Army Audit Agency audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements and to determine the reliability and effectiveness of processes and procedures used to prepare those statements. This report focuses on the oversight objective. The objective for determining the consistency and accuracy of financial data compiled by the Corps of Engineers Finance Center will be addressed in a subsequent AAA report. See Appendix A for a discussion of the audit process.

Results. The Army Audit Agency report, “FY 2000 Financial Statements: U.S. Army Corps of Engineers, Civil Works,” February 14, 2001, states that the auditors were unable to express an opinion on the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements. We concur with the Army Audit Agency disclaimer of opinion; our endorsement of that disclaimer is included in Exhibit 1. Excerpts of the Army Audit Agency report are included in Exhibit 2 and provide the reasons for the disclaimer of opinion and identify the material weaknesses and reportable conditions associated with the internal controls and compliance with laws and regulations. The complete Army Audit Agency report can be accessed on the Internet at <https://www.aaa.army.mil>. The FY 2000 U.S. Army Corps of Engineers, Civil Works Program financial statements can be accessed on the Internet at www.dtic.mil/comptroller.

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U.S. Army Corps of Engineers, Civil Works

Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the “Chief Financial Officers Act of 1990,” as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” and Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, we performed oversight of the independent audit conducted by the Army Audit Agency (AAA) of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements. We reviewed the AAA audit approach and monitored audit progress at key points.

Reviewing the AAA Audit Approach. We used the “Federal Financial Statement Audit Manual,” January 1993, issued by the President’s Council on Integrity and Efficiency, and the “Financial Audit Manual,” December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the AAA audit approach. We reviewed the notification letter, formulation of strategy, entity profile, general risk analyses, cycle memoranda, and audit programs. In addition, we participated in the AAA conferences on the U.S. Army Corps of Engineers, Civil Works Program, financial statements. The conferences covered the AAA audit planning and strategy formulation and included presentations on issues identified by audit.

Monitoring Audit Progress. Through the DoD Financial Statement Audit Executive Steering Committee, and an integrated line-item oversight effort, we provided a forum for a centrally managed exchange of guidance and information. We participated in audit working groups on significant topics in financial reporting relating to the Corps of Engineers, Civil Works Program. For example, we participated in the audit Working Groups for DoD-wide real property, eliminating entries, and statistical analyses. We reviewed and commented on the AAA audit opinion and internal control report, which included discussions of issues on internal controls and compliance with laws and regulations.

In addition to the oversight procedures, we performed other procedures necessary to determine the fairness and accuracy of the AAA audit approach and conclusions. For example, we co-performed audit steps with AAA and the General Accounting Office to determine the adequacy of the internal control environment surrounding the Corps of Engineers Financial Management System. We also worked closely with AAA in performing its audit work related to the Fund Balance With Treasury, and real property.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following corporate-level goals, subordinate performance goal, and performance measures:

FY 2001 Corporate-Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**

FY 2001 Subordinate Performance Goal 2.5: Improve DoD financial and information management. **(01-DoD-2.5)**

FY 2001 Performance Measure 2.5.2: Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Objectives and Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Area. Objective: Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Audit Type, Period, and Standards. We performed this financial statement audit from October 12, 2000, through February 14, 2001, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data to conduct our oversight of the AAA audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements.

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

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army
Commander and Chief of Engineers, U.S. Army Corps of Engineers

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organization

Director, Defense Finance and Accounting Service

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

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 Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

**Exhibit 1. Inspector General, DoD,
Endorsement Memorandum**



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

February 14, 2001

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

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, Financial Statements (Project No. D2001-D00FI-0034)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Army Audit Agency (AAA) the audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, financial statements. Summarized as follows are the AAA disclaimer of opinion on the FY 2000 Army Corps of Engineers financial statements and the results of our review of the AAA audit. This memorandum provides the reasons for the AAA disclaimer. We endorse the disclaimer of opinion expressed by AAA.

Disclaimer of Opinion. The AAA disclaimer of opinion on the FY 2000 Army Corps of Engineers, Civil Works Program, financial statements, dated February 14, 2001, states that AAA was unable to express an opinion on the financial statements. We concur with the AAA disclaimer of opinion. The AAA was unable to express an opinion on the financial statements primarily because of limitations to the scope of their work, as indicated in the following examples:

- Audit work was not completed on \$2.1 billion of additions and deletions to general property, plant, and equipment for the fiscal year ended September 30, 2000.
- Beginning balances were not determined for \$33.9 billion of general property, plant, and equipment.
- The general and application control review of the Corps financial management system was incomplete; therefore, computer-processed data could not be relied upon as support for day-to-day transactions.

Internal Controls. The AAA tested internal controls but did not express a separate opinion because opining on internal controls was not one of its objectives. However, AAA identified areas in which internal controls needed improvements, including general property, plant, and equipment, and information systems. Details on those matters are discussed in the significant matters section and the internal controls section of the AAA audit report.

Compliance with Laws and Regulations. The AAA identified areas of noncompliance with laws and regulations, which are discussed in more detail in the laws and regulations section of the AAA audit report. The AAA was unable to demonstrate that the financial statements produced by the U.S. Army Corps of Engineers Financial Management System complied with generally accepted accounting principles relating to general property, plant, and equipment and information systems. Further, the U.S. Army Corps of Engineers did not always comply with Office of Management and Budget Bulletin No. 97-01, "Form and Content

of Agency Financial Statements," as amended, and Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards," February 28, 1997, requirement to present the Statement of Net Cost by business program.

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

We reviewed the AAA work on the FY 2000 Army Corps of Engineers, Civil Works Program, financial statements, from October 12, 2000, through February 14, 2001, in accordance with generally accepted Government auditing standards.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

**Exhibit 2. Excerpts from Army Audit
Agency Report, FY 2000
Financial Statements: U.S.
Army Corps of Engineers,
Civil Works**

Fiscal Year 2000 Financial Statements

**U.S. Army Corps of Engineers,
Civil Works**

**14 February 2001
Audit Report: AA 01-187**



U.S. Army Audit Agency





DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

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14 February 2001

Acting Secretary of the Army
Commander, U.S. Army Corps of Engineers

This report summarizes the results of our efforts to audit the U.S. Army Corps of Engineers, Civil Works Principal Financial Statements for the fiscal year ended 30 September 2000. The Commander, U.S. Army Corps of Engineers and The Auditor General signed an engagement letter in October 2000 defining this audit. We performed our work pursuant to the Chief Financial Officers Act of 1990 as expanded by the Government Management Reform Act of 1994.

We are unable to express an opinion on the financial statements at this time primarily because we have been unable to resolve issues associated with the reasonableness of the valuation for general property, plant and equipment. We also have not completed followup work related to the general and application control deficiencies identified in the Corps financial management system. We requested an extension of the required reporting date to complete our audit work. The extension was not granted.

This report doesn't contain recommendations, but it does include brief discussions of our results and conclusions. More detailed discussions of our results and conclusions are in supporting audit reports (see Annex C).

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


FRANCIS E. REARDON, CPA
The Auditor General

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BACKGROUND

BACKGROUND

Mission and Organization

The U.S. Army Corps of Engineers is a complex organization with civil works and military missions. As the largest public engineering, design, and construction management agency, it employs a workforce of about 25,500 civilians and 160 military personnel to accomplish its civil works mission. The Corps also contracts with commercial architectural, engineering, and construction firms for most design work and for all construction work.

Within the civil works program, the Corps develops, maintains, and manages many of the nation's water and related environmental resources. This mission includes designing, constructing, and operating projects for:

- Commercial navigation of rivers, harbors, and channels.
- Flood control.
- Hydroelectric power development.
- Restoration of fish and wildlife.
- Recreation areas.

Under its military program, the Corps manages and administers contracts for engineering services for the Army. When requested, the Corps provides these services to the Air Force, other DOD and government agencies, and foreign governments. The Corps also does research and development in engineer support (specialized equipment and procedures) of combat operations.

The Corps had appropriations totaling about \$4.1 billion for its FY 00 Civil Works Program. It operates a revolving fund for common services that apply to multiple projects.

The Corps uses a decentralized management structure consisting of 62 major operations located worldwide that include a headquarters, divisions, districts, laboratories, centers, and field operating activities.

Federal Accounting Standards

The Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General are the co-principals of the Joint Financial Management Improvement Program. They are responsible for setting Federal Government accounting standards and are accomplishing this task through the Federal Accounting Standards Advisory Board (FASAB). The American Institute of Certified Public Accountants recognizes the Statements of Federal Financial Accounting Standards developed by the advisory board as generally accepted accounting principles for Federal government entities. Federal agencies are to use the following hierarchy to prepare financial statements:

1. Individual standards (Statements of Federal Financial Accounting Standards) agreed to by the Director of the Office of Management and Budget, the Comptroller General, and the Secretary of the Treasury and published by the Office of Management and Budget and the General Accounting Office.
2. Interpretations related to the Statements of Federal Financial Accounting Standards issued by the Office of Management and Budget in accordance with the procedures outlined in its Circular A-134, "Financial Accounting Principles and Standards."
3. Requirements contained in the Office of Management and Budget Form and Content Bulletin in effect for the period covered by the financial statements.
4. Accounting principles published by other authoritative standard-setting bodies and other authoritative sources (a) in the absence of other guidance in the first three parts of this hierarchy, and (b) if the use of such accounting principles improves the meaningfulness of the financial statements.
5. United States Government Standard General Ledger published by the Department of the Treasury, Financial Management Service, through its Treasury Financial Manual.
6. Policies and guidance published in the DOD Financial Management Regulation.
7. Interim policies and guidance issued by the Office of the Under Secretary of Defense (Comptroller) through various memoranda.

Financial Statements

Federal Agencies are required to submit a set of financial statements, overview, and notes that were standardized by the Federal Accounting Standards Advisory Board. The statements include the following:

- Balance Sheet.
- Statement of Net Cost.
- Statement of Changes in Net Position.
- Statement of Budgetary Resources.
- Statement of Financing.

Balance Sheet

The balance sheet presents, as of a specific time, amounts of future economic benefits owned or managed by the reporting entity exclusive of items subject to stewardship reporting (assets), amounts owed by the entity (liabilities), and amounts which comprise the difference (net position). The balance sheet identifies separately intragovernmental assets and liabilities.

Statement of Net Cost

The Statement of Net Cost is designed to show separately the components of the net cost of the reporting entity's operations for the period. Net cost of operations is the gross cost incurred by the reporting entity less any exchange revenue earned from its activities. The gross cost of a program consists of the full cost of the outputs produced by that program plus any non-production costs that can be assigned to the program (non-production costs are costs linked to events other than the production of goods and services). The net cost of a program consists of gross cost less related exchange revenues. By disclosing the gross and net cost of the entity's programs, the Statement of Net Cost provides information that can be related to the outputs and outcomes of the programs and activities.

Preparers of the Statement of Net Cost should decide the exact classification of major programs. This decision should be based on the missions and outputs described in its Government Performance and

Results Act strategic and annual plans, the entity's budget structure, and the guidance for defining and structuring responsibility segments presented in accounting standards.

Statement of Changes in Net Position

The Statement of Changes in Net Position reports the beginning net position, the items which caused net position to change during the reporting period, and the ending net position. The entity should display information on the Statement of Changes in Net Position organized in the same manner as was done for the Statement of Net Cost.

Statement of Budgetary Resources

The Statement of Budgetary Resources and the related disclosures provide information about how budgetary resources were made available as well as their status at the end of the period. This statement should be prepared by reporting entities whose financing comes wholly or partially from budgetary resources. Monitoring of budget execution is at the individual account level. Accordingly, budgetary information aggregated for the Statement of Budgetary Resources should be disaggregated for each of the reporting entity's major budget accounts and presented as supplementary information. Small budget accounts may be aggregated.

Recognition and measurement of budgetary information reported on this statement should be based on budget terminology, definitions, and guidance in Office of Management and Budget Circular A-34, "Instructions on Budget Execution," dated 26 December 1995.

Statement of Financing

Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of Budgetary Resources. In order to understand these differences, information is needed to reconcile financial (proprietary) net cost of operations with obligations of budget authority. This reconciliation also makes sure there is a proper relationship between proprietary and budgetary accounts in the reporting entity's financial management system. The Statement of Financing is designed to report those differences and facilitate the reconciliation.

AUDITOR'S REPORT

AUDITOR'S REPORT



DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
OFFICE OF THE AUDITOR GENERAL
3101 Park Center Drive
Alexandria, VA 22302-1596

Acting Secretary of the Army
Commander, U.S. Army Corps of Engineers

In accordance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the U.S. Army Corps of Engineers prepared the accompanying financial statements for fiscal year 2000. The Corps engaged us to audit its Balance Sheet as of 30 September 2000, and the Statements of Net Cost, Budgetary Resources, Financing, and Changes in Net Position for the fiscal year ended 30 September 2000. The financial statements are the responsibility of Corps management.

We are unable to express an opinion on the financial statements at this time primarily because we have been unable to resolve issues associated with the reasonableness of the valuation of general property, plant and equipment. In addition, the followup of the general and application control review of the Corps financial management system has not been completed, so we could not rely on the computer-processed data as support for day-to-day transactions related to the operating statements. We requested an extension of the required reporting date to complete our audit work. The extension was not granted. The lack of a completed system review prevented us from using any practical methods to conduct audit work of sufficient scope to support an opinion. As a result, we do not express an opinion on the U.S. Army Corps of Engineers financial statements. Except for the limitations on the scope of our work on the principal statements described above, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 01-02 (Audit Requirements for Federal Financial Statements).

We performed limited tests of internal controls in order to determine if controls were working as designed. Our review showed that there were areas in which internal controls needed improvements including general property, plant, and equipment and information systems. Internal controls consist of the following components: control environment, risk assessment, control activities, information and communication, and

monitoring. Effective implementation of these controls provides reasonable assurance that accounting data is accumulated, recorded, and reported properly by management and the assets are safeguarded. Management is responsible for internal controls. Our tests of internal controls do not provide sufficient evidence to support an opinion; therefore, we do not express an opinion on the internal controls. We also could not assess the risk of material misstatement in the financial statements.

We also reviewed the Corps compliance with laws and regulations in relation to its financial statements. Our objective was to assess compliance, not to express an opinion. Therefore, we do not express an opinion on compliance with laws and regulations. The Corps did not comply with Office of Management and Budget Bulletin Number 97-01 (Form and Content of Agency Financial Statements) and Statement of Federal Financial Accounting Standards Number 4, (Managerial Cost Accounting Standards) requirements to present the Statement of Net Cost by business programs. Also, because of previously identified deficiencies in general and application controls related to the Corps financial system, we could not confirm that the system complied with the first requirement of the Federal Financial Management Improvement Act of 1996.

We also reviewed the information presented in the Corps overview section accompanying its financial statements. We do not express an overall opinion on this information. However, we found no material inconsistencies between the information presented in the overview and the information presented in the financial statements.


FRANCIS E. REARDON, CPA
The Auditor General

14 February 2001

SIGNIFICANT MATTERS

SUMMARY

The U.S. Army Corps of Engineers is a leader among the major DOD commands in striving to meet the goals of the Chief Financial Officers Act. In FY 93, the Corps was among the first to prepare and submit a separate set of financial statements. In FY 94, the Corps volunteered as a pilot project under the Government Performance and Results Act. During FY 98, the Corps completed fielding of its new financial management system and made changes in business practices to strengthen internal controls and meet the requirements of both acts.

We haven't completed our audit work to determine if the category of General Property, Plant and Equipment is fairly stated. Since this category represents about \$34.54 billion (86 percent) of the Corps assets, we are unable to express an opinion on the balance sheet at this time. On a positive note, we didn't find significant problems during our FY 00 audit work on several material asset and liability categories such as Fund Balance With Treasury, Investments, Accounts Receivable, Accounts Payable, and Other Liabilities.

We performed, under a contract let by the General Accounting Office and an independent auditor, a comprehensive test of general and application controls over the Corps of Engineers Financial Management System. A General Accounting Office audit report addressed system general and application controls, and an Agency report addressed system security issues. Corps management has reported that corrective action was taken on many of the deficiencies. However, followup audit work has not been completed to assess those corrective actions. As a result, we were unable to rely on the system controls when developing audit procedures. In addition, the Corps didn't present the Statement of Net Cost by business programs.

During previous audits we discovered a number of problems that required correction by the Corps. During the FY 00 audit, we followed up to determine whether action was taken to correct the problems related to the following areas:

- Property, plant and equipment documentation.
- Statement of Net Cost.

DISCUSSION

In this section we discuss:

- General property, plant and equipment additions and deletions.
- General property, plant and equipment beginning balances.
- General and application controls review.

We also discuss followup work on prior year issues related to:

- General property, plant and equipment documentation.
- Statement of Net Cost.

Additions and Deletions

The Corps general property, plant and equipment is the most significant asset category on its financial statements. For FY 00, the Corps reported a net value of about \$34.5 billion for general property, plant and equipment. Overall, the total net value of the Corps property, plant and equipment increased about \$631 million in FY 00 compared to FY 99. The value and change in value for FY 00 by individual category was as follows:

Category	FY 00 Acquisition Value (\$000)	FY 00 Net Book Value (\$000)	FY 99 Net Book Value (\$000)	FY 00 Net Increase/(Decrease) (\$000)
Land	\$ 7,801,562	\$ 7,801,562	\$ 7,360,455	\$441,107
Buildings, Structures, and Facilities	30,301,933	18,324,585	19,029,621	(705,036)
Leasehold Improvements	1,206	589	834	(245)
Automatic Data Processing Software	47,446	34,708	29,939	4,769
Equipment	1,106,589	610,325	625,022	(14,697)
Construction In Progress	7,753,407	7,753,407	6,861,391	892,016
Other	12,916	12,916	0	12,916
Total	\$47,025,059	\$34,538,092	\$33,907,262	\$630,830

Although the total net increase of about \$631 million represents a less than 2 percent change in property, plant and equipment, the material increases and decreases in individual categories must be analyzed. Our

analysis of the changes to the balances of land, buildings and structures and construction in progress is not yet complete.

Beginning Balances

In order to establish the beginning property balances for FY 00, we separated Corps property assets into two categories:

- Assets on Power-producing Projects.
- Assets on Non-power-producing Projects.

Assets on Power-producing Projects

To establish the beginning balances for assets on power projects, we reviewed and relied on audits performed by independent accounting firms that audit the financial statements of the Power Marketing Administrations. The Power Marketing Administrations market hydropower on behalf of the Department of Energy. About \$9.5 billion of the FY 00 beginning balance for Corps land, buildings, and structures is related to power producing projects. As part of their rate-setting practices, these Power Marketing Administrations engage independent public accounting firms to perform annual audits of the recorded values for these power-producing assets. We reviewed the work of the public accounting firms and were able to rely on it [wcc1]to agree with the recorded values for the power-producing assets.

Assets on Non-Power-producing Projects

We used a combination of methods to review the beginning balances for the remaining \$16.9 billion recorded for land, buildings, and structures, and the \$6.9 billion recorded for construction in progress. For example, we sampled individual properties and obtained supporting documentation for the recorded property values. We also performed other reviews on the assets related to non-power-producing projects.

Land. The beginning FY 00 balance for land assets on non-power-producing projects was \$4.4 billion. This cost included both the cost paid to the previous owner to acquire the land tracts and the administrative cost associated with the acquisition. Therefore we performed two reviews to determine the reasonableness of the costs recorded for land. We selected a judgmental sample of 177 land tracts to determine the amount paid to previous owners for the land. We also reviewed 89 projects to evaluate recorded amounts for administrative

costs. Statement of Federal Financial Accounting Standards Number 6 states that asset costs will include all costs incurred to bring the land to a form and location suitable for its intended use, which includes the administrative costs of acquiring the land. These administrative costs include Corps labor and legal fees as well as costs such as relocations required to prepare the land for its intended use. To date, our sample of the land tract costs and the review of the administrative costs show that recorded costs for land are reasonable. However, our review is still not complete.

Buildings and Structures. The Corps FY 00 beginning balance, net of depreciation, for buildings and other structures on non-power-producing projects was \$12.5 billion. To verify the recorded values for these assets, we selected a statistical sample of 371 buildings and structures from a universe of 31,180. Corps management provided available documentation in an effort to support the recorded values for the sample items. The documentation provided included both internally generated documentation and documentation obtained from sources external to the Corps. Our review of the supporting documentation showed that the recorded values for buildings and structures were generally reasonable. However, because the majority of the sample items were supported by internal documentation, we established an assessment process in order to provide additional support for the validity of the values supported by internal documentation. At this time, the assessments haven't been completed.

Construction In Progress. The FY 00 beginning balance for construction in progress was \$6.9 billion. To verify the beginning balance for construction in progress, we selected a statistical sample of 161 of the Corps 1,703 ongoing projects. Many of the projects reviewed were actually started prior to the deployment of the Corps of Engineers Financial Management System. For these projects, costs were recorded using the previous financial system—the Corps of Engineers Management Information System. During the conversion, Corps personnel transferred construction in progress balances to the new financial management system. However, the costs weren't always distributed to the proper method of accomplishment codes. The method of accomplishment codes identify the type of cost incurred (for example, contract cost, in-house labor, reimbursable cost). The conversion process, along with post-conversion transfers from the construction in progress accounts, has made it difficult to validate the reported balances for construction in progress. We continue to work with Corps management to develop alternative procedures to validate recorded costs for construction in progress.

General and Application Controls Review

The Corps needs to improve general and application controls related to network and data processing activities. We made an initial review of the general and application controls and concluded that we couldn't rely on the data in the Corps financial management system as support for day-to-day transactions related to the operating statements. Because of the control environment related to the financial management system, we didn't attempt to perform the audit work needed to provide an opinion on the statements of net cost, changes in net position, budgetary resources, and financing. We will continue the general and application control review and monitor corrective actions taken by Corps management. When controls are improved and the review is completed, we should be able to rely on the financial data recorded in the financial system.

Property, Plant and Equipment Documentation

In FY 99, we reported that the Corps hadn't provided adequate documentation to support the recorded values for over half of the properties in our valuation sample. During FY 00 we worked with the Corps in a major effort to obtain and reconstruct supporting documentation for values on property, plant and equipment assets. Through this effort we were able to obtain documentation for the items in our sample. In addition, the Corps agreed to maintain supporting documentation for the life of the asset.

Statement of Net Cost

Again in FY 00, the Corps prepared its Statement of Net Cost by appropriation rather than by business programs. In doing so, the Corps complied with DOD guidance, but didn't fully implement the requirements established by the Federal Accounting Standards Advisory Board. In FY 99 we reported that the Corps didn't fully implement the requirements established by the Federal Accounting Standards Advisory Board for its Statement of Net Cost. The Federal Accounting Standards require the Corps to present the statement by business programs, but the Corps presented the statement by appropriation. However, the Corps did comply with the requirements of the DOD Financial Management Regulation. This regulation requires DOD activities to report program costs by appropriation rather than by business program.

The Statement of Net Cost explains and analyzes the net cost of operations of an entity. The total net cost of operations is the gross cost of the outputs of an entity less any exchange revenue from its activities.

The statement displays revenue and expense information by business program or sub-organization. The reporting entity must determine its different business programs based on the missions and outputs described in its strategic and annual plans for the Government Performance and Results Act. The Corps has the capability to report by business programs since it has fielded its new standard financial management system.

REPORT ON INTERNAL CONTROLS

INTERNAL CONTROLS

For financial reporting purposes, the Corps internal control objectives are to ensure that:

- Transactions properly record and maintain accountability for assets and permit the preparation of accurate and reliable financial statements.
- Funds, property, and other assets are safe from loss, unauthorized use, or misappropriation.
- Transactions are in accordance with applicable laws and regulations.

Numerous factors, both individually and collectively, comprise the overall control environment. For example:

- Management's perceptions and integrity concerning the importance of controls will reflect in the entity's overall attitude.
- Policies designed to establish some measure of control must be strictly enforced.

Procedures implemented by management should adhere to fundamental control techniques, such as segregating key duties, providing for tests and reconciliations, and limiting access. A comprehensive internal control structure consisting of checks and balances ensures that the control objectives will be met.

FY 00 Review

In planning and performing our audit, we:

- Obtained an understanding of the Corps internal controls.
- Determined whether these internal controls had been placed in operation.
- Assessed control risk.
- Performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.

We randomly selected Corps of Engineers operating activities, transactions, and personnel and conducted limited testing of internal controls related to:

- Property, plant and equipment.
- Revenues and receipts.
- Expenses and disbursements.
- Payroll.
- Budgetary resources.
- Financial Reporting.
- Information systems.

Our tests of internal controls did not provide sufficient evidence to support an opinion; therefore, we do not express an opinion on the internal controls. We also could not assess the risk of material misstatement in the financial statements. Our review showed that there were two areas in which controls needed some improvements:

- Construction in progress.
- Information systems.

Construction in Progress

Personnel didn't effectively review the Construction in Progress accounts to ensure that they only included the proper costs in the accounts. Our testing of the construction in progress accounts showed that there were costs in construction in progress for:

- Assets that should have been transferred to plant in service or to project sponsors.
- Items that should have been expensed.

Corps personnel should transfer, in a timely manner, construction in progress costs to the appropriate asset account or project sponsor upon completion or substantial completion of a project or major portion of a project. However, the Corps didn't have clear guidance identifying how

and when personnel should transfer these costs from the construction in progress accounts. Corps personnel must monitor the project status and the construction in progress accounts to ensure a timely transfer at the proper cost.

Corps guidance, "Civil Works Property Capitalization Policies," dated 29 September 1997, states that all costs associated with the initial construction of a capital asset will be capitalized as construction in progress. Costs incurred that do not result in the creation of a capital asset are an expense. Examples of capitalized items are:

- Contractor and in-house construction costs.
- Land acquisition costs.
- Relocation costs.
- Engineering and design costs.
- Supervision and administration costs.

Examples of expensed items are:

- Reconnaissance and feasibility studies.
- Beach replenishment.
- Excavation and dredging of channels.
- Engineering and design, and supervision and administration costs related to expense items.

Proper recognition and classification of work items begins when the district establishes the project hierarchy. In order for costs to be accurately captured, managers must correctly identify parent work items, asset work items, or expense work items. Also, districts must review construction in progress accounts to ensure that they only include proper costs.

Information Systems

The testing of Corps information system's general and application controls is currently in process; we will address the final results of those tests in a separate report. However, during the initial phase of the testing, general and application control weaknesses were identified. The Corps has reported that corrective actions have been taken to address

those weaknesses. However, followup audit work has not been completed to verify the corrective action was completed.

Limitations

Our review of the Corps internal controls wouldn't necessarily disclose all matters related to financial reporting that might be considered reportable conditions. Under standards issued by the American Institute of Certified Public Accountants:

- Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Corps ability to record, process, summarize, and report financial data consistent with the financial statements.
- Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce—to a relatively low level—the risk that misstatements in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Therefore, losses, noncompliance, or misstatements may occur and not be detected because of the inherent limitations in any system of internal controls. We caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate due to changes in conditions or the degree of compliance with controls may deteriorate.

**REPORT ON COMPLIANCE WITH
LAWS AND REGULATIONS**

COMPLIANCE WITH LAWS AND REGULATIONS

We evaluated the Corps compliance with the provisions of the laws and regulations listed in the Audit Scope and Methodology section of this report and in Office of Management and Budget Bulletin 01-02 (Audit Requirements for Federal Financial Statements). Our objective was to assess compliance with laws and regulations in relation to the financial statements, not to express an opinion. Therefore, we do not express an opinion on compliance with laws and regulations.

The audit did not identify instances of material noncompliance with selected laws and regulations. An instance of material noncompliance is reportable if it could result in a material misstatement to the financial statements, or if the sensitivity of the matter would cause others to perceive it as significant.

Chief Financial Officers Act of 1990

We evaluated Corps compliance with the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, and various implementing regulations issued by the Office of Management and Budget and DOD, as they relate to financial statement presentation. The Corps has made a concerted effort to meet the act's requirements. In this report, we discuss areas in which the Corps can achieve financial reporting improvements; however, we do not believe these areas represent material noncompliance with the act.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act of 1982 requires the Corps to report annually to the Secretary of the Army about whether its management controls comply with the act's requirements. In its FY 00 annual assurance statements, the Corps added a reported materiel weakness related to its computer system controls. We addressed these general and application controls weaknesses in the system-related reports listed in Annex B of this report.

Federal Financial Management Improvement Act of 1996

Under the Federal Financial Management Improvement Act of 1996, we are required to report whether the Corps financial management system substantially complied with the Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. To meet this requirement, we performed some tests of compliance and reviewed prior audit work performed during the system's development and after the system was deployed.

We found that the Corps financial management system substantially complied with two of the three requirements of the Federal Financial Management Improvement Act of 1996. However, because of previously identified deficiencies in general and application controls related to the system, we could not confirm that the system complied with the first requirement of the act.

- **Federal Financial Management System Requirements.** Federal financial management system requirements have been well-established in Office of Management and Budget Circular A-127, "Financial Management Systems," 23 July 1993, that requires financial management systems to provide complete, reliable, consistent, timely, and useful information. To achieve this goal, the Corps established and maintained a single, integrated financial management system. A review of the system in FY 00 identified deficiencies related to general and application controls of the system. Management personnel at the Corps have reported that action has been taken to correct many of the deficiencies identified. A follow-up review is scheduled for completion in FY 01. Auditors from the Agency, the General Accounting Office, and an independent public accounting firm will jointly conduct that review. Until this review is completed, we are unable to verify the system complies with Federal financial management system requirements.

- **Federal Accounting Standards.** Federal agencies reporting under the Government Management Reform Act of 1994 are to follow accounting standards and concepts agreed to by the Director of the Office of Management and Budget, the Comptroller General, and the Secretary of the Treasury. For FY 00 the financial management system substantially complied with the Federal Accounting Standards. However, the Corps didn't fully implement the requirements established by the Federal Accounting Standards Advisory Board and format included in Office of Management and

Budget Bulletin 97-01 for its FY 00 Statement of Net Cost. The Standards and Bulletin require reporting activities to present the statement by business programs, but the Corps presented the statement by appropriation. The Corps did comply with the requirements of the DOD Financial Management Regulation to report program costs by appropriation rather than by business program. The Corps does have the capability to present the statement by business program since it has completed fielding of its standard, integrated financial management system. However, because of the DOD requirement to report by appropriation, the Corps hasn't changed its reporting software to actually produce the report by business program.

In addition, we haven't completed our audit work on valuation of property, plant and equipment to ensure it meets the requirements of the Federal Accounting Standards. However, we haven't identified material instances of noncompliance based on our audit work to date.

- **U.S. Standard General Ledger at the Transaction Level.** The U.S. Standard General Ledger should be implemented at the transaction level or have adequate crosswalks to the U.S. Standard General Ledger. Federal agencies are permitted to supplement their application of the U.S. Standard General Ledger to meet agency-specific information requirements. However, agency standard general ledgers must maintain consistency with the U.S. Standard General Ledger. The Corps financial management system has a standard, transaction-driven general ledger, but the Corps general ledger accounts don't always conform to the U.S. Standard General Ledger accounts at the transaction level. The Corps does have adequate crosswalks from its general ledger to the U.S. Standard General Ledger.

OTHER MATTERS

OTHER MATTERS

Overview Information

The Corps overview information is incorporated into the Army's financial statements overview. We reviewed the following information presented in the Corps overview:

- Background.
- Mission.
- Performance Results.
- Management Initiatives.

We don't express an overall opinion on this information. However, we compared this information for consistency with the financial statements. Based on this limited work, we found no material inconsistencies between the information presented in the overview and the information presented in the financial statements.

Required Supplementary Stewardship Information

The Stewardship Statement addresses only heritage assets because that is the only type of stewardship assets managed under the Corps Civil Works program. Deferred Maintenance is reported for Civil Works Water Resources Projects operated and maintained by the Corps. The amount for Deferred Maintenance was determined through the budget development process. We made inquiries of management regarding the methods of preparing the required supplementary stewardship information. We also compared the information to previous periods for consistency. However, we did not audit and do not express an opinion on this information.

AUDIT SCOPE AND METHODOLOGY

AUDIT SCOPE AND METHODOLOGY

Corps management is responsible for:

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

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

- Evaluated and, as necessary, tested relevant internal controls encompassing:
 - Property, plant and equipment.
 - Revenues and receipts.
 - Expenses and disbursements.
 - Payroll.
 - Budgetary resources.
 - Information systems.
- Conducted limited follow-up reviews on previously reported problems related to:
 - Property, plant and equipment documentation.
 - Statement of Net Cost.
- Evaluated compliance with selected provisions of the following laws and regulations:
 - Chief Financial Officers Act of 1990 (Public Law 101-576).
 - Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255).

- Budget and Accounting Procedures Act of 1950 (31 U.S.C., Chapter 946; 64 Stat. 832).
- Anti-Deficiency Act (31 U.S.C. 1341, 1342, 1351, 1517).
- Federal Financial Management Improvement Act of 1996 (in Public Law 104-208, Omnibus Consolidated Appropriations Act).
- Office of Management and Budget Bulletin 97-01, Form and Content of Agency Financial Statements as amended.
- Office of Management and Budget Circular A-127, Financial Management Systems.

We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin 01-02 (Audit Requirements for Federal Financial Statements) as amended.

Audit Team Members

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