

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

INTERNAL CONTROLS AND COMPLIANCE WITH
LAWS AND REGULATIONS FOR THE DEFENSE
BUSINESS OPERATIONS FUND CONSOLIDATED
FINANCIAL STATEMENTS FOR FY 1995

Report No. 96-178

June 26, 1996

Department of Defense

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Acronyms

ADP	Automated Data Processing
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
IG	Inspector General
JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget



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June 26, 1996

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 Defense Business Operations Fund Consolidated Financial Statements for FY 1995 (Report No. 96-178)

We are providing this audit report for your information and use. Financial statement audits are required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General, DoD, to render an opinion on the financial statements and report on the adequacy of internal controls and compliance with laws and regulations.

We will also issue an update to our audit report, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," Report No. 95-294, August 18, 1995. In the update, we will discuss some of the systemic issues that prevent auditors from issuing an audit opinion other than a disclaimer. We will also explain DoD's progress in addressing the fundamental problems affecting the Defense Business Operations Fund.

We were unable to render an opinion on the Consolidated Financial Statements because the lack of a sound internal control structure for the Defense Business Operations Fund, and significant deficiencies in the accounting systems, prevented the preparation of accurate financial statements. Our opinion and the financial statements are included in Appendix B. Part I of this report discusses material weaknesses in internal controls and noncompliance with laws and regulations. Part II of this report contains relevant appendixes for management's use.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Raymond D. Kidd, Audit Program Director, at (703) 604-9110 (DSN 664-9110), or Mr. John M. Seeba, Audit Project Manager, at (703) 604-9134 (DSN 664-9134). The distribution of this report is in Appendix I. A list of the audit team members is inside the back cover.

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Office of the Inspector General, DoD

Report No. 96-178
(Project No. 5FH-2006.01)

June 26, 1996

Internal Controls and Compliance With Laws and Regulations for the Defense Business Operations Fund Consolidated Financial Statements for FY 1995

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an annual audit of the financial statements of the Defense Business Operations Fund. The Defense Business Operations Fund was established as a revolving fund in FY 1992 and consists of business areas such as Supply Management, Depot Maintenance, and Transportation. Oversight responsibilities of the Defense Business Operations Fund rest with the Defense Business Operations Fund Corporate Board and the Office of the Under Secretary of Defense (Comptroller), while day-to-day management and operational responsibilities rest with the Military Departments and Defense agencies. The Defense Business Operations Fund Corporate Board was established to develop, review, and recommend Defense Business Operations Fund policies and procedures; review business areas for inclusion in or exclusion from the Defense Business Operations Fund; and evaluate business performance.

Audit Objectives. The objective of the audit was to determine whether the Consolidated Statement of Financial Position and selected accounts on the Statement of Operations of the Defense Business Operations Fund for FY 1995 were presented fairly in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. In addition, we determined whether controls were adequate to ensure that the consolidated financial statements were free of material error. We also assessed compliance with laws and regulations for transactions and events that have a direct and material effect on the financial statements. Additionally, we followed up on conditions noted in previous audits of the Defense Business Operations Fund financial statements.

Disclaimer of Opinion. We were unable to render an opinion on the Consolidated Financial Statements of the Defense Business Operations Fund as of September 30, 1995. Our opinion was included in the published financial statements transmitted by the Under Secretary of Defense (Comptroller) to the Office of Management and Budget. See Appendix B for the financial statements and the audit opinion.

Internal Controls. The Defense Business Operations Fund's financial systems continue to lack a sound internal control structure. We were unable to use other audit tests and procedures to determine whether the account balances were fairly presented.

- Expenses were misstated because of a lack of standard general ledger accounts and incorrect translation of general ledger accounts to the financial statements.
- Sales transactions between activities were not eliminated correctly.
- Incorrect prior-period adjustments caused Expenses and Revenue to be understated.

- For Accounts Receivable, estimates were used in place of actual data, transactions were not posted correctly, receivables were not reported, and amounts were reported that were not owed.

- Liabilities and Accounts Payable were misstated because of system processing problems, misclassifications, use of estimates, improper reporting, and untimely processing of payments.

- For Property, Plant and Equipment, leases were not capitalized, assets were incorrectly reported and recorded, and depreciation charges were incorrect.

- For Cash Disbursements and Collections, lack of procedures resulted in billings that were not validated prior to payment.

- Revenue was misstated because of a lack of procedures for calculating revenue using the percentage-of-completion method.

- Four accounts (Material In-Transit to Supply, Automated Data Processing Software, Sales, and Purchases) could not be validated due to a lack of supporting documentation.

Part I. A. contains our report on internal controls.

Compliance with Laws and Regulations. Noncompliance with laws and regulations continues to be a significant issue for the Defense Business Operations Fund. Systems of accounting and internal controls do not completely or accurately disclose the financial position of the activities of the Defense Business Operations Fund as required by title 31, United States Code. We could not determine the range and magnitude of noncompliance with fiscal statutes.

We identified noncompliance with regulations in accounting systems; accounting estimates; cash reconciliation; inventory valuation; facilities, equipment, and software; and revenue recognition. Those instances of noncompliance materially affected the reliability of the Defense Business Operations Fund's financial statements. Part I. B. contains our report on compliance with laws and regulations. Part II, Appendix D, lists the laws and regulations we tested.

Summary of Recommendations. The supporting Service audit organizations made specific recommendations. Part II, Appendix E, lists those reports and gives details of the recommendations.

Related Reports. We will issue an update to our audit report, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994." We plan to report on some of the systemic issues that prevent auditors from issuing an audit opinion other than a disclaimer, and explain DoD progress in addressing the fundamental problems affecting the Defense Business Operations Fund.

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Part I - Audit Results

Audit Background

The Chief Financial Officers Act, as amended by the Federal Financial Management Act of 1994, requires annual audited financial statements for revolving funds such as the Defense Business Operations Fund (DBOF). The Under Secretary of Defense (Comptroller) (USD[C]) and the DBOF Corporate Board (the Corporate Board) oversee the DBOF, and the Military Departments and Defense agencies are responsible for management and operations. Preparation of the financial statements is the responsibility of the Defense Finance and Accounting Service (DFAS). The DoD Components and DFAS are jointly responsible for the information in the statements.

Disclaimer of Opinion. We were unable to render an opinion on the DBOF Consolidated Financial Statements for FY 1995. See Appendix B for the Financial Statements and Auditor Opinion.

Related Reports. We plan to issue a separate report focusing on the major deficiencies of the DBOF. That report will discuss the major obstacles in the development and use of the DBOF financial statements. We will also highlight DoD's progress in correcting fundamental problems in the DBOF internal control structure.

DBOF History. Congress created the DBOF on October 1, 1991, by combining DoD- and Service-owned revolving funds previously called the stock and industrial funds. Subsequently, the DFAS, the Defense Information Systems Agency, the Defense Commissary Agency, the Defense Technical Information Center, the U.S. Transportation Command, the Joint Logistics Systems Center, and a Defense Logistics Agency function (the Defense Reutilization and Marketing Service) were added to the DBOF. Part II, Appendix F, shows the reporting entities that make up the DBOF.

DBOF Purpose. The DBOF is intended to establish incentives to control resources more efficiently and provide improved financial management tools. DBOF activities should use those tools to identify the total costs of business operations that produce goods and services for customers. The DBOF management process was created to:

- foster a businesslike buyer-seller approach that enables customers to make economical buying decisions and forces sellers to become more cost-conscious;
- identify the full costs of items, measure performance on the basis of cost and output goals, and improve efficiency and productivity;
- consolidate cash control and reduce required cash balances; and
- provide timely and accurate information so that decisionmakers can measure business performance.

DBOF Corporate Board. The Corporate Board was established in 1993 to develop, review, and recommend DBOF policies and procedures; to review business areas for inclusion in or exclusion from the DBOF; and to evaluate business performance. The Corporate Board also reviews and recommends actions to improve the DBOF financial systems. In February 1994, the Corporate Board approved a two-phased migratory system strategy for the DBOF. The first phase is the interim phase, which consolidates DBOF accounting systems by components or business areas and converts key legacy systems to interim migratory systems. The second phase is the transition from interim systems to final migratory systems. During FY 1995, the Corporate Board issued several decision papers to establish additional guidance in DoD Regulation 7000.14-R, "DoD Financial Management Regulation."

DBOF Status Report. In March 1996, the Office of the USD(C) issued the "Defense Business Operations Fund Status Report." The report gives a detailed history of the implementation of the DBOF through FY 1995, discusses future plans for the DBOF, and describes actions that have been accomplished since 1993 to improve the implementation and operation of the DBOF. The report summarizes the major improvements in the DBOF as follows.

- Managers DoD-wide are aware of the total costs incurred to provide products and services to their customers, and customers are aware of the total costs of the services and products they request and receive.

- DoD has developed detailed functional and technical requirements for financial systems and has applied the requirements to the numerous DBOF financial systems. This effort will reduce the number of DBOF financial systems from more than 80 to approximately 17.

- The DoD Components and organizations in the Office of the Secretary of Defense are jointly developing standardized policies for DBOF business areas.

Although some improvements have been made in the DBOF, numerous problems still exist, as shown by the findings discussed in this report. For example, lack of policy and procedures and accounting system deficiencies continue to be widespread issues in the DBOF.

Audit Objectives

Our overall objective was to determine whether the Consolidated Statement of Financial Position and selected accounts on the Statement of Operations of the DBOF for FY 1995 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. Additional objectives were to evaluate internal controls and compliance with applicable laws and regulations, and to follow up on conditions noted in previous audits of the DBOF financial statements. Part I. A. contains our report on internal controls.

Audit Results

Part I. B. contains our report on compliance with laws and regulations. Part II, Appendix A, provides the scope and methodology, auditing standards, and accounting principles. Appendix A also discusses the Overview to the DBOF FY 1995 financial statements and assistance from the Service audit organizations.

**Part I. A. - Review of Internal Control
Structure**

Introduction

Audit Responsibilities. Our audit objective was to determine whether controls over transactions supporting the accounts in the FY 1995 DBOF Statement of Financial Position and selected accounts on the Statement of Operations were adequate to ensure that the accounts were free of material error. In planning and performing our audit of the DBOF accounts for the year ended September 30, 1995, we evaluated the internal control structure. Specifically, we:

- determined the auditing procedures necessary to express an opinion on the financial statements; and
- determined whether an internal control structure had been established.

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

Management Responsibilities. DBOF management is responsible for establishing and maintaining an internal control structure. In fulfilling that responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The Office of the USD(C) and the Corporate Board oversee the DBOF, and the Military Departments and Defense agencies are responsible for management and operations. The purpose of our review of the internal control structure was to render an opinion on the financial statements. The objectives of an internal control structure 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 consolidating statements, and are in compliance with any

other laws and regulations that the OMB, entity management, or the Inspector General (IG), DoD, have identified as being significant and for which compliance can be objectively measured and evaluated;

- data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information; and

- questions are answered as to whether performance measures existed and whether those performance measures were adequate to enable the fund to fulfill its purpose.

The three elements of the control structure are the control environment, accounting and related systems, and control procedures. The control environment is the collective effort 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 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 accounting and related systems, which management has established to provide reasonable assurance that specific objectives will be achieved.

Reportable Conditions

We attempted to examine the internal control structure of the DBOF for the year ended September 30, 1995. Our review of DBOF internal controls disclosed material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. We also identified conditions that we considered to be reportable under OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure 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 control structure 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, or material to a performance measure or aggregation of related performance measures, and would not be detected in a timely manner by employees in the normal course of performing their functions.

Review of Internal Control Structure

We classified the significant internal controls, policies, and procedures into the following categories: Expenses; Eliminating Entries; Prior-Period Adjustments; Accounts Receivable; Liabilities; Accounts Payable; Property, Plant and Equipment; Cash Disbursements and Collections; Revenue; and Supporting Documentation.

Table 1. summarizes the major internal control deficiencies reported by the Service auditors, and the corresponding impact on the FY 1995 DBOF Consolidated Financial Statements.

Table 1. Summary of Major Internal Control Deficiencies for the FY 1995 DBOF Consolidated Financial Statements

<u>Issue</u>	<u>Impact</u>
Expenses	Cost of Goods Sold was overstated by about \$3.1 billion. Other Expenses was understated by \$2.2 billion.
Eliminating Entries	Revenue and Cost of Goods Sold were overstated by \$848 million because of incorrect eliminating entries. Revenue was overstated by \$8.4 billion because intrafund sales were not eliminated.
Prior-Period Adjustments	Expenses was understated by \$358.9 million and Revenues was understated by \$45.6 million because prior-period adjustments were incorrectly included in the Statement of Operations.
Accounts Receivable	Accounts Receivable was understated by \$158.6 million and overstated by \$103.8 million.
Liabilities	Other Federal Liabilities was overstated by \$36.9 million and understated by \$17.9 million.
Accounts Payable	Accounts Payable, Federal, was understated by \$104.9 million and overstated by \$6 million. Accounts Payable, Non-Federal, was overstated by \$81.9 million and understated by \$14.4 million.
Property, Plant and Equipment	Property, Plant and Equipment was understated by \$1.3 billion. Differences of \$282 million were not reconciled.
Cash Disbursements and Collections	Disbursements of \$235 million were made without validating the accurateness or appropriateness of the billings.
Revenue	Contract Revenue was overstated by \$1.1 billion and Organic Revenue was overstated by \$11.4 million because revenue was not calculated properly using the percentage-of-completion method.
Lack of Supporting Documentation	Material In-Transit of \$193 million could not be validated, Equipment of \$220.6 million was not supported, and Sales of \$1 billion and Purchases of \$1.6 billion could not be validated.
<p>Note: This table combines the results of our review of several DBOF activities. The table illustrates only high-dollar problem areas and selected accounts that were tested. All accounts were not tested at each activity.</p>	

Conditions Noted in Each Area. Internal controls for the DBOF were not adequate. Material internal control weaknesses existed in each area we reviewed. 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 inadequacies in the internal control structure, we could not determine whether the amounts reflected all errors; therefore, we could not determine whether account balances were fair and reasonable. Specific material weaknesses in each area are as follows.

Review of Internal Control Structure

Expenses. The DFAS Indianapolis Center did not correctly calculate Cost of Goods Sold and Other Expenses. This condition occurred because the DFAS Indianapolis Center had not established the standard general ledger accounts necessary to properly account for and report inventory gains and losses. Additionally, the DFAS Indianapolis Center's report mapping¹ for the financial statements did not reduce Cost of Goods Sold for inventory losses that were not the result of sales, and did not include these losses in Other Expenses. As a result, the amount reported for Cost of Goods Sold was overstated by about \$3.1 billion, or 4.9 percent of the consolidated DBOF account. Also, Other Expenses was understated by about \$2.2 billion, or 25.8 percent of the consolidated DBOF account. The Army Audit Agency's recommendations included directing the DFAS Indianapolis Center to add explanatory footnotes, correctly report the lines in the computation of the Cost of Goods Sold, and update the report mapping for financial statements.

Eliminating Entries. Because of the process used by the DFAS Indianapolis Center to eliminate the value of sales transactions between wholesale and retail activities, the FY 1995 Statement of Operations for Supply Management, Army, was misleading. The data base that DFAS personnel used to identify and eliminate intrafund sales transactions (transactions between wholesale and retail activities) included only net sales (gross sales less materiel returns); as a result, DFAS eliminated a smaller amount than was necessary. Also, the DFAS Indianapolis Center did not have oversight of the correct amount of intrafund sales transactions that should be eliminated. The lack of oversight did not affect the overall results of the Statement of Operations; however, Revenue and Cost of Goods Sold were overstated by about \$848 million. Specifically, within the Cost of Goods Sold calculation, Purchases at Cost was overstated.

The Army Audit Agency recommended that the Director, DFAS Indianapolis Center, require the accounting offices to report gross sales; use the amounts reported to reduce revenue and purchases at cost for intrafund eliminations; and include a footnote to the financial statements explaining that intrafund transactions for Revenue from Sales and Services and Cost of Goods Sold were eliminated at net rather than gross amounts. The Army Audit Agency further recommended that the Director, DFAS Indianapolis Center, establish a subaccount to identify gross sales transactions between wholesale and retail activities when the DFAS Indianapolis Center converts from the Army general ledger to the standard general ledger; and use amounts in that subaccount to reduce revenues and purchases at cost for intrafund eliminations.

Neither the DFAS nor the Defense Logistics Agency eliminated the Defense Logistics Agency's sales to DBOF customers. According to accounting principles, revenue resulting from sales between an entity's segments should not affect the entity's consolidated financial statements, and should be eliminated when determining the amount of consolidated revenues. DFAS had not established procedures to eliminate intrafund revenues, and the Defense

¹The DFAS Indianapolis Center's report mapping is a process used to translate general ledger accounts to the appropriate line items on the financial statements.

Logistics Agency accepted the revenue amounts presented in the financial statements without questioning DFAS officials about the inclusion of those intrafund revenues. Because the Defense Logistics Agency's sales to DBOF entities were not eliminated, revenues on the FY 1995 DBOF Consolidated Financial Statements were overstated by at least \$8.4 billion, or 11 percent of the consolidated amount. The IG, DoD, recommended that the Director, DFAS Columbus Center, establish procedures to identify and eliminate applicable intrafund revenues from the FY 1996 financial statements. We also recommended that the Director, Defense Logistics Agency, implement procedures to review and evaluate account balances and financial presentations provided by DFAS to determine whether that information is reasonable, and notify DFAS when the financial statements appear to have material inaccuracies.

Prior-Period Adjustments. The overall operating results shown in the Army Statement of Operations were inaccurate. The financial statements for the Army Supply Management business area included results that were not part of FY 1995 operations. Specifically, Expenses were understated by \$358.9 million, and Revenue was understated by \$45.6 million. These understatements occurred when local accounting offices converted the Army general ledger accounts to standard general ledger accounts before sending the financial statement information to the DFAS Indianapolis Center. Visibility was lost over the prior-period amounts recorded in the Army general ledger; therefore, the DFAS Indianapolis Center did not adjust account balances to correctly report prior-period adjustments. The Army Audit Agency recommended that the Director, DFAS Indianapolis Center, require supply management accounting offices to report prior-period amounts in the Army general ledger accounts under Other Income and Other Expenses; make a correcting adjustment; include an explanatory footnote to the FY 1995 Statement of Operations; and update crosswalks.

Accounts Receivable. At the nine Navy activities reviewed, Accounts Receivable, Net, Federal, was understated by \$158.6 million and overstated by \$103.8 million. This condition occurred because of the use of estimates rather than actual data, incorrect posting of transactions, unreported accounts receivable, and incorrect reporting of receivables that were not owed. When accounts receivable are misstated, the Navy does not have accurate information on funds that will be received and may forecast cash requirements inaccurately. The Naval Audit Service recommended that the Director, DFAS, discontinue estimating sales and transferring unbillable Work in Process to Accounts Receivable, Net, Federal; and direct subordinate activities to perform the required quarterly reconciliations of Accounts Receivable, Net, Federal. The Naval Audit Service also recommended that the Assistant Secretary of the Navy direct Navy DBOF activities to maintain accounting records for Accounts Receivable, Net, Federal.

Liabilities. At the two Navy activities reviewed, the Other Federal (Intragovernmental) Liabilities account was overstated by \$36.9 million and understated by \$17.9 million. These conditions occurred because of systemic processing problems regarding liabilities in the Advance Return of Depot Level Repairable Carcasses account. Specifically, the Carcass Tracking System did not always receive or recognize transactions. A carcass is a depot-level

Review of Internal Control Structure

repairable item that is unserviceable and has been sent to a supply management activity. Overstated liabilities cause funds to be unnecessarily set aside to pay nonexistent liabilities. The Naval Audit Service recommended that the Assistant Secretary of the Navy direct the Naval Supply Systems Command to establish more comprehensive procedures to have Naval Inventory Control Point Offices review the account balance in Advance Return of Depot Level Repairable Carcasses for validity.

Accounts Payable. At the 10 Navy activities reviewed, Accounts Payable, Federal, was understated by \$104.9 million and overstated by \$6 million. Understatements occurred because of the lack of a subsidiary account, failure to report, improper reconciliation, misclassification, inappropriate use of estimates, and recording in the incorrect year. Overstatements occurred because of failure to make adjustments, bookkeeping and input errors, and misclassification. The Naval Audit Service recommended that the Director, DFAS, direct subordinate activities to comply with the requirement to properly reconcile Accounts Payable, Federal, and to periodically review Accounts Payable, Federal, to ensure that all valid liabilities are recorded and reported.

At the 10 Navy activities reviewed, Accounts Payable, Non-Federal, was overstated by \$81.9 million and understated by \$14.4 million. This condition occurred because of untimely processing of payments and liabilities, misclassification of transactions, inadequate records, and accounting system deficiencies. The Naval Audit Service recommended that the Assistant Secretary of the Navy (Financial Management and Comptroller) require Navy DBOF activities to maintain supporting documentation and ensure that liabilities are recorded in the correct accounting period; and that the Director, DFAS, periodically reconcile the Accounts Payable, Non-Federal, balances.

Property, Plant and Equipment. Failure to capitalize leases, incorrect reporting and recording of assets, and incorrect depreciation charges caused Navy DBOF activities' Property, Plant and Equipment, Net, at the 13 Navy activities reviewed, to be understated by \$1.3 billion, or 10.9 percent of the consolidated DBOF Property, Plant and Equipment account. The Naval Audit Service recommended that the Assistant Secretary of the Navy (Financial Management and Comptroller) direct DFAS to require the Military Sealift Command to capitalize leased assets that meet the DoD criteria for capitalization; direct the Navy DBOF activities to report Property, Plant and Equipment accurately and promptly; and direct the Navy DBOF activities to correctly charge depreciation for all Property, Plant and Equipment.

DFAS personnel did not properly reconcile \$282 million in differences between trial balance amounts and associated subsidiary records for equipment, facilities, and related depreciation. This condition occurred because DFAS personnel did not follow the required reconciliation procedures in the "DoD Financial Management Regulation." Further, DFAS managers did not provide adequate oversight to ensure compliance with reconciliation requirements. Unless the Air Force Materiel Command and DFAS provide additional resources and management attention in this area, it will continue to be a significant internal control weakness affecting the reliability and accuracy of account balances for

equipment and facilities. The Air Force Audit Agency recommended that the Director, DFAS, reemphasize the importance of reconciling trial balances to subsidiary records, and establish oversight procedures for compliance with reconciliation requirements.

Cash Disbursements and Collections. DFAS personnel disbursed at least \$235 million without validating the accuracy or appropriateness of Air Force Standard Form 1080 billings prior to payment. This condition occurred because the Air Force Materiel Command did not develop and implement automated procedures or implement manual processes to verify the receipt of items billed. DFAS personnel were aware of the requirement to validate the billings, but said that verification was not practical because of the large volume of transactions and the staffing levels. The lack of internal controls over disbursements may result in losses if a billing includes items not received or credits for material returns not received. The Air Force Audit Agency recommended developing and implementing automated and interim procedures to compare material receipts of the Depot Maintenance Service Business Area to Supply Management billings.

Revenue. DFAS activities did not properly measure Contract Maintenance Revenue and Organic Revenue included in financial reports of the Depot Maintenance Business Area. This condition occurred because DFAS had not established procedures and data sources to calculate revenue properly using the percentage-of-completion method. As a result, Contract Revenue was overstated by at least \$1.1 billion for the current and prior fiscal years, and Organic Revenue was overstated by \$11.4 million. The Air Force Audit Agency recommended that the Director, DFAS, establish procedures and identify the data sources that local DFAS activities should use to record Organic Revenues, based on proper calculation of revenues using the percentage-of-completion method; direct DFAS activities to adjust revenue data posted to the general ledger revenue accounts to reflect only those revenues that are funded on customer orders; and modify the Depot Maintenance Production Cost System to give DFAS personnel the information necessary to make proper percentage-of-completion revenue calculations by customer order. Revenue recognition is discussed further in the "Compliance With Laws and Regulations" section of this report.

Supporting Documentation. The Air Force Materiel Command did not have sufficient accounting records to determine whether \$193 million of the Material In-Transit to Supply account actually existed. This condition occurred because personnel at the Air Force Materiel Command did not establish a subsidiary ledger to identify and account for specific items shipped by contractors but not received. Also, they did not resolve outstanding returns promptly, and financial systems did not correctly process material returns from contractors. The Air Force Audit Agency recommended that the Air Force Materiel Command, Director, Financial Management and Comptroller, establish a subsidiary ledger for the Material In-Transit to Supply account, and emphasize that production management specialists need to promptly resolve outstanding Government Furnished Material In-Transit balances.

Review of Internal Control Structure

Personnel at the Air Force Materiel Command and DFAS did not comply with accounting regulations for proper documentation, recording, and depreciation of ADP software and hardware. This condition occurred because Air Force Materiel Command personnel did not know they were responsible for retaining supporting documentation for capitalized software and hardware; were not aware of the appropriate general ledger accounts to record ADP assets and associated amortization; and believed they had received direction from the Assistant Secretary of the Air Force (Financial Management and Comptroller) to use 10 years for depreciation rather than the required 5 years. As a result, management could not verify either the accuracy of \$220.6 million of ADP software and hardware costs or approval of the method used to compute accumulated depreciation. The Air Force Audit Agency recommended that the Air Force Materiel Command retain supporting documentation for all trial balance accounts; use the appropriate general ledger account codes to record software and the related amortization costs; and adhere to DBOF depreciation policy by establishing a 5-year useful life for ADP software and hardware used by supply management, or request a waiver from the DBOF Corporate Board.

The Air Force Stock Control and Distribution System Program Office did not maintain current documentation for the Financial Inventory Accounting and Billing System that detailed system criteria for assigning indicator values to document identifiers. This condition occurred because neither the Stock Control and Distribution System Program Office nor the DFAS representative to the program officer placed sufficient emphasis on maintaining a current matrix that cross-indexed transactions to general ledger accounts, as required in the "DoD Financial Management Regulation." As a result, the Air Force Audit Agency could not validate balances of \$1 billion in sales and \$1.6 billion in purchases. The Air Force Audit Agency had reported this condition previously, and the Air Force Materiel Command had developed a complete and current transaction matrix that was cross-indexed to general ledger accounts. However, DFAS personnel had not input all data required for the matrix. The Air Force Audit Agency recommended that the Director, DFAS, develop and maintain the matrix of cross-indexed transactions to general ledger account codes as required by the "DoD Financial Management Regulation."

Summary. DBOF internal controls still need considerable improvement. Weaknesses stem from a lack of policies and procedures; the improper recording and reporting of transactions; deficiencies in automated systems; the improper use of estimates to report actual accounting activity; the lack of standard general ledger accounts; improper eliminating entries; incorrect prior-period adjustments; and a lack of supporting documentation. The IG, DoD, and the Service audit organizations have reported these conditions since the establishment of the DBOF. The USD(C) continues to recognize the extent of procedural deficiencies in DoD accounting and financial systems and has cited his concerns in the management representation letter to the auditors (Appendix G). The candor of that representation letter is noteworthy. The DBOF will continue to have significant problems until the DBOF Corporate Board standardizes the accounting systems and provides guidance that all DBOF activities can implement.

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

Introduction

We evaluated the DBOF for material instances of noncompliance with laws and regulations for the year ended September 30, 1995. Our audit objective was to assess compliance with laws and regulations for those transactions and events that have a direct and material effect on the financial statements. Such tests are required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We reviewed compliance with laws and regulations to obtain reasonable assurance that the financial statements were free of material misstatements; we are not rendering an opinion on compliance with such provisions. See Part II, Appendix D, for a list of the laws and regulations we reviewed.

The Deputy Secretary of Defense; the USD(C); the Secretaries of the Military Departments; the directors of affiliated DoD agencies; and the Director, DFAS, are responsible for ensuring compliance with laws and regulations applicable to the DBOF. As part of obtaining reasonable assurance on whether the Principal Statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements, and with other laws and regulations designated by the OMB and the DoD.

Since FY 1992, the USD(C) has updated sections of DoD Manual 7220.9-M, the "DoD Accounting Manual," as amended June 17, 1991, and has incorporated those sections into new volumes of the "DoD Financial Management Regulation." The USD(C) had issued 11 completed volumes as of April 1996 and plans to issue 4 additional volumes by August 1996. The "DoD Financial Management Regulation," when completed, will serve as the single DoD-wide financial management regulation. All DoD Components will use it for accounting, budgeting, finance, and financial management education and training.

Reportable Conditions

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 failures is either material to the financial statements, or the sensitivity of the matter would cause others to perceive it as significant.

We were unable to accomplish all tests necessary to determine compliance with laws and regulations. Weak internal controls and lack of audit trails for transactions prevented us from obtaining sufficient information to fulfill this objective.

Review of Compliance With Laws and Regulations

Table 2. illustrates the major instances of noncompliance with laws and regulations, and the corresponding dollar effect (if any) on the FY 1995 DBOF Consolidated Financial Statements.

Table 2. Major Instances of Noncompliance With Laws and Regulations for the FY 1995 DBOF Consolidated Financial Statements

<u>Compliance Issue</u>	<u>Impact</u>
Accounting Systems	Inaccurate and unreliable data.
Use of Accounting Estimates	Fund Balance With Treasury was overstated by \$150.3 million. Potential Antideficiency Act violation.
Cash Reconciliation	Collections were potentially understated by \$1.3 billion. Disbursements were potentially understated by \$1 billion. Potential Antideficiency Act violation.
Facilities, Equipment, and Software Reporting	Facilities were understated by \$83 million. Equipment was understated by \$366 million. Computer Software was understated by \$330 million. Automated Data Processing Software was understated by \$396 million. Accumulated Amortization of Automated Data Processing Software was understated by \$292 million.
Revenue Recognition	Revenue was understated by \$111 million.

Noncompliance With Laws. The systems of accounting and internal controls for the DBOF do not completely or accurately disclose the financial position of the DBOF activities as required by title 31, United States Code. Because of inadequacies in the DBOF internal control structure and accounting systems, there is no assurance that transactions are accurately and reliably accounted and reported for. We were unable to determine, through audit tests and procedures, the range and magnitude of noncompliance with fiscal statutes. Lack of supporting documentation and inadequate or nonexistent audit trails continue to hamper effective oversight. We are working with the USD(C) to establish integrated accounting systems and improve internal controls to ensure reasonable compliance with fiscal statutes and regulations.

Noncompliance With Regulations. Widespread noncompliance with regulations materially affected the reliability of the DBOF financial statements. We were unable to determine, through audit tests and procedures, the range and magnitude of noncompliance with the regulations identified in Part II, Appendix D, of this report.

Accounting Systems. Problems with accounting systems have continued to plague the DBOF financial statements since the DBOF was established in FY 1992. The systems have been and are noncompliant with OMB and DoD regulations. OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, requires that accounting systems interface with logistical systems and meet other requirements such as system documentation,

Review of Compliance With Laws and Regulations

audit trails, and general ledger controls. The DFAS Annual Statement of Assurance for FY 1995 reported that 249 DoD systems met the OMB definition of a financial management system. However, DFAS recognizes that most of the 249 financial management systems do not meet the requirements of OMB Circular No. A-127. Until the DBOF systems can meet these requirements, the financial data generated by the systems, including the yearend financial statements, cannot be relied on. DFAS also recognized the problems with the DBOF financial systems as a material weakness in the DFAS Annual Statement of Assurance for FY 1995, stating, "DBOF execution reports are so inaccurate, untimely, incomplete, and inconsistent that the Department is unable to effectively manage the Fund." DFAS has set a target completion date of FY 2000 to modify the systems.

The U.S. Government Standard General Ledger still has not been incorporated into the DBOF accounting systems. The "DoD Financial Management Regulation," Volume 1, May 1993, requires DoD accounting systems to use the standard general ledger chart of accounts. DBOF activities used at least seven different general ledger structures in FY 1995. When several general ledger structures are used, the DBOF activities must use crosswalks to transfer the data from the component-unique accounts to the U.S. Standard General Ledger. The lack of a standard general ledger for the DBOF accounting systems increases both the potential for errors in the financial statements and the effort required to prepare and audit the financial statements.

Accounting Estimates. The Navy used estimates instead of actual figures for collections from sales, causing an overstatement of \$150.3 million in the Fund Balance With Treasury account. The Navy had developed the estimating process to overcome timing and processing problems at the end of the reporting period. The "DoD Financial Management Regulation," Volume 11B, December 1994, requires that financial transactions be adequately supported with source records and pertinent documents, and prohibits estimates on the Statement of Accountability. Both the DFAS Cleveland Center and the USD(C) have issued memorandums stating that the practice of estimating sales collections should be eliminated. The Assistant Secretary of the Navy (Financial Management and Comptroller), in a memorandum issued on March 5, 1996, stated that estimating collections from sales is inappropriate, but that the necessary procedures and controls to eliminate this practice will not be in place until late FY 1996.

The Navy may have violated the Antideficiency Act because it used sales collection estimates. As of August 31, 1995 the Fund Balance With Treasury account was overstated by \$129.4 million, and as of December 31, 1995, the Fund Balance With Treasury account was overstated by \$148.6 million. If actual collection figures had been used, the Fund Balance With Treasury account would have had negative balances of \$89.5 million and \$65.6 million, respectively, for those dates. The negative balances may have violated the Antideficiency Act. This potential violation was referred to the Assistant Secretary of the Navy (Financial Management and Comptroller) for review.

Cash Reconciliation. Collections and Disbursements reported on the Navy DBOF financial statements did not agree with individual DBOF activities' records, even after cash reconciliations were performed. The financial statements report collections of \$24.0 billion and disbursements of \$23.2 billion. These amounts represent the collections and disbursements that were processed through the Navy's finance network. Preparers of the Navy's financial statements only used information processed through the Navy finance network, but activities' records included additional information that had not yet been processed through the network. Also, DFAS did not provide activities with all data processed through the finance network. Individual activities reported an additional \$1.3 billion in collections and \$1 billion in disbursements. Failure to match financial statements and activity records could result in cash management problems and potential Antideficiency Act violations. The Naval Audit Service recommended that DFAS provide Navy DBOF activities with data on all collections and disbursements reported in the finance network. The Naval Audit Service also recommended that future directives require all Navy activities to reconcile collections and disbursements to the amounts reported in the finance network and post these reconciled items to the records.

Inventory Valuation. The DFAS Cleveland Center did not establish an allowance account for Inventory Holding Gains and Losses in calculating the Inventory, Net, account as required by the "DoD Financial Management Regulation," Volume 11B. The "DoD Financial Management Regulation" requires that inventory be reported on the financial statements at the latest acquisition cost, minus an Allowance for Unrealized Holding Gains and Losses account. The Navy used an alternate method to calculate that amount for the financial statements. The Navy recommended that DFAS create and use an Allowance for Inventory Holding Gains and Losses account.

Facilities, Equipment, and Software. The Air Force Materiel Command and depot maintenance activities did not report facilities, equipment, and computer software in accordance with the "DoD Financial Management Regulation," Volume 11B. DFAS personnel interpreted the policy differently and implemented inconsistent accounting procedures. As a result, DFAS activities understated facilities by \$83 million, equipment by \$366 million, and computer software by \$330 million. In June 1995, DFAS issued accounting procedures that included specific entries for the Invested Capital Used account; however, the depot maintenance activities did not fully implement these procedures. The Air Force Audit Agency stated that these procedures appeared adequate and that they will review the procedures during their FY 1996 audit. The Air Force Audit Agency recommended that the Air Force Materiel Command reemphasize the DoD policy of reporting equipment financed by resources other than DBOF. The Air Force Audit Agency also recommended that the Air Force Materiel Command establish procedures for identifying and capitalizing the value of computer software that depot maintenance activities used before the DBOF was established, and maintain a complete inventory of computer software.

Air Force Materiel Command and DFAS personnel did not capitalize and record the value of automated data processing (ADP) software for the Supply

Review of Compliance With Laws and Regulations

Management business area, as required by the "DoD Financial Management Regulation," Volume 11B. DFAS had not developed procedures to establish the value of existing software, and the Air Force Materiel Command did not develop procedures to obtain the complete value for ADP systems that progressed from development to operations. As a result, ADP software was materially understated by \$396 million and associated depreciation on the software was understated by \$292 million. The Air Force Audit Agency recommended that the Director, DFAS, establish procedures for capitalizing existing ADP software; and that the Director, Financial Management and Comptroller, Air Force Materiel Command, establish procedures to capitalize and record the value of ADP software expenditures that meet the DBOF criteria for capitalization.

Revenue Recognition. The Air Force took exception to the DoD revenue recognition policy, stating that in certain cases, revenue and expenses were not correctly matched to the appropriate fiscal year. The Air Force Depot Maintenance Business Area deferred recognition of at least \$109.5 million in revenue and \$180.3 million in expenses from FY 1994 to 1995, in accordance with the "DoD Financial Management Regulation." Because the Air Force used the completed-order method, revenues and expenses were not matched to the appropriate fiscal year. The "DoD Financial Management Regulation" requires that depot maintenance activities use the completed-order method to recognize revenue for customer orders with an estimated value of less than \$1 million or a planned production cycle of less than 1 year. With this method, activities recognize all revenue and expenses when a customer's order is completed. When work on an order occurs in more than one fiscal year, under the completed-order method, all revenue and expenses are recognized in the fiscal year that the order was completed, although some revenues may have been earned in the prior fiscal year and some expenses may have been incurred in the prior fiscal year. The Air Force Audit Agency recommended that the Director, DFAS, request that the USD(C) revise the "DoD Financial Management Regulation" to require that all customer orders use the percentage-of-completion method.

The Army Audit Agency also took exception to the DoD policy on revenue recognition, which requires the use of the completed-order method. The Army's Standard Industrial Fund System was designed to report revenue when individual units are completed (the completed-unit method, which is a form of the percentage-of-completion method). Under the completed-unit method, customer orders are divided into units, and revenue is recognized at the completion of each unit. As a result of using the completed-order method, four Army depots did not recognize revenues of \$111 million for work completed in FY 1995. Army Audit Agency officials recommend the use of the completed-unit method because, like Air Force Audit Agency officials, they do not believe that the completed-order method matches revenues to the appropriate fiscal years. The Army Audit Agency recommended that the USD(C) reconsider his position and allow the Army to use the completed-unit method.

Summary. Noncompliance with laws and regulations continues to be a major concern for the DBOF. Noncompliance issues include incomplete and inaccurate disclosure of the DBOF financial position; inadequate accounting

Review of Compliance With Laws and Regulations

systems; the use of accounting estimates; potential Antideficiency Act violations resulting from accounting estimates and inadequate cash reconciliations; incorrect valuation of inventory; incorrect reporting of facilities, equipment, and software; and improper recognition of revenue. Many of these problems have been reported by the IG, DoD, and the Service audit organizations in previous reports on the DBOF, and will continue unless corrective action is taken.

Part II - Additional Information

Appendix A. Scope and Methodology

Statements Reviewed. We examined the Consolidated Statement of Financial Position and selected accounts on the Statement of Operations contained in the Annual Financial Statements of the DBOF for the year ended September 30, 1995. The DBOF Consolidated Financial Statements were submitted to us on March 19, 1996.

We did not examine all business entities of the DBOF. The excluded entities represent approximately \$18.5 billion (19.8 percent) of the \$93.5 billion of total DBOF assets. Generally accepted auditing standards require us to consider materiality and audit risk as part of our overall audit work. We do not believe that examining the excluded entities would have affected our disclaimer of opinion. See Part II, Appendix E, "Summary of Work Performed by Others," for a list of the entities we examined.

To fulfill our responsibility to express an opinion on the DBOF Consolidated Financial Statements, we coordinated our audit efforts with the Service audit organizations (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.

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 GAO and on our professional judgment.

Accounting Principles. Accounting principles and standards for the Federal Government are under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the principals of the Joint Financial Management Improvement Program (JFMIP), who are the Director, OMB; the Secretary of the Treasury; and the Comptroller General. The Director, OMB, and the Comptroller General issue standards agreed on by those officials. To date, five accounting standards and two accounting concepts have been published in final form, and three accounting standards have been published in draft form. See Table 1 for a list of the accounting standards and concepts.

Table 1. OMB Statements of Federal Financial Accounting Standards and Concepts

<u>Number</u>	<u>Title</u>	<u>Status</u>	<u>Date</u>
Standard No. 1	Accounting for Selected Assets and Liabilities	Final	March 30, 1993
Standard No. 2	Accounting for Direct Loans and Loan Guarantees	Final	August 23, 1993
Standard No. 3	Accounting for Inventory and Related Property	Final	October 27, 1993
Standard No. 4	Managerial Cost Accounting Concepts and Standards for the Federal Government	Final	July 31, 1995
Standard No. 5	Accounting for Liabilities of the Federal Government	Final	September 1995
Concept No. 1	Objectives of Federal Financial Reporting	Final	September 2, 1993
Concept No. 2	Entity and Display	Final	June 6, 1995
TBD	Accounting for Property, Plant and Equipment	Draft	February 28, 1995
TBD	Accounting for Revenue and Other Financing Sources	Draft	July 1995
TBD	Supplementary Stewardship Reporting	Draft	August 1995

Until all aspects of financial statement reporting are governed by accounting standards that will constitute "generally accepted accounting principles for the Federal Government," agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. The hierarchy constitutes an "other comprehensive basis of accounting" to be used for preparing Federal agencies' financial statements. A summary of the hierarchy defined and approved by the JFMIP Principals follows:

- standards agreed to and published by the JFMIP Principals,
- form and content requirements of the OMB,
- accounting standards in agency guidance, and
- accounting principles published by other authoritative sources.

Because only five accounting standards and two accounting concepts have been published by the JFMIP Principals, most accounting standards for the "other

Appendix A. Scope and Methodology

comprehensive basis of accounting" used by DoD, are in DoD accounting guidance. Previously, DoD Manual 7220.9-M, the "DoD Accounting Manual," was the primary DoD accounting guidance. Since FY 1992, the USD(C) has updated sections of the "DoD Accounting Manual," and has incorporated those sections into new volumes of the "DoD Financial Management Regulation." The USD(C) had issued 11 completed volumes as of April 1996 and plans to issue 4 additional volumes by August 1996. The "DoD Financial Management Regulation," when completed, will be the single DoD-wide regulation that all DoD Components will use for accounting, budgeting, finance, and education and training for financial management. In the interim, unless superseded by published Federal accounting standards or OMB requirements, the policy in the "DoD Accounting Manual" or in the "DoD Financial Management Regulation," as applicable, is the authoritative basis for preparing financial statements in accordance with an "other comprehensive basis of accounting."

Performance Measures. Performance measures have not been developed for the DBOF Consolidated Financial Statements, and are not required by "DoD Guidance on Form and Content of Financial Statements for FY 1994 and FY 1995 Financial Activity," October 20, 1994; accordingly, none were included. Performance measures are objective indicators of program effectiveness and efficiency that are directly or indirectly tied to program results or outcomes. Performance measures have been created for the DoD Components, the Military Departments, and the Defense agencies. Reviews of performance measures are included in the audit reports for those entities. Until the information in the DBOF Consolidated Financial Statements fairly presents the financial position of the DBOF, use of performance measures at that level could be misleading.

Overview. We also reviewed the financial information in the Overview to the DBOF FY 1995 financial statements. We did not find any instances in which the information presented in the Overview was materially inconsistent with the information presented in the Principal Statements. That information has not been audited by us; accordingly, we are not expressing an opinion on that information.

Audit Assistance. We relied on audit assistance from the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency. See Part II, Appendix E, for specific areas and the scope of information reviewed by those audit organizations. The information in this report is a summary of the most significant deficiencies reported by the Service audit organizations. Refer to the Service audit reports and the IG, DoD, audit reports listed in Part II, Appendix E, for detailed explanations of the findings summarized in this report.

Scope of Review of Internal Controls. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements, including the accompanying notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statements. We reviewed internal controls related to the FY 1995 DBOF Consolidated Financial Statements.

Our previous audits disclosed an inadequate internal control structure, along with significant deficiencies in DBOF accounting systems. Because of these deficiencies, we could not rely on internal controls and could not render an opinion on the financial statements. This remains the basis for our disclaimer of opinion for FY 1995. Therefore, we revised our planned audit work to focus on reviewing internal controls in more detail.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions, and would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Scope of the Review of Compliance With Laws and Regulations. Compliance with laws and regulations is the responsibility of the DBOF managers. As part of our examination to obtain reasonable assurance that the DBOF Consolidated Financial Statements were free of material misstatements, we performed tests of compliance with laws and regulations that may directly affect the financial statements and other laws and regulations designated by the OMB and DoD. See Part II, Appendix D, for a list of laws and regulations reviewed.

We did not review management's implementation of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, because of the lack of a sound internal control structure within the DBOF. We revised our audit approach to focus on specific internal controls.

Computer-Processed Data. Based on the audit work performed by the Service audit organizations and the IG, DoD, we concluded that computer-processed data were not completely reliable. For evaluations of the DBOF entities' computer-processed data, refer to the reports of the Service audit organizations listed in Part II, Appendix E.

Time Period and Locations. We conducted the audit from January 1995 to March 1996 at various DBOF offices, including offices of the DFAS and of the Military Departments' business areas. Part II, Appendix H, lists the organizations we visited or contacted.

Representation Letters. We received a management representation letter from the USD(C), dated February 23, 1996, on the DBOF Consolidated Financial Statements. The letter cites major deficiencies in the accounting systems and the standard general ledger, as well as internal control weaknesses and compliance problems for many DBOF accounts. See Part II, Appendix G, for the management representation letter from the USD(C). We received a legal representation letter from the General Counsel, DoD, dated May 24, 1996. While the management representation letter was reasonably timely, the legal representation letter was much too late. This is a continuing problem that needs to be resolved.

**Appendix B. Financial Statements and Auditor
Opinion**

Defense Business Operations Fund

Chief Financial
Officer
Consolidated
Financial
Statement
FY 1995

March 1, 1996

DEFENSE BUSINESS OPERATIONS FUND

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Overview

***DEFENSE
BUSINESS
OPERATIONS
FUND***

OVERVIEW

Overview _____

Overview

DEFENSE BUSINESS OPERATIONS FUND OVERVIEW

Establishment of the Defense Business Operations Fund

The Defense Business Operations Fund (DBOF) was established in October 1991. The premise of DBOF was to provide a financial tool to assist in understanding and controlling the size and cost of defense support functions. The objective was to help maximize the availability of resources that directly support force readiness by more accurately defining support requirements and their costs.

The DBOF is a revolving fund financial structure that places funding in the hands of the customers of DBOF providers in lieu of appropriating funds directly to the providers. The ultimate DBOF customers are the operating forces. The customers request the amount and level of products and services they require from the DBOF providers, and reimburse the providers for the total cost associated with the products and services received. In this process, DBOF providers sometimes become customers of other DBOF providers. These customer-provider relationships serve to discipline both the customers' demands for support and the providers' decisions that affect the cost of providing the support.

The DBOF was established in Fiscal Year (FY) 1992 by consolidating nine separate stock and industrial funds managed by the DoD Components into a single revolving fund that was named the Defense Business Operations Fund. In addition to consolidating the nine revolving funds, a few Defense Agency support functions that were previously funded through direct appropriations were converted to DBOF funded management. Establishment of the single revolving fund account provided the best framework to standardize business processes and financial practices of similar business activities and reduce the overall level of working capital needed by the Department.

Although the DBOF consolidated nine revolving funds into a single account, it did not alter the operational control of the support activities operating under the account. The depot maintenance activities, inventory control points, and other revolving fund activities continue to be managed by the Military Department or Agency that controlled them prior to conversion to DBOF.

The DBOF was initially authorized by Section 316 of the National Defense Authorization Act for FY 1992 and FY 1993 (Pub. L. 102-190, 105 Stat. 1338). This legislation provided that working-capital funds established under Title 10 U.S.C. Section 2208 could be managed through the Defense Business Operations Fund. Prior to FY 1995, legislation imposed a year by year sunset clause on the DBOF, but the sunset clause was eliminated for FY 1995 and thereafter. In section 371 of the FY 1996 National Defense Authorization Act, Congress officially codified DBOF for the first time in section 2216 of title 10, United States Code.

Overview

Scope of Operations

DBOF business areas are listed below and detailed descriptions of each business area are provided in the Component financial statements:

Base Support	Information Services
Commissaries	Joint Logistics Systems Center
Corporate Account	Printing and Publications
Depot Maintenance	Research and Development
Distribution Depots	Reutilization and Marketing
Financial Operations	Supply Management
Industrial Plant Equipment	Transportation

In FY 1995, the total operating cost of DBOF support activities was approximately \$77 billion. In addition to these operating costs, FY 1995 capital costs, which include minor construction, software development, and procurement of equipment totaled approximately \$1.0 billion.

Total Cost Visibility and Full Cost Recovery

Two factors shaped the foundation from which DBOF was structured.

First, DBOF support providers must be given incentives to control and reduce operation costs. This requirement was accommodated by implementing standard business management techniques within DBOF and by making the total cost of providing support to the operating forces visible, both to the support providers and to the operating forces that request, use, and pay for the support.

- When the work of a support organization is managed from a total cost perspective, cost management goals useful to managers at all levels can be established, and budgets can be allocated to working level managers based on cost goals that are tied to their work outputs. This focus on costs related to specific outputs ensures that work activities are funded for the type and amount of outputs actually furnished to customers, rather than for a predetermined estimate of the amount, by type, of outputs that will be produced. This funding process, called unit cost resourcing, provides greater flexibility to accommodate workload changes that occur during the nearly 18 month interval between preparation and execution of annual budgets.

Overview

- The DBOF price development process requires that all direct, indirect, general and administrative, and capital depreciation costs be allocated appropriately to each product or service provided to DBOF customers. Given the need for full cost recovery from customers, the management of all elements of cost is a critical responsibility of

DBOF support providers. Total cost visibility and resourcing based on actual work output enables managers at all levels throughout the Department to gain a better understanding of what is required to furnish support functions and reduce overall operations costs.

Second, it has been difficult to define a suitable balance between the support infrastructure and the operating forces. Traditionally, most support activities were justified and operated independently from the operating forces. DBOF transfers to the customers the responsibility to define their support requirements and pay for the services and products received. When full cost recovery is required and management goals are based on cost control, customer satisfaction, and the quality and timeliness of the services and products provided, the inherent incentives will be to structure and size support infrastructure to meet the customers' needs, and to eliminate excess capacity and overhead. This relationship and dependency between DBOF customers and providers improves the balance between the support infrastructure and the operating forces and also helps answer the question of how much support is needed. When support providers have a clear picture of their total costs and require full recovery of those costs from customers, then total cost management becomes an essential role in DoD resource management by both providers and customers.

Capital Budgeting

A significant change instituted by DBOF was implementation of capital budgeting concepts that recognize the integral relationship between capital investments and daily operations.

Prior to DBOF, capital investments were usually funded through direct investment appropriations. A primary factor in determining whether a capital asset was purchased was the availability of investment funds based upon that capital asset's priority relative to other items funded in the same account. Generally, capital equipment required for the support establishment did not compete well for funds against major weapon system purchases.

When a purchased asset is placed in operation in a DBOF business area, the business depreciates the cost of the asset in the operating budget over a specified time period. The prorated depreciation costs are included in the unit cost prices to the business area's customers.

Overview

The budgeting of capital investment items is one of the most important areas for managerial decisionmaking since decisions effected today to make large capital investments will impact an activity's operations , and costs, for years to come. The magnitude of resources involved, the length of time needed to realize the return on the investment, and the overall impact on operation costs require sound analysis and judgment. DBOF provides managers improved cost data to assist in these analyses.

Stabilized Rates

DBOF rates, also known as unit cost prices, are established on a fiscal year basis and are set to recover the provider's estimated total cost of providing the products or services. In addition to the anticipated operating costs during the year of execution, the rates also include adjustments to offset financial gains or losses incurred by the business area during prior years. Gains or losses occur when costs incurred are lower or higher than the expected costs as reflected in the annual rates. The intent of gains and losses adjustments is to insure a business area's accumulated operating result breaks even over the long run.

The established rates are held constant during the year of budget execution, and resources are budgeted in the customers' appropriated fund accounts to pay the established rates. This stabilized rate policy protects appropriated fund customers from unforeseen cost changes and permits more effective management of resources by customers and providers alike.

Financial Systems

To fully achieve DBOF objectives, modern and standard finance and accounting systems are needed to:

- provide accurate, consistent, and timely automated information;
- accurately and efficiently record and account for DBOF financial transactions;
- satisfy Chief Financial Officer Act requirements; and
- link cost with performance effectiveness.

The many, disparate, and unlinked financial systems inherited to support DBOF activities were not designed to fully support these requirements. To accomplish these goals, major system improvements are needed. It will be difficult and costly to correct current system shortcomings and will require modernization of financial, as well as functional, systems.

Overview

In 1994, 80 financial systems were identified as being used in DBOF business areas. Subsequently, the DBOF Corporate Board established a policy that a maximum of one interim migratory financial system would be selected initially for each business area within a Component. Evaluation of candidate systems was accomplished by teams that were chaired by the Defense Finance and Accounting Service and included members from the Components. As a result of the detailed system evaluations 14 systems were identified as interim migratory systems, and cost analyses on enhancing and deploying these systems were developed in 1995. More extensive economic analyses are being conducted in the Depot Maintenance and Transportation business areas to assist in selecting the interim migratory systems. In addition, commercial off-the-shelf systems are being competitively solicited for the Navy Public Works Center and Printing and Publication business areas.

Enhancement and deployment of the selected interim migratory systems and elimination of the more than 60 legacy (nonselected) systems began in 1995, but these essential efforts will increase substantially during 1996.

Continuing DBOF Improvements

Establishment and implementation of the Defense Business Operations Fund in October 1991 was merely a continuation of a long history of applying revolving fund concepts within the Department. However, as occurs with most changes and implementations of new programs, problems arose, or were perceived, during the first years of DBOF implementation. During 1993 and 1994, these problems were thoroughly identified, reviewed and addressed. As a result of this analysis and subsequent actions, the senior Department leadership strongly endorsed the DBOF concept. DBOF policies and business practices continue to receive high-level review and oversight through the operations of the DBOF Corporate Board. The Board consists of senior representatives from the Military Services, Defense Agencies, several Office of Secretary of Defense organizations, and representatives from Office of Inspector General, Defense Finance and Accounting Service, and Office of Management and Budget.

In 1995, application of the DBOF concepts and operation of the Fund became the normal mode of business for DBOF providers and customers, and the benefits of the fund became more obvious. In spite of inflation and rising wage rates, DBOF operating costs have declined, and DBOF rates to customers will average about 4% lower in FY 1996 than in FY 1995. In conjunction with the Department's overall drawdown of military and civilian personnel, the staffing in DBOF support activities decreased more than 20 % between FY 1993 and FY 1995, and will continue to decrease in FY 1996.

Overview _____

Conclusion

The Defense Business Operations Fund concept of financial operations has become entrenched in the Department's daily business operations, and is providing managers at all levels valuable resource information that is resulting in lower support costs to the operating forces.

Although reducing the number of financial systems used in DBOF business areas and enhancing the remaining systems will require ongoing efforts and expense for several years, significant progress has been accomplished in selecting the systems to be retained and scheduling the enhancement and deployment of the selected systems.

Refinements and improvement of DBOF policies and operating practices will continue to be pursued in FY 1996 through the joint efforts of the DBOF activities, the DBOF Corporate Board, the Defense Finance and Accounting Service, and the affected organizations in the Office of Secretary of Defense.

Principal Statements

***DEFENSE BUSINESS
OPERATIONS FUND***

***CONSOLIDATED
PRINICIPAL STATEMENTS***

Principal Statements _____

Appendix B. Financial Statements and Auditor Opinion

	Principal	Statements
<p>DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND STATEMENT OF FINANCIAL POSITION AS OF 30 SEPTEMBER 1995 (\$ IN THOUSANDS)</p>		
	<u>FY 95</u>	<u>FY 94</u>
	<u>TOTAL</u>	<u>TOTAL</u>
ASSETS		
1. Entity Assets:		
a. Transactions With Federal (Intragovernmental)		
Entities:		
(1) Fund Balance With Treasury	4,656,849	2,459,234
(a) Funds Collected	72,572,249	75,626,810
(b) Funds Disbursed	(71,489,503)	(78,984,218)
(c) Funds With Treasury	3,574,103	5,816,642
(2) Investments, Net	0	0
(3) Accounts Receivable, Net	6,239,154	6,347,802
(4) Interest Receivable	0	0
(5) Advances and Prepayments	297,966	422,606
(6) Other Federal (Intragovernmental)	644,682	137
b. Transaction With Non-Federal (Governmental)	0	0
Entities:		
(1) Investments, Federal	0	0
(2) Accounts Receivable, Net	2,278,308	1,856,660
(3) Credit Program Receivables/Related Foreclosed Property, Net	0	0
(4) Interest Receivable, Net	57	44
(5) Advances and Prepayments	830,989	887,411
(6) Other Non-Federal (Governmental)	0	836
c. Cash and Other Monetary Assets	2	54
d. Inventory, Net	55,260,195	68,051,873
e. Work in Process	2,680,960	896,253
f. Operating Materials/Supplies, Net	1,501,927	1,407,036
g. Stockpile Materials, Net	4,780,335	6,280,263
h. Seized Property	0	0
i. Forfeited Property, Net	0	0
j. Goods Held Under Procurement Support and Stabilization Programs, Net	0	0
k. Property, Plant and Equipment, Net	11,948,382	11,168,529
l. Other Entity Asset	1,547,858	1,994,889
m. Total Entity Assets	<u>92,667,664</u>	<u>101,773,627</u>
2. Non-Entity Assets:		
a. Transactions With Federal (Intragovernmental)		
Entities:		
(1) Fund Balance with Treasury	18,290	0
(2) Accounts Receivable, Net	0	12,984
(3) Interest Receivable, Net	0	0
(4) Other	733,297	701,530
b. Transactions With Non-Federal (Governmental)		
Entities:		
(1) Accounts Receivable, Net	0	0
(2) Interest Receivable, Net	0	0
(3) Other	0	0
c. Cash and Other Monetary Assets	0	0
d. Other Non-Entity Assets	45,685	60,342
e. Total Non-Entity Assets	<u>797,272</u>	<u>774,836</u>
3. TOTAL ASSETS:	<u>93,464,936</u>	<u>102,548,463</u>

Appendix B. Financial Statements and Auditor Opinion

Principal Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF FINANCIAL POSITION
 AS OF 30 SEPTEMBER 1995
 (\$ IN THOUSANDS)

	FY 95 TOTAL	FY 94 TOTAL
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions With Federal (Intragovernmental)		
Entities:		
(1) Accounts Payable	3,115,657	1,949,227
(2) Interest Payable	0	0
(3) Debt	1,432,108	1,479,554
(4) Other Federal (Intragovernmental) Liabilities	7,282,783	6,153,781
b. Transactions With Non-Federal (Governmental)		
Entities:		
(1) Accounts Payable	3,526,745	2,920,924
(2) Accrued Payroll and Benefits	0	0
(a) Salaries and Wages	552,310	776,574
(b) Annual Accrued Leave	721,905	710,946
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	2	1
(4) Liabilities for Loan Guarantees	0	0
(5) Lease Liabilities	3,622	0
(6) Pensions and Other Actuarial Liabilities	469	0
(7) Other Non-Federal (Governmental) Liabilities	3,422,972	2,652,240
c. Total Liabilities Covered by Budgetary Resources:	<u>20,058,573</u>	<u>16,643,207</u>
5. Liabilities not Covered by Budget Resources:		
a. Transactions With Federal (Intragovernmental)		
Entities:		
(1) Accounts Payable	18,290	12,985
(2) Debt	0	0
(3) Other Federal (Intragovernmental) Liabilities	0	4,879
b. Transactions With Non-Federal (Governmental)		
Entities:		
(1) Accounts Payable	0	0
(2) Debt	0	0
(3) Lease Liabilities	0	0
(4) Pensions and Other Actuarial Liabilities	0	995
(5) Other Non-Federal (Governmental) Liabilities	190,014	588,959
c. Total Liabilities not Covered by Budgetary Resources	<u>208,304</u>	<u>407,818</u>
6. TOTAL LIABILITIES:	<u>20,266,877</u>	<u>17,051,025</u>
7. BALANCES:		
a. Unexpended Appropriations	7,455	7,455
b. Invested Capital	99,512,198	91,197,329
c. Cumulative Results of Operations	(20,963,206)	(6,671,212)
d. Other	(5,150,084)	1,316,847
e. Future Funding Requirements	(208,304)	(352,961)
f. Total Net Position	<u>73,198,059</u>	<u>85,497,458</u>
8. TOTAL LIABILITIES AND NET POSITION:	<u>93,464,936</u>	<u>102,548,483</u>

Appendix B. Financial Statements and Auditor Opinion

	Principal	Statements
DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND STATEMENT OF OPERATIONS (AND CHANGES IN NET POSITION) AS OF 30 SEPTEMBER 1995 (\$ IN THOUSANDS)		
	TOTAL FY 95 DBOF	TOTAL FY94 DBOF
REVENUES & FINANCING SOURCES		
1. Appropriated Capital Used	14,603	1,165,365
2. Revenues from Sales of Goods and Services		
a. To the Public	9,741,083	6,651,941
b. Intragovernmental	65,982,683	65,367,841
3. Interest & Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes	0	0
6. Other Revenues & Financing Sources	857,435	6,814,368
7. Less: Taxes & Receipts Transferred to the Treasury/Other Agny	0	0
8. Total Revenues & Financing Sources	<u>76,593,804</u>	<u>79,997,515</u>
EXPENSES		
9. Program or Operating Expenses (Note 3)	7,781,468	4,275,150
10. Cost of Goods Sold		
a. To the Public	7,315,277	6,454,090
b. Intragovernmental	55,823,923	69,197,896
11. Depreciation and Amortization	833,555	1,067,221
12. Bad Debts & Write-offs	23,463	17,263
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	14,514	6,671
14. Other Expenses	8,344,789	2,365,030
15. Total Expenses	<u>80,136,989</u>	<u>83,381,521</u>
16. Excess (Shortage) of revenues & Financing Sources over Total Expenses Before Extraordinary Items	(3,541,185)	(3,383,808)
17. Plus (Minus) Adjustments:	<u>(6,538,793)</u>	<u>(105,333)</u>
18. Excess (Shortage) of Revenues & Financing Sources over Total Expenses	<u>(10,079,978)</u>	<u>(3,489,141)</u>
19. Net Position, Beginning Balance, as Previously Stated	85,497,457	88,460,554
20. Adjustments	1,402,641	145,076
21. Net Position, Beginning Balance, as Restated	86,900,098	88,605,410
22. Excess (Shortage) of Revenues & Financing Sources Over Total Expenses	(10,079,978)	(3,489,141)
23. Plus (Minus) Non Operating Changes	(3,622,061)	381,189
24. Net Position, Ending Balance	<u>73,198,059</u>	<u>85,497,458</u>

Appendix B. Financial Statements and Auditor Opinion

Principal Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF CASH FLOWS
 AS OF 30 SEPTEMBER 1995
 (\$ IN THOUSANDS)

	FY 95 TOTAL	FY 94 TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES:		
1. Excess (Shortage) of Revenue & Financing Sources Over Total Expenses	(10,079,978)	(3,489,143)
ADJUSTMENTS AFFECTING CASH FLOW:		
2. Appropriations Capital Used	(14,603)	(1,163,363)
3. Decrease (Increase) in Accounts Receivable	620,753	201,416
4. Decrease (Increase) in Other Assets	10,326,451	8,533,394
5. Decrease (Increase) in Accounts Payable	1,253,805	(3,764,405)
6. Increase (Decrease) in Other Liabilities	1,108,321	(2,256,138)
7. Depreciation & Amortization	849,641	1,078,214
8. Other Unfunded Expenses	(171,027)	120,667
9. Other Adjustments	(1,246,466)	(1,468,350)
10. Total Adjustments	12,726,875	1,281,235
11. Net Cash Provided (Used) by Operating Activities	2,646,897	(2,207,908)
Cash Flows from Non-Operating Activities:		
12. Sale of Property, Plant and Equipment	9,069	0
13. Purchase of Property, Plant and Equipment	(505,392)	(1,188,277)
14. Sale of Securities	0	0
15. Purchase of Securities	0	0
16. Collection of Loans Receivable	0	0
17. Creation of Loans Receivable	0	0
18. Other Investing Cash Provided (Used)	0	30,024
19. Net Cash Provided (Used) by Non-Investing Activities	(496,323)	(1,158,253)
Cash Provided (Used) by Financial Activities		
20. Appropriations (Current Warrants)	177,732	1,102,295
21. Add:		
a. Restorations	0	7,455
b. Transfers of Cash from Others	4,826,102	3,359,495
22. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	4,956,838	3,291,041
23. Net Appropriations	46,996	1,178,204
24. Borrowing from the Public	0	0
25. Repayments on Loans to the Public	0	0
26. Borrowing from the Treasury & the Federal Financing Bank	0	0
27. Repayment on Loans from the Treasury & the Federal Financing Bank	0	(48,705)
28. Other Borrowing & Repayments	0	0
29. Net Cash Provided (Used) by Financing Activities	46,996	1,129,499
30. Net Cash Provided (Used) by Operating, Investing & Financing Activities	2,197,570	(2,236,662)
31. Fund Balance with Treasury, Cash & Foreign Currency, Beginning	2,459,287	4,695,949
32. Fund Balance with Treasury, Cash & Foreign Currency, Ending	4,656,837	2,459,287
Supplemental Disclosure of Cash Flow Information:		
33. Total Interest Paid	14,512	
Supplemental Schedule of Financing and Investing Activity:		
34. Property & Equipment Acquired Under Capital Lease Obligations	0	
35. Property Acquired Under Long-term Financing Arrangements	0	
36. Other Exchanges of Noncash Assets or Liabilities	1,387,797	

Footnotes

***DEFENSE BUSINESS
OPERATIONS FUND***

***FOOTNOTES TO THE
CONSOLIDATED
PRINCIPAL STATEMENTS***

Footnotes _____

Footnotes

DEFENSE BUSINESS OPERATIONS FUND
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

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

The establishment of the Fund did not change any previous organizational reporting structure or command authority relationship. The primary goal of implementing the Fund is to provide a business management structure that encourages managers and employees of DoD support organizations to provide quality products or services at the lowest cost. A major feature of this business management structure is increased emphasis on business operations. This business operations structure identifies each business area, the products or services, and the total cost of operations within that business area.

The DBOF Principal and Combining Statements represent the overall activity of DoD Components and business areas within DoD Components that were previously managed using industrial or stock funds and a few additional Defense Agency activities that also lend themselves to a business management mechanism. These DoD Components have prepared CFO Financial Statements and have reported as separate DBOF reporting entities. Notes to the Principal Statements were included in each of these separate CFO Financial Statements.

B. Accounting Standards

These financial statements are presented in accordance with the accounting and reporting standards presented in Office of Management and Budget Bulletin 94-01 and supplemented by accounting policies of the Office of the Secretary of Defense (OSD), the Department of Defense Financial Management Regulation (DoD 7000.14-R), and the Department of Defense Accounting Manual (7220.9-M). To the extent that accounting issues are not provided in the preceding, the Defense Business Operations Fund follows guidance promulgated by GAO, the Department of the Treasury, or the Federal Accounting Standards Advisory Board (FASAB), as appropriate.

C. Budgets and Budgetary Accounting

The Defense Business Operations Fund is financed through working capital revolving funds.

Footnotes

D. Basis of Accounting

The basis of accounting for the DoD Components is discussed in the DoD Component CFO Financial Statements. At the departmental level, transactions are recorded when they occur. Receipt of appropriations or transfers to or from the DBOF are recorded in the month in which they occur.

E. Revenues and Other Financing Sources

The DBOF receives congressional appropriations which are retained at the DBOF subnumbered account level. The revenues generated by sales of goods or services through a reimbursable order process are recorded and reported by the individual DoD Components.

F. Accounting for Intra-governmental Activities

Inter/intra-agency transactions and balances have, for the most part, not been eliminated in the Principal and Combining Statements because data elements resident in the DoD accounting systems have not been revised to identify those transactions within a department 97 (DoD) account. Sufficient detail information is not available in the standard DOD general ledger accounts to perform the elimination. No eliminations are reflected in the Combining Statements.

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

During FY 1995, the basis for reporting and controlling Funds with the U. S. Treasury was changed. The control of DBOF cash was transferred from the DoD departmental level to the Army, Navy, Air Force, and the Defense Logistics Agency (for all Defense Agencies). A limited amount of Funds with the U. S. Treasury was retained at the DoD departmental level. Five separate subnumbered accounts were established at the Treasury to reflect this change in DoD policy.

The FY 1995 DBOF Principal and Combining Statements present a full financial statement at the above Component level. The Business Fund cash account, general ledger accounts 1013 - Funds With Treasury, 1014 - Undistributed Collections and 1015 - Undistributed Disbursements, are held at the above Component level.

The FY 1994 DBOF Principal and Combining Statements present a full financial statement at the DoD level. The Business Fund cash account, general ledger accounts 1013 - Funds With Treasury, 1014 - Undistributed Collections and 1015 - Undistributed Disbursements, are held at the DoD level.

H. Equity

Equity for activities consists of invested capital, donated material, contributed fixed assets, and cumulative result of operations as presented in the DoD Component statements of financial position.

Footnotes

I. Comparative Data

Comparative data for FY 1995 and FY 1994 is presented. Both FY 1995 and FY 1994 columns contain audit adjustments

Note 2. Fund Balance with Treasury

The total DBOF Fund Balance with Treasury is \$4,656,850,000 and \$2,459,233,000 for FY 1995 and FY 1994, respectively. Fund Balance with Treasury represents cumulative transactions recorded for the DBOF since inception.

Footnotes _____

Combining Statements

***DEFENSE BUSINESS
OPERATIONS FUND***

***MAJOR
DEFENSE
DEPARTMENTS***

***COMBINING
STATEMENTS***

Combining Statements _____

Combining Statements							
DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE							
REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND							
STATEMENT OF FINANCIAL POSITION							
AS OF 30 SEPTEMBER 1995							
(\$ IN THOUSANDS)							
	DEPARTMENTAL	ARMY	NAVY	AIR FORCE	OSD CORP ACCT	DEFENSE AGENCIES	TOTAL
ASSETS							
1. Entity Assets:							
a. Transactions With Federal (Intragovernmental) Entities:							
(1) Fund Balance With Treasury	0	560,050	1,609,230	545,312	123,667	1,818,591	4,656,850
(a) Funds Collected	0	7,132,746	23,978,280	13,498,128	(13,352)	27,976,447	72,572,249
(b) Funds Disbursed	0	(6,758,433)	(23,160,498)	(13,099,555)	(210,536)	(28,260,480)	(71,489,502)
(c) Funds With Treasury	0	185,737	791,418	146,739	347,555	2,102,624	3,574,103
(2) Investments, Net	0	0	0	0	0	0	0
(3) Accounts Receivable, Net	0	206,103	2,508,136	653,404	13,352	2,858,159	6,239,154
(4) Interest Receivable	0	0	0	0	0	0	0
(5) Advances and Prepayments	0	15,892	145,297	116,735	0	20,042	297,966
(6) Other Federal (Intragovernmental)	0	0	0	619,697	0	24,985	644,682
b. Transaction With Non-Federal (Governmental) Entities:							
(1) Investments, Federal	0	0	0	0	0	0	0
(2) Accounts Receivable, Net	0	37,273	1,565,404	107,382	0	568,249	2,278,308
(3) Credit Program Receivables/Related Foreclosed Property, Net	0	0	0	0	0	0	0
(4) Interest Receivable, Net	0	0	57	0	0	0	57
(5) Advances and Prepayments	0	194,210	372,997	37,670	0	226,112	830,989
(6) Other Non-Federal (Governmental)	0	0	0	0	0	0	0
c. Cash and Other Monetary Assets	0	0	0	2	0	0	2
d. Inventory, Net	0	7,766,749	12,973,009	26,127,856	0	8,392,581	55,260,195
e. Work in Process	0	332,188	1,663,706	682,559	0	2,507	2,680,960
f. Operating Materials/Supplies, Net	0	130,363	702,536	628,323	0	40,705	1,501,927
g. Stockpile Materials, Net	0	2,372,874	152,855	784,254	0	1,470,352	4,780,335
h. Seized Property	0	0	0	0	0	0	0
i. Forfeited Property, Net	0	0	0	0	0	0	0
j. Goods Held Under Procure Support and Stabilization Programs, Net	0	0	0	0	0	0	0
k. Property, Plant and Equipment, Net	0	2,203,370	4,942,555	1,484,514	0	3,317,943	11,948,382
l. Other Entity Asset	0	685,149	347,089	0	0	515,620	1,547,858
m. Total Entity Assets	<u>0</u>	<u>14,504,221</u>	<u>26,982,871</u>	<u>31,787,708</u>	<u>137,019</u>	<u>19,235,846</u>	<u>92,667,665</u>
2. Non-Entity Assets:							
a. Transactions With Federal (Intragovernmental) Entities:							
(1) Fund Balance with Treasury	0	0	0	0	0	18,290	18,290
(2) Accounts Receivable, Net	0	0	0	0	0	0	0
(3) Interest Receivable, Net	0	0	0	0	0	0	0
(4) Other	0	0	733,297	0	0	0	733,297
b. Transactions With Non-Federal (Governmental) Entities:							
(1) Accounts Receivable, Net	0	0	0	0	0	0	0
(2) Interest Receivable, Net	0	0	0	0	0	0	0
(3) Other	0	0	0	0	0	0	0
c. Cash and Other Monetary Assets	0	0	0	0	0	0	0
d. Other Non-Entity Assets	0	0	0	0	0	45,685	45,685
e. Total Non-Entity Assets	<u>0</u>	<u>0</u>	<u>733,297</u>	<u>0</u>	<u>0</u>	<u>64,975</u>	<u>797,271</u>
3. Total Assets	<u>0</u>	<u>14,504,221</u>	<u>27,716,168</u>	<u>31,787,708</u>	<u>137,019</u>	<u>19,319,821</u>	<u>93,464,937</u>

Appendix B. Financial Statements and Auditor Opinion

COMBINING STATEMENTS

DEPARTMENT OF DEFENSE
REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
STATEMENT OF FINANCIAL POSITION
AS OF 30 SEPTEMBER 1995
(\$ IN THOUSANDS)

	DEPARTMENTAL	ARMY	NAVY	AIR FORCE	OSD COMP. ACCT.	DEFENSE AGENCIES	TOTAL
4. LIABILITIES COVERED BY BUDGETARY RESOURCES:							
a. Transactions With Federal (Intragovernmental) Entities:							
(1) Accounts Payable	211,562	1,465,024	241,179	1,067,321	(1,194,427)	1,870,270	3,115,658
(2) Interest Payable	0	0	0	0	0	0	0
(3) Debt	0	0	0	0	0	0	0
(4) Other Federal (Intragovernmental) Liabilities	823,737	5,985,713	1,067,321	1,067,321	0	206,012	7,282,783
b. Transactions With Non-Federal (Governmental) Entities:							
(1) Accounts Payable	567,166	241,606	169,689	169,689	0	2,548,084	3,526,745
(2) Accrued Payroll and Benefits	0	0	0	0	0	0	0
(a) Salaries and Wages	63,534	309,491	51,354	51,354	0	127,714	552,110
(b) Annual Accrued Leave	80,760	222,307	92,565	92,565	0	26,187	721,905
(c) Severance Pay and Separation Allowance	0	0	0	0	0	0	0
(1) Interest Payable	0	1	0	0	0	1	2
(4) Liabilities for Loan Guarantees	0	0	0	0	0	0	0
(5) Lease Liabilities	0	0	0	0	0	0	0
(6) Pensions and Other Actuarial Liabilities	0	0	0	0	0	3,622	3,622
(7) Other Non-Federal (Governmental) Liabilities	1,439	2,925,507	18	18	0	495,588	3,422,972
c. Total Liabilities Covered by Budgetary Resources:	1,768,818	11,913,144	2,124,321	2,124,321	(1,194,427)	5,446,696	20,058,574
5. LIABILITIES NOT COVERED BY BUDGET RESOURCES:							
a. Transactions With Federal (Intragovernmental) Entities:							
(1) Accounts Payable	0	0	0	0	0	18,290	18,290
(2) Debt	0	0	0	0	0	0	0
(3) Other Federal (Intragovernmental) Liabilities	0	0	0	0	0	0	0
b. Transactions With Non-Federal (Governmental) Entities:							
(1) Accounts Payable	0	0	0	0	0	0	0
(2) Debt	0	0	0	0	0	0	0
(3) Other Non-Federal (Governmental) Liabilities	0	0	0	0	0	0	0
c. Total Liabilities not Covered by Budgetary Resources:	0	0	0	0	0	18,290	18,290
6. TOTAL LIABILITIES:							
a. Total Liabilities Covered by Budgetary Resources:	1,768,818	11,913,144	2,124,321	2,124,321	(1,194,427)	5,655,000	20,266,878
b. Total Liabilities not Covered by Budgetary Resources:	0	0	0	0	0	18,290	18,290
7. BALANCES:							
a. Funded Appropriations	0	0	0	0	0	2,455	2,455
b. Invested Capital	14,855,641	14,455,790	19,279,577	14,111,416	1,111,416	30,489,745	99,312,199
c. Cumulative Results of Operations	0	2,642,086	(9,216,191)	0	0	(11,258,841)	(20,964,204)
d. Other	0	(284,852)	0	0	0	(4,065,212)	(5,150,084)
e. Future Funding Requirements	0	0	0	0	0	0	0
f. Total Net Position	12,715,181	15,801,021	29,663,386	1,111,416	1,111,416	13,661,823	71,198,662
8. Total Liabilities and Net Position	14,591,221	27,716,168	49,292,709	11,225,737	1,111,416	19,119,821	91,464,940

Appendix B. Financial Statements and Auditor Opinion

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF FINANCIAL POSITION
 AS OF 30 SEPTEMBER 1994
 (\$ IN THOUSANDS)

ASSETS	DEPARTMENTAL					TOTAL
	ARMY	NAVY	AIR FORCE	OSD CORP/ACCT	DEFENSE AGENCIES	
1. Entity Assets:						
a. Transactions With Federal (Intragovernmental)						
Entities:						
(1) Fund Balance With Treasury	0	1,609,210	545,312	123,667	1,818,590	0
(a) Funds Collected	0	23,978,280	11,498,128	(13,332)	27,976,447	4,656,849
(b) Funds Disbursed	0	(6,758,333)	(13,099,555)	(210,536)	(28,266,481)	(71,572,249)
(c) Funds With Treasury	0	185,737	791,448	347,555	2,102,624	(71,469,503)
(2) Investments, Net	0	0	0	0	0	3,574,103
(3) Accounts Receivable, Net	0	206,103	2,508,136	13,352	2,858,159	6,239,154
(4) Interest Receivable	0	0	116,735	0	20,042	297,966
(5) Advances and Prepayments	0	15,892	145,297	0	24,983	644,682
(6) Other Federal (Intragovernmental)	0	0	619,697	0	0	0
b. Transaction With Non-Federal (Governmental)						
Entities:						
(1) Investments, Federal	0	0	0	0	0	0
(2) Accounts Receivable, Net	0	37,273	1,565,404	107,382	568,249	2,278,308
(3) Credit Program Receivables/Related Foreclosed Property, Net	0	0	0	0	0	0
(4) Interest Receivable, Net	0	0	0	0	0	57
(5) Advances and Prepayments	0	194,210	372,997	37,670	276,112	830,980
(6) Other Non-Federal (Governmental)	0	0	0	0	0	0
c. Cash and Other Monetary Assets	0	0	2	0	0	2
d. Inventory, Net	0	7,766,749	12,973,009	26,127,856	0	55,260,195
e. Work in Progress	0	332,184	1,663,706	682,559	0	2,680,060
f. Operating Materials/Supplies, Net	0	130,363	702,536	628,323	0	1,501,027
g. Stockpile Materials, Net	0	2,372,874	152,455	784,254	0	4,786,135
h. Seized Property	0	0	0	0	0	0
i. Forfeited Property, Net	0	0	0	0	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net	0	2,203,370	4,942,555	1,484,314	0	11,948,382
k. Property, Plant and Equipment, Net	0	484,137	0	0	0	1,577,274
l. Other Entity Asset	0	0	0	0	0	0
m. Total Entity Assets	0	14,504,221	27,716,168	31,787,708	19,235,843	92,067,608
2. Non-Entity Assets:						
a. Transactions With Federal (Intragovernmental)						
Entities:						
(1) Fund Balance with Treasury	0	0	0	0	18,290	18,290
(2) Accounts Receivable, Net	0	0	0	0	0	0
(3) Interest Receivable, Net	0	0	0	0	0	0
(4) Other	0	0	713,297	0	0	713,297
b. Transactions With Non-Federal (Governmental)						
Entities:						
(1) Accounts Receivable, Net	0	0	0	0	0	0
(2) Interest Receivable, Net	0	0	0	0	0	0
(3) Other	0	0	0	0	0	0
c. Cash and Other Monetary Assets	0	0	0	0	0	0
d. Other Non-Entity Assets	0	0	0	0	45,685	45,685
e. Total Non-Entity Assets	0	0	713,297	0	45,685	777,272
3. Total Assets	0	14,504,221	27,716,168	31,787,708	19,199,826	92,067,608

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF FINANCIAL POSITION
 AS OF 30 SEPTEMBER 1994
 (\$ IN THOUSANDS)

	DEPARTMENTAL	ARMY	NAVY	AIR FORCE	OSD CORP ACCT	DEFENSE AGENCIES	TOTAL
LIABILITIES							
4. Liabilities Covered by Budgetary Resources:							
a. Transactions With Federal (Intragovernmental)							
Entities:							
(1) Accounts Payable	0	231,562	1,465,074	743,179	(1,194,437)	1,870,269	3,115,637
(2) Interest Payable	0	0	0	0	0	0	0
(3) Debt	0	0	1,263,359	0	0	168,749	1,432,108
(4) Other Federal (Intragovernmental) Liabilities	0	823,717	5,185,713	1,067,321	0	206,012	7,282,783
b. Transactions With Non-Federal (Governmental)							
Entities:							
(1) Accounts Payable	0	567,366	241,606	169,689	0	2,548,084	3,526,745
(2) Accrued Payroll and Benefits	0	0	0	0	0	0	0
(3) Salaries and Wages	0	63,554	109,491	51,551	0	127,714	532,310
(b) Annual Accrued Leave	0	80,760	522,193	92,565	0	26,187	731,905
(6) Severance Pay and Separation Allowance	0	0	0	0	0	0	0
(7) Interest Payable	0	0	1	0	0	1	2
(8) Liabilities for Loan Guarantees	0	0	0	0	0	0	0
(9) Lease Liabilities	0	0	0	0	0	3,622	3,622
(10) Pensions and Other Actuarial Liabilities	0	0	0	0	0	469	469
(11) Other Non-Federal (Governmental) Liabilities	0	1,859	2,925,907	18	0	495,588	1,432,972
c. Total Liabilities Covered by Budgetary Resources:	0	1,768,838	11,213,144	2,124,321	(1,194,437)	5,446,695	20,098,573
5. Liabilities not Covered by Budget Resources:							
a. Transactions With Federal (Intragovernmental)							
Entities:							
(1) Accounts Payable	0	0	0	0	0	18,290	18,290
(2) Debt	0	0	0	0	0	0	0
(3) Other Federal (Intragovernmental) Liabilities	0	0	0	0	0	0	0
b. Transactions With Non-Federal (Governmental)							
Entities:							
(1) Accounts Payable	0	0	0	0	0	0	0
(2) Debt	0	0	0	0	0	0	0
(3) Lease Liabilities	0	0	0	0	0	0	0
(4) Pensions and Other Actuarial Liabilities	0	0	0	0	0	0	0
(5) Other Non-Federal (Governmental) Liabilities	0	0	0	0	0	190,014	190,014
c. Total Liabilities not Covered by Budgetary Resources:	0	0	0	0	0	208,304	208,304
6. Total Liabilities	0	1,768,838	11,913,144	2,124,321	(1,194,437)	5,654,999	20,266,877
7. Balances:							
a. Unexpended Appropriations	0	0	0	0	0	7,455	7,455
b. Invested Capital	0	14,855,641	11,455,790	39,379,576	1,311,446	30,489,745	99,512,198
c. Cumulative Results of Operations	0	(2,120,258)	2,612,086	(9,716,191)	0	(11,758,843)	(20,963,206)
d. Other	0	0	(284,853)	0	0	(4,865,212)	(5,150,084)
e. Future Funding Requirements	0	12,715,183	15,803,021	27,663,385	1,311,446	(208,304)	71,198,059
f. Total Net Position	0	14,590,421	27,716,168	31,787,708	137,019	19,319,820	93,464,916

Appendix B. Financial Statements and Auditor Opinion

Combining Statements							
	DEPARTMENTAL	ARMY	NAVY	AIR FORCE	OSD CORP/ACCT	DEFENSE AGENCIES	TOTAL
REVENUES & FINANCING SOURCES							
1. Appropriated Capital Used	0	0	0	0	0	14,603	14,603
2. Revenues from Sales of Goods and Services	0	494,011	287,763	132,295	0	8,226,992	9,241,061
a. To the Public	0	9,756,372	23,468,764	14,011,083	0	18,746,459	65,982,683
b. Intragovernmental	0	0	0	0	0	0	0
3. Interest & Penalties, Non-Federal	0	0	0	0	0	0	0
4. Interest, Federal	0	0	0	0	0	0	0
5. Taxes	0	29,471	287	224,265	0	601,012	857,415
6. Other Revenues & Financing Sources	0	0	0	0	0	0	0
7. Less: Taxes & Receipts Transferred to the Treasury/Other Agncy	0	0	0	0	0	0	0
8. Total Revenues & Financing Sources	0	16,280,281	21,756,814	14,107,643	0	28,191,062	76,995,804
EXPENSES							
9. Program or Operation Expenses (Note 3)	0	871,662	1,141,174	794,515	0	4,771,917	7,781,468
10. Cost of Goods Sold	0	360,869	25,778	364,502	0	6,564,928	7,315,277
a. In the Public	0	6,872,542	20,916,869	11,044,848	0	16,999,624	55,823,823
b. Intragovernmental	0	58,092	103,022	129,146	0	341,295	813,555
11. Depreciation and Amortization	0	0	0	16,540	0	6,924	23,464
12. Bad Debts & Write-offs	0	0	0	0	0	0	0
13. Interest	0	0	0	0	0	0	0
a. Federal Financing Bank/Treasury Borrowing	0	0	0	0	0	0	0
b. Federal Securities	0	0	0	0	0	0	0
c. Other	0	2	0	0	0	14,512	14,514
14. Other Expenses	0	2,348,285	192,866	3,297,366	0	1,896,271	8,344,288
15. Total Expenses	0	10,710,652	22,801,999	16,116,957	0	10,507,471	80,116,909
16. Excess (Shortage) of Revenues & Financing Sources over Total Expenses (Before Extraordinary Items)	0	(430,371)	954,915	(1,249,314)	0	(2,116,405)	(3,541,185)
17. Plus (Minus) Adjustments:	0	0	(15,113)	(6,503,660)	0	0	(6,518,773)
18. Excess (Shortage) of Revenues & Financing Sources over Total Expenses	0	(430,371)	939,802	(1,264,474)	0	(2,116,405)	(10,059,958)
19. Net Position, Beginning Balance, as Previously Stated	6,416,183	14,291,768	19,169,653	14,268,514	0	11,411,318	85,497,456
20. Adjustments	0	13,763	1,129,167	2,265	0	15,946	1,492,641
21. Net Position, Beginning Balance, as Restated	6,416,183	14,305,531	20,448,820	14,271,299	0	11,427,264	86,990,097
22. Excess (Shortage) of Revenues & Financing Sources over Total Expenses	0	(430,371)	910,772	(8,255,914)	0	(2,116,405)	(10,019,918)
23. Plus (Minus) Non-Operating Changes	(6,416,184)	(1,160,271)	(5,555,968)	164,960	1,311,246	4,531,962	(16,222,664)
24. Net Position, Ending Balance	0	12,715,183	15,803,052	29,624,185	1,311,246	11,661,823	71,097,499

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF OPERATIONS (AND CHANGES IN NET POSITION)
 AS OF 30 SEPTEMBER 1994
 (\$ IN THOUSANDS)

REVENUES & FINANCING SOURCES	DEPARTMENTAL	ARMY	NAVY	AIR FORCE	OSD CORP ACCT	DEFENSE AGENCIES	TOTAL
1. Appropriated Capital Used	1,102,295	0	0	0	0	61,068	1,163,363
2. Revenues from Sales of Goods and Services	0	389,203	263,888	149,172	0	5,849,678	6,651,941
a. To the Public	0	6,817,914	23,668,730	12,819,361	0	22,041,816	65,367,841
b. Intragovernmental	0	0	0	0	0	0	0
3. Interest & Penalties, Non-Federal	0	0	0	0	0	0	0
4. Interest, Federal	0	0	0	0	0	0	0
5. Taxes	0	0	0	0	0	0	0
6. Other Revenues & Financing Sources	0	3,498,374	2,812,521	400,259	0	73,214	6,814,368
7. Less: Taxes & Receipts Transferred to the Treasury (Other Agn)	0	0	0	0	0	0	0
8. Total Revenues & Financing Sources	1,102,295	10,705,491	26,775,119	13,388,792	0	28,025,796	79,897,513
EXPENSES							
9. Program or Operation Expenses (Note 3)	(598,230)	0	0	0	0	4,871,380	4,273,150
10. Cost of Goods Sold	0	389,203	18,205	151,269	0	5,895,413	6,454,000
a. To the Public	0	12,370,396	26,052,058	12,810,125	0	17,965,317	69,197,896
b. Intragovernmental	0	70,324	464,110	199,635	0	333,152	1,067,221
11. Depreciation and Amortization	0	246	0	13,604	0	3,413	17,263
12. Bad Debt & Write-offs	0	0	0	0	0	0	0
13. Interest	0	0	0	0	0	0	0
a. Federal Financing Bank/Treasury Borrowing	0	0	0	0	0	0	0
b. Federal Securities	0	17	1	207	0	6,446	6,671
c. Other	0	350,695	399	36,510	0	1,977,426	2,365,010
14. Other Expenses	(598,230)	13,180,881	26,533,773	13,211,350	0	31,052,517	83,381,321
15. Total Expenses	1,700,525	(2,475,190)	240,366	177,442	0	(1,026,751)	(3,183,608)
16. Excess (Shortage) of revenues & Financing Sources over Total Expenses Before Adjustments	0	0	333,101	(169,340)	0	(69,294)	(105,311)
17. Plus (Minus) Adjustments:							
Total Expenses	1,700,525	(2,475,190)	571,667	(191,898)	0	(1,096,045)	(3,489,111)
18. Excess (Shortage) of Revenues & Financing Sources over Total Expenses	1,391,677	16,570,809	23,432,128	15,416,051	0	11,676,678	88,368,331
19. Net Position, Beginning Balance, as Previously Stated	0	(122,749)	317,508	164	0	(79,927)	135,076
20. Adjustments	0	0	0	0	0	0	0
21. Net Position, Beginning Balance, as Restated	1,391,677	16,448,061	23,789,716	15,416,215	0	11,556,751	88,603,410
22. Excess (Shortage) of Revenues & Financing Sources Over Total Expenses	1,700,525	(2,475,190)	571,667	(191,898)	0	(1,096,045)	(3,489,111)
23. Plus (Minus) Non-Operating Changes	3,420,082	119,107	(5,251,700)	(955,781)	0	2,950,613	381,189
24. Net Position, Ending Balance	6,116,181	11,291,268	10,199,531	11,266,531	0	11,111,310	85,971,258

Appendix B. Financial Statements and Auditor Opinion

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF CASH FLOWS
 AS OF 30 SEPTEMBER 1995
 (\$ IN THOUSANDS)

	DEPARTMENTAL	AIRMY	NAVY	AIR FORCE	CSD CORP ACCT	DEFENSE AGENCIES	TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES:							
1. Excess (Shortage) of Revenue & Financing Sources Over Total Expenses	0	(496,171)	919,772	(8,252,974)	0	(2,316,403)	(10,079,976)
ADJUSTMENTS AFFECTING CASH FLOW:							
2. Appropriations Capital Used	0	0	0	0	0	(14,603)	(14,603)
3. Decrease (Increase) in Accounts Receivable	0	74,174	(1,187,490)	346,053	(13,157)	1,601,168	620,753
4. Decrease (Increase) in Other Assets	0	316,826	2,997,924	4,509,171	0	2,502,510	10,326,451
5. Decrease (Increase) in Accounts Payable	0	(371,286)	1,221,082	(1,035)	(210,516)	520,610	1,233,805
6. Increase (Decrease) in Other Liabilities	0	(192,218)	1,111,066	(80,304)	0	(1,653,223)	1,108,321
7. Depreciation & Amortization	0	58,072	301,072	172,146	0	159,181	492,611
8. Other Unfunded Expenses	0	0	(7)	0	0	(171,620)	(171,627)
9. Other Adjustments	0	1,402,111	(6,591,291)	1,413,263	0	12,291	(1,246,469)
10. Total Adjustments	0	1,545,971	(251,690)	8,351,263	(231,819)	3,205,114	17,726,875
11. Net Cash Provided (Used) by Operating Activities	0	1,115,600	668,166	198,290	(231,819)	886,711	2,646,899
Cash Flows from Non-Operating Activities:							
12. Sale of Property, Plant and Equipment	0	0	0	0	0	9,069	9,069
13. Purchase of Property, Plant and Equipment	0	(125,616)	149,616	200,216	0	(729,607)	(505,391)
14. Sale of Securities	0	0	0	0	0	0	0
15. Purchase of Securities	0	0	0	0	0	0	0
16. Collection of Loans Receivable	0	0	0	0	0	0	0
17. Creation of Loans Receivable	0	0	0	0	0	0	0
18. Other Investing Cash Provided (Used)	0	0	0	0	0	0	0
19. Net Cash Provided (Used) by Non-Investing Activities	0	(125,616)	149,616	200,216	0	(720,538)	(196,322)

Combining Statements

**DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
STATEMENT OF CASH FLOWS
AS OF 30 SEPTEMBER 1995
(\$ IN THOUSANDS)**

Cash Provided (Used) by Financial Activities

	DEPARTMENTAL	ARMY	NAVY	MR FORCE	OSD CORP ACCT	DEFENSE AGENCIES	TOTAL
20. Appropriations (Current Varrants)	0	0	0	0	0	177,712	177,712
21. Add:							
a. Restorations	0	0	0	0	0	0	0
b. Transfers of Cash from Others	0	1,433,897	1,064,072	0	367,375	1,960,758	4,826,102
22. Deduct:							
a. Withdrawals	0	0	0	0	0	0	0
b. Transfers of Cash to Others	6,416,183	1,184,644	(1,807,992)	(168,907)	19,820	(686,901)	4,956,818
23. Net Appropriations	(6,416,183)	239,253	2,872,071	168,907	347,555	2,835,193	46,996
24. Borrowing from the Public	0	0	0	0	0	0	0
25. Repayment on Loans to the Public	0	0	0	0	0	0	0
26. Borrowing from the Treasury, & the Federal Financing Bank	0	0	0	0	0	0	0
27. Repayment on Loans from the Treasury, & the Federal Financing Bank	0	0	0	0	0	0	0
28. Other Borrowing & Repayments	0	0	0	0	0	0	0
29. Net Cash Provided (Used) by Financing Activities	(6,416,183)	249,253	2,872,071	168,907	347,555	2,835,193	46,996
30. Net Cash Provided (Used) by Operating, Investing & Financing Activities	(6,416,183)	1,219,217	3,689,853	567,431	123,662	2,991,586	2,497,323
31. Fund Balance with Treasury, Cash & Foreign Currency, Beginning	6,316,183	(629,147)	(2,084,431)	(23,119)	(11,667)	(1,111,992)	2,457,827
32. Fund Balance with Treasury, Cash & Foreign Currency, Ending	0	589,070	1,602,210	544,312	12,000	1,878,594	4,656,800

Supplemental Disclosure of Cash Flow Information:

33. Total Interest Paid	0	0	0	0	0	14,512	14,512
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Supplemental Schedule of Financing and Investing Activity:

34. Property & Equipment Acquired Under Capital Lease Obligations	0	0	0	0	0	0	0
35. Property Acquired Under Long-term Financing Arrangements	0	0	0	0	0	1,187,797	1,187,797
36. Other Exchanges of Noncash Assets or Liabilities	0	0	0	0	0	0	0

Appendix B. Financial Statements and Auditor Opinion

Combining Statements							
DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE							
REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND							
STATEMENT OF CASH FLOWS							
AS OF 30 SEPTEMBER 1994							
(\$ IN THOUSANDS)							
	DEPARTMENTAL	ARMY	NAVY	AIR FORCE	OSD CORP VECT	DEFENSE AGENCIES	TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES:							
1. Excess (Shortage) of Revenue & Financing Sources Over Total Expenses	1,700,525	(2,475,109)	571,667	(191,898)	0	(3,096,048)	(3,402,143)
ADJUSTMENTS AFFECTING CASH FLOW:							
2. Appropriations Capital Used							(1,163,363)
3. Decrease (Increase) in Accounts Receivable	(1,102,295)	67,099	78,317	352,481	0	(61,068)	201,316
4. Decrease (Increase) in Other Assets		652,467	3,234,408	1,218,858	0	(296,381)	8,511,394
5. Increase (Decrease) in Accounts Payable		(116,662)	(2,869,389)	(711,403)	0	(26,851)	(3,764,405)
6. Increase (Decrease) in Other Liabilities		(857,751)	463,110	(816,560)	0	(196,381)	(2,256,110)
7. Depreciation & Amortization		70,324	463,110	199,615	0	143,145	1,078,214
8. Other Unfunded Expenses		215	0	0	0	120,422	120,667
9. Other Adjustments		2,080,651	(3,268,678)	201,924	0	(384,517)	(1,408,550)
10. Total Adjustments	(1,102,295)	1,884,370	(2,706,575)	407,003	0	2,401,710	1,281,335
11. Net Cash Provided (Used) by Operating Activities	598,230	(591,019)	(2,132,908)	215,107	0	(294,318)	(2,207,908)
Cash Flows from Non-Operating Activities:							
12. Sale of Property, Plant and Equipment	0	0	0	0	0	0	0
13. Purchase of Property, Plant & Equipment	0	(85,148)	52,286	(217,261)	0	(918,152)	(1,188,277)
14. Sale of Securities	0	0	0	0	0	0	0
15. Purchases of Securities	0	0	0	0	0	0	0
16. Collection of Loans Receivable	0	0	0	0	0	0	0
17. Creation of Loans Receivable	0	0	0	0	0	0	0
18. Other Investing Cash Provided (Used)	0	0	0	0	0	10,024	10,024
19. Net Cash Provided (Used) by Non-Investing Activities	0	(85,148)	52,286	(217,261)	0	(888,128)	(1,158,253)

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF CASH FLOWS
 AS OF 30 SEPTEMBER 1994
 (\$ IN THOUSANDS)

Cash Provided (Used) by Financial Activities

	DEPARTMENT/AGENCY	ARMY	NAVY	AIR FORCE	OSD CORP ACCT	DEFENSE AGENCIES	TOTAL
20. Appropriations (Current Warrants)	1,102,295	0	0	0	0	0	1,102,295
21. Add:							
a. Reservations	0	0	0	0	0	7,455	7,455
b. Transfer of Cash from Others	3,858,183	0	0	0	0	1,312	3,859,495
22. Deduct:							
a. Withdrawals	0	0	0	0	0	0	0
b. Transfer of Cash to Others (Note 4)	4,368,478	(890,822)	(1,753,437)	(1,359,115)	0	(712,141)	3,291,041
23. Net Appropriations	0	(890,822)	(1,753,437)	(1,359,115)	0	721,110	1,178,204
24. Borrowing from the Public	0	0	0	0	0	0	0
25. Repayment on Loans to the Public	0	0	0	0	0	0	0
26. Borrowing from the Treasury & the Federal Financing Bank	(48,705)	0	0	0	0	0	(48,705)
27. Repayment on Loans from the Treasury & the Federal Financing Bank	0	0	0	0	0	0	0
28. Other Borrowing & Repayments	0	0	0	0	0	0	0
29. Net Cash Provided (Used) by Financing Activities	4,411,773	(890,822)	(1,753,437)	(1,359,115)	0	721,110	1,129,499
30. Net Cash Provided (Used) by Operating, Investing & Financing Activities	5,010,083	(1,569,989)	(1,834,069)	(1,381,271)	0	(461,136)	(2,236,662)
31. Fund Balance with Treasury, Cash & Foreign Currency, Beginning	3,406,180	890,822	1,753,246	1,357,157	0	(713,656)	4,693,910
32. Fund Balance with Treasury, Cash & Foreign Currency, Ending	6,416,183	(679,167)	(2,080,823)	(224,114)	0	(1,174,992)	2,331,287

Supplemental Disclosure of Cash Flow Information:

33. Total Interest Paid	0	0	0	0	0	0	0
Supplemental Schedule of Financing and Investing Activity:							
34. Property & Equipment Acquired Under Capital Leases (Milestones)	0	0	0	0	0	0	0
35. Property Acquired Under Long-term Financing Arrangements	0	0	0	0	0	0	0
36. Other Exchange of Noncash Assets or Liabilities	0	0	0	0	0	0	0

Combining Statements

***DEFENSE BUSINESS
OPERATIONS FUND***

***DEFENSE
AGENCIES***

***COMBINING
STATEMENTS***

Combining Statements _____

Appendix B. Financial Statements and Auditor Opinion

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
STATEMENT OF FINANCIAL POSITION
AS OF 30 SEPTEMBER 1995
(\$ IN THOUSANDS)

	DEA (EXCLUDE DHC)	DMAS	DFCA	USC	US TRAMS COMMAND	DIRSA	ASSO CURI	DTIC	COMPONENT LEVEL ADD	DEFENSE AGENCIES TOTAL
ASSETS										
1. ENTITY ASSETS:										
a. Transactions With Federal (Intragovernmental)										
Facilities:										
(1) Fund Balance With Treasury	806,828	319,455	(533,193)	(6,413)	417,234	5,677	(14,536)	(36,732)	0	0
(2) Funds Collected	13,379,899	1,918,802	5,526,404	(410)	4,724,822	2,476,978	(934)	14,533	860,610	1,818,590
(3) Funds Advanced	(12,326,351)	(1,817,137)	(6,188,929)	(110,803)	(4,458,579)	(2,502,047)	(15,602)	0	(81,137)	27,976,417
(4) Funds With Treasury	(46,720)	197,700	429,332	304,000	151,031	30,746	0	0	(91,268)	(28,560,481)
(5) Investments, Net	0	0	0	0	0	0	0	0	1,036,535	2,102,624
(6) Accounts Receivable, Net	1,437,295	51,457	42,511	11	841,597	390,533	0	10,578	84,137	2,858,159
(7) Interest Receivable	0	0	0	0	0	0	0	0	0	0
(8) Advances and Prepayments	162	0	0	0	19,925	0	14	1	0	20,042
(9) Other Federal (Intragovernmental)	0	0	0	0	24,844	141	0	0	0	24,985
b. Transactions With Non-Federal (Governmental)										
Facilities:										
(1) Investments, Federal	239,019	0	0	0	196,835	0	0	0	0	0
(2) Accounts Receivable, Net	0	0	85,514	0	0	46,783	0	0	0	568,249
(3) Credit Program Receivables/Refused	0	0	0	0	0	0	0	0	0	0
(4) Interest Receivable, Net	215,645	794	0	0	2,432	6,267	0	0	0	216,112
(5) Advances and Prepayments	0	0	0	0	0	0	0	0	0	0
(6) Other Non-Federal (Governmental)	0	0	0	0	0	0	0	0	0	0
c. Cash and Other Monetary Assets	7,940,991	0	451,599	0	0	0	0	0	0	8,392,591
d. Inventory, Net	0	0	0	0	0	0	0	0	0	0
e. Work in Process	22,321	0	0	0	575	1,932	0	0	0	2,507
f. Operating Materials/Supplies, Net	1,470,352	0	0	0	17,902	282	0	0	0	40,705
g. Stockpile Materials, Net	0	0	0	0	0	0	0	0	0	1,470,352
h. Seized Property	0	0	0	0	0	0	0	0	0	0
i. Forfeited Property, Net	0	0	0	0	0	0	0	0	0	0
j. Goods Held Under Process Support and Stabilization Programs, Net	619,714	324,582	646	832,642	1,098,261	370,474	24,033	7,089	0	3,317,913
k. Property, Plant and Equipment, Net	252,285	104,807	151,528	0	0	0	0	0	0	513,620
l. Other Entity Asset	1,027,752	803,191	199,530	83,840	2,620,145	822,729	9311	(19,061)	911,767	19,351,815
m. Total Entity Assets	18,290	0	0	0	0	0	0	0	0	18,290
2. NON-ENTITY ASSETS:										
a. Transactions With Federal (Intragovernmental)										
Facilities:										
(1) Fund Balance With Treasury	0	0	0	0	0	0	0	0	0	0
(2) Accounts Receivable, Net	0	0	0	0	0	0	0	0	0	0
(3) Interest Receivable, Net	0	0	0	0	0	0	0	0	0	0
(4) Other	0	0	0	0	0	0	0	0	0	0
b. Transactions With Non-Federal (Governmental)										
Facilities:										
(1) Accounts Receivable, Net	0	0	0	0	0	0	0	0	0	0
(2) Interest Receivable, Net	0	0	0	0	0	0	0	0	0	0
(3) Other	0	0	0	0	0	0	0	0	0	0
c. Cash and Other Monetary Assets	0	0	0	0	0	0	0	0	0	0
d. Other Non-Federal Assets	45,685	0	0	0	0	0	0	0	0	45,685
e. Total Non-Federal Assets	61,973	0	0	0	0	0	0	0	0	61,973
Total Assets	18,290	0	0	0	0	0	0	0	0	18,290

Appendix B. Financial Statements and Auditor Opinion

Combining Statements										
ASSETS	D.A (EXCLUDE/DHC)	DEAS	DECA	JLSC	US TRANS COMBAND	DISA	MSSO CUM	DHC	COMPONENT LEVEL ADD	DEFENSE AGENCIES TOTAL
1. EMITY ASSETS:										
a. Transactions With Federal (Intragovernmental)										
Facilities:										
(1) Fund Balance With Treasury	564,892	(88,250)	(1,168,131)	(334,079)	(76,571)	(56,077)	(1,877)	8,063	0	0
(2) Funds Collected	12,909,032	1,340,660	5,648,138	369	5,574,396	1,988,157	2,862	70,221	0	(1,171,992)
(3) Funds Disbursed	(12,317,101)	(1,328,910)	(6,816,309)	(334,488)	(5,650,909)	(2,011,231)	(4,702)	(62,158)	0	22,533,838
(4) Funds With Treasury	0	0	0	0	0	0	0	0	0	(28,708,870)
(5) Investments, Net	0	0	0	0	0	0	0	0	0	0
(6) Advances and Prepayments	1,562,234	155,309	91,476	1	930,211	451,478	64	35,703	0	3,226,676
(7) Interest Receivable, Net	0	0	0	0	0	0	0	0	0	0
(8) Interest Receivable	0	0	0	0	0	0	0	0	0	0
(9) Advances and Prepayments	1,757	0	0	0	26,912	18,439	11	10	0	47,159
(10) Other Federal (Intragovernmental)	0	0	0	0	0	0	0	0	0	0
b. Transactions With Non-Federal (Extragovernmental)										
Facilities:										
(1) Investments, Federal	179,929	1,372	92,053	0	1,495,160	32,954	0	75	0	1,801,343
(2) Accounts Receivable, Net	0	0	0	0	0	0	0	0	0	0
(3) Credit Program Receivable Related	0	0	0	0	0	0	0	0	0	0
(4) Interest Receivable, Net	244,284	0	796	0	922	424	0	0	0	2,46,476
(5) Advances and Prepayments	0	0	0	0	0	0	0	0	0	0
(6) Other Non-Federal (Extragovernmental)	0	0	0	0	0	0	0	0	0	0
(7) Cash and Other Monetary Assets	8,686,381	0	574,683	0	0	0	0	0	0	9,261,064
(8) Inventory, Net	92	0	0	0	8835	0	0	0	0	8,927
(9) Work in Process	20,730	0	0	0	20,439	0	0	0	0	41,169
(10) Operating Materials, Supplies, Net	1,596,459	0	0	0	5,079	0	0	0	0	1,601,538
(11) Stockpile Materials, Net	0	0	0	0	0	0	0	0	0	0
(12) Seized Property	0	0	0	0	0	0	0	0	0	0
(13) Forfeited Property, Net	0	0	0	0	0	0	0	0	0	0
(14) Goods Held Under Process Support and	0	0	0	0	0	0	0	0	0	0
(15) Stabilization Programs, Net	0	0	0	0	0	0	0	0	0	0
(16) Property, Plant and Equipment, Net	638,668	216,767	973	552,109	769,476	0	0	5,169	0	2,183,512
(17) Other Emty Asset	303,259	99,154	0	0	0	383,792	9,632	0	0	796,337
m. Total Emty Assets	13,982,185	381,532	(408,190)	198,071	3,180,241	817,810	7,870	39,720	0	18,070,319
2. Non-Emty Assets:										
a. Transactions With Federal (Intragovernmental)										
Facilities:										
(1) Fund Balance with Treasury	0	0	0	0	0	0	0	0	0	0
(2) Accounts Receivable, Net	12,984	0	0	0	0	0	0	0	0	12,984
(3) Interest Receivable, Net	0	0	0	0	0	0	0	0	0	0
(4) Other	0	0	0	0	0	0	0	0	0	0
b. Transactions With Non-Federal (Extragovernmental)										
Facilities:										
(1) Accounts Receivable, Net	0	0	0	0	0	0	0	0	0	0
(2) Interest Receivable, Net	0	0	0	0	0	0	0	0	0	0
(3) Other	0	0	0	0	0	0	0	0	0	0
(4) Cash and Other Monetary Assets	60,342	0	0	0	0	0	0	0	0	60,342
(5) Other Non-Emty Assets	73,326	0	0	0	0	0	0	0	0	33,316
c. Total Non-Emty Assets	13,825,311	381,532	(408,190)	198,071	3,180,241	817,810	7,870	39,720	0	18,127,218
Total Assets										

Appendix B. Financial Statements and Auditor Opinion

Combining Statements										
DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND STATEMENT OF OPERATIONS (AND CHANGES IN NET POSITION) AS OF 30 SEPTEMBER 1995 (\$ IN THOUSANDS)										
	DLA (EXCLUDE DTC)	DFAS	DECA	JL SC	US TRANS COMBAND	DISA	MSOY CMI	DTC	COMPONENT LEVEL ADD	DEFENSE AGENCIES TOTAL
REVENUES & FINANCING SOURCES										
1. Appropriated Capital Used	0	0	0	0	0	0	0	0	0	14,601
2. Revenues from Sales of Goods and Services										
a. To the Public	513,195	0	5,329,358	0	2,928,563	55,676	0	0	0	8,826,992
b. Intragovernmental	12,666,775	1,848,595	150,938	0	1,678,267	2,414,418	(998)	(10,666)	0	18,746,459
3. Interest & Penalties, Non-Federal	0	0	0	0	0	0	0	0	0	0
4. Interest, Federal	0	0	0	0	0	0	0	0	0	0
5. Taxes	0	0	0	0	0	0	0	0	0	0
6. Other Revenues & Financing Sources	151,410	197,709	251,600	0	724	1,578	0	0	0	603,012
7. Less: Taxes & Receipts Transferred to the Treasury/Other	0	0	0	0	0	0	0	0	0	0
8. Total Revenues & Financing Sources	13,331,380	2,046,225	5,731,196	0	3,607,534	2,486,305	(998)	(10,666)	0	28,191,966
EXPENSES										
9. Program or Operating Expenses (Note 3)	4,742,519	0	0	29,398	0	0	0	0	0	4,771,917
10. Cost of Goods Sold										
a. To the Public	165,257	0	4,777,209	0	0	1,622,462	0	0	0	6,564,928
b. Intragovernmental	8,137,381	1,718,957	1,785,557	0	4,565,612	780,151	263	11,703	0	16,999,624
11. Depreciation and Amortization	56,298	69,304	208	357	85,203	110,012	0	1,913	0	343,295
12. Bad Debt & Write-offs	38	0	1,158	0	5,728	0	0	0	0	6,924
13. Interest	0	0	0	0	0	0	0	0	0	0
a. Federal Financing Bank/Treasury Borrowing	0	0	0	0	0	0	0	0	0	0
b. Federal Securities	0	0	0	0	0	0	0	0	0	0
c. Other	0	14,585	(73)	0	0	0	0	0	0	14,512
14. Other Expenses	1,744,059	1,840	51,218	0	9,467	777	0	(1,110)	0	1,806,271
15. Total Expenses	14,845,552	1,803,686	6,615,297	29,755	4,666,010	2,513,402	263	12,506	0	30,507,371
16. Excess (Shortage) of revenues & Financing Sources over Total Expenses Before Extraordinary Items	(1,514,172)	241,609	(884,101)	(29,755)	(58,456)	(47,097)	(1,261)	(23,172)	0	(2,316,405)
17. Plus (Minus) Adjustments	0	0	0	0	0	0	0	0	0	0
18. Excess (Shortage) of Revenues & Financing Sources over Total Expenses	(1,514,172)	241,609	(884,101)	(29,755)	(58,456)	(47,097)	(1,261)	(23,172)	0	(2,316,405)
19. Net Position, Beginning Balance, as Previously Stated	(1,835,078)	(503,310)	(1,432,568)	201,913	512,235	330,859	1,200	1,062	0	(1,141,110)
20. Adjustments	(841,852)	(24,063)	(69,989)	1,428	293,589	(64,052)	0	0	0	15,916
21. Net Position, Beginning Balance, as Restated	(11,493,220)	(74,373)	(1,272,579)	203,341	825,725	267,807	1,240	1,062	0	(11,427,285)
22. Excess (Shortage) of Revenues & Financing Sources over Total Expenses	(1,514,172)	241,609	(884,101)	(29,755)	(58,456)	(47,097)	(1,261)	(23,172)	0	(2,316,405)
23. Plus (Minus) Other Financing Receipts	978,866	1,318,587	1,318,587	658,777	253,852	136,599	1,817	(2,562)	1,036,835	4,531,961
24. Net Position, Ending Balance	(10,953,920)	(298,567)	(668,095)	832,341	1,021,121	177,301	1,816	(7,671)	1,036,835	11,661,821

Appendix B. Financial Statements and Auditor Opinion

Combining Statements										
	DLA (EXCLUDE DTIC)	DEAS	DLCA	JLSC	US TRANS COMMAND	DISA	ASSD CBI	DTIC	COMPONENT LEVEL ADD	DEFENSE AGENCIES TOTAL
DEPARTMENTAL: DEPARTMENT OF DEFENSE REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND STATEMENT OF CASH FLOWS AS OF 30 SEPTEMBER 1995 (IN THOUSANDS)										
CASH FLOWS FROM OPERATING ACTIVITIES:										
1. Excess (Shortage) of Revenue & Financing Sources Over Total Expenses	(1,514,172)	241,609	(884,101)	(29,755)	(98,456)	(47,097)	(1,261)	(23,172)	0	(2,316,302)
ADJUSTMENTS AFFECTING CASH FLOW:										
2. Appreciation Capital Used	74,029	105,376	0	0	0	(14,601)	0	0	0	(14,601)
3. Decrease (Increase) in Accounts Receivable	2,347,914	(794)	54,311	(10)	1,386,940	47,076	64	25,198	(91,768)	1,681,168
4. Decrease (Increase) in Other Assets	98,148	9,171	(18,620)	0	(3,457)	10,240	0	10	0	2,502,510
5. Increase (Decrease) in Accounts Payable	(85,057)	(17,556)	(16,091)	19,056	539,242	(49,289)	1,067	(36,294)	(84,137)	570,610
6. Increase (Decrease) in Other Liabilities	75,266	69,304	208	(1,696)	(1,844,419)	13,962	0	(344)	0	(1,655,221)
7. Depreciation & Amortization	(170,796)	866	0	357	83,203	127,130	0	1,913	0	359,381
8. Other Unfunded Expenses	(128,951)	(18,531)	(3,370)	1,769	214,544	(72,950)	0	(1,110)	0	(171,020)
9. Other Adjustments	2,530,563	231,788	173,112	19,476	6,540,311	61,566	1,128	(10,637)	(175,905)	3,205,134
10. Total Adjustments	716,391	473,397	(710,262)	(10,279)	593,577	14,469	(131)	(33,799)	(175,905)	888,729
11. Net Cash Provided (Used) by Operating Activities										
Cash Flows from Non-Operating Activities:										
12. Sale of Property, Plant and Equipment	9,005	0	64	0	0	0	0	0	0	9,069
13. Purchase of Property, Plant and Equipment	(108,152)	(151,942)	0	(100,514)	(329,134)	(36,615)	(14,401)	(2,912)	0	(729,608)
14. Sale of Securities	0	0	0	0	0	0	0	0	0	0
15. Purchase of Securities	0	0	0	0	0	0	0	0	0	0
16. Collection of Loans Receivable	0	0	0	0	0	0	0	0	0	0
17. Creation of Loans Receivable	0	0	0	0	0	0	0	0	0	0
18. Other Investing Cash Provided (Used)	0	0	0	0	0	0	0	0	0	0
19. Net Cash Provided (Used) by Non-Investing Activities	117,157	(151,942)	64	(100,514)	(329,134)	(36,615)	(14,401)	(2,912)	0	(720,519)

Combining Statements

DEPARTMENT/AGENCY: DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF CASH FLOWS
 AS OF 30 SEPTEMBER 1995
 (\$ IN THOUSANDS)

Cash Provided (Used) by Financial Activities	DIA EXCLUDE DTIC	DEAS	DECA	II SC	US TRANS COMMAND	DISA	MISSO CUM	DTIC	COMPONENT EXCL ADJ	DEFENSE AGENCIES TOTAL
20. Appropriations (Current Warrants)	0	0	177,732	0	0	0	0	0	0	177,732
21. Add:										
a. Restorations	237,069	0	0	0	0	86,823	0	0	1,616,866	1,940,758
b. Transfers of Cash from Others	0	0	0	0	0	0	0	0	0	0
22. Deduct:										
a. Withdrawals	0	0	0	0	0	0	0	0	0	0
b. Transfers of Cash to Others	(813,681)	(88,310)	(1,168,131)	(658,079)	(327,604)	2,923	(1,827)	8,063	600,311	(686,903)
23. Net Appropriations	(608,612)	(88,310)	1,145,863	(658,079)	217,604	(81,906)	(1,827)	(8,063)	(1,016,515)	2,253,193
24. Borrowing from the Public	0	0	0	0	0	0	0	0	0	0
25. Repayments on Loans to the Public	0	0	0	0	0	0	0	0	0	0
26. Borrowing from the Treasury & the Federal Financing Bank	0	0	0	0	0	0	0	0	0	0
27. Repayment on Loan from the Treasury & the Federal Financing Bank	0	0	0	0	0	0	0	0	0	0
28. Other Borrowing & Repayments	0	0	0	0	0	0	0	0	0	0
29. Net Cash Provided (Used) by Financing Activities	(608,612)	88,310	1,145,863	658,079	217,604	(81,906)	1,827	(8,063)	1,016,515	2,232,193
30. Net Cash Provided (Used) by Operating, Investing & Financing Activities	244,295	407,206	431,934	317,266	491,847	61,714	(12,699)	(54,282)	869,140	2,993,583
31. Fund Balance with Treasury, Cash & Foreign Currency, Beginning	217,282	(19,349)	(1,111,171)	(3,187,817)	(7,431)	(3,977)	(4,312)	(4,312)	0	(1,317,292)
32. Fund Balance with Treasury, Cash & Foreign Currency, Ending	808,574	(19,349)	(679,237)	(2,870,551)	(7,431)	57,737	(4,312)	(4,312)	869,140	1,676,291

Supplemental Disclosure of Cash Flow Information:

33. Total Interest Paid	0	14,585	(71)	0	0	0	0	0	0	14,512
Supplemental Schedule of Financing and Investing Activity:										
34. Property & Equipment Acquired Under Capital Lease Obligations	0	0	0	0	0	0	0	0	0	0
35. Property Acquired Under Long-term Financing Arrangements	1,387,297	0	0	0	0	0	0	0	0	1,387,297
36. Other Exchanges of Noncash Assets or Liabilities	0	0	0	0	0	0	0	0	0	0

Combining Statements

DEFENSE AGENCY, DEPARTMENT OF DEFENSE
 REPORTING ENTITY: DEFENSE BUSINESS OPERATIONS FUND
 STATEMENT OF CASH FLOWS
 AS OF 30 SEPTEMBER 1994
 (IN THOUSANDS)

Cash Provided (Used) by Financial Activities

	DEAS	DECA	HSNC	US TRANS COMBINED	DSSA	ASSOV CMA	DTIC	COMPONENT FSAAL ADD	DEFENSE AGENCIES TOTAL
20 Appropriations (Current Varrants)	0	0	0	0	0	0	0	0	0
21 Add:									
a. Reservations	0	0	0	0	7,455	0	0	0	7,455
b. Transfer of Cash from Others	1,312	0	0	0	0	0	0	0	1,312
22 Deduct:									
a. Withdrawals	0	0	0	0	0	0	0	0	0
b. Transfer of Cash to Others (Note 4)	(1,015,025)	(922,019)	(211,955)	(291,144)	(16,971)	(1,019)	6,213	0	(112,110)
23 Net Appropriations	(1,013,713)	(922,019)	(211,955)	(291,144)	(16,971)	(1,019)	(6,213)	0	(1,563,034)
24 Borrowing from the Public	0	0	0	0	44,532	0	0	0	44,532
25 Repayment on Loans to the Public	0	0	0	0	0	0	0	0	0
26 Repayment from the Treasury & the Federal Financing Bank	0	0	0	0	0	0	0	0	0
27 Repayment on Loan from the Treasury & the Federal Financing Bank	0	0	0	0	0	0	0	0	0
28 Other Borrowing & Repayments	0	0	0	0	0	0	0	0	0
29 Net Cash Provided (Used) by Financing Activities	(1,013,713)	(922,019)	(211,955)	(291,144)	44,428	1,019	(6,213)	0	(1,200,592)
30 Net Cash Provided (Used) by Operating Investing & Financing Activities	(141,420)	(246,112)	(106,144)	(217,271)	(19,106)	(791)	1,950	0	(661,310)
31 Fund Balance with Treasury, Cash & Foreign Currency, Beginning	1,011,712	(927,019)	(211,955)	(291,144)	(16,971)	(1,019)	6,213	0	(111,855)
32 Fund Balance with Treasury, Cash & Foreign Currency, Ending	870,292	(1,173,131)	(318,099)	(508,415)	(61,073)	(1,810)	2,263	0	(1,171,952)

Supplemental Disclosures of Cash Flow Information:

33 Total Interest Paid	0	6,309	0	0	(1)	0	0	0	0
34 Supplemental Schedule of Financing and Investing Activity:									
35 Property & Equipment Acquired Under Capital Leases Obligations	0	0	0	0	0	0	0	0	0
36 Other Acquired Under Long-Term Financing Arrangements	0	0	0	0	0	0	0	0	0
37 Other Exchange of Non-cash Assets or Liabilities	1,833,414	0	0	0	0	0	0	0	0

Audit Opinion

***DEFENSE BUSINESS
OPERATIONS FUND***

AUDIT OPINION

Audit Opinion _____

Appendix B. Financial Statements and Auditor Opinion

Audit Opinion



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



March 29, 1996

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

SUBJECT: Disclaimer of Opinion on the Defense Business Operations Fund Financial
Statements for FY 1995 (Project No. 5FH-2006)

Introduction

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by statutory Inspectors General. The CFO Act prescribes the responsibilities of management and the auditors with respect to the financial statements, internal controls, and compliance with laws and regulations. Fund managers are responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to the Defense Business Operations Fund (DBOF). Our responsibilities are to express an opinion on the financial statements based on our audit, and to determine whether internal controls are adequate and whether the DBOF complied with laws and regulations.

Disclaimer of Opinion

We were unable to render an opinion on the Defense Business Operations Fund Consolidated Financial Statements for FY 1995. Significant deficiencies in the accounting systems and the lack of a sound internal control structure prevented the preparation of accurate financial statements. Without a sound internal control structure, the financial information provided to management for the operation of the DBOF, as well as the financial statements, cannot be relied on for making decisions or assessing performance. However, we were able to evaluate some internal controls and aspects of compliance with laws and regulations. The following paragraphs summarize the major internal control and compliance weaknesses facing the DBOF.

Internal Controls

Internal controls for the DBOF are not adequate. The accounting systems do not provide reasonable assurance that financial information is reliable. The systems do not provide consistency in financial reporting or comparability of information on DBOF operations. Additionally, the U.S. Government Standard General Ledger (USGSGL) accounts have not been fully implemented. DBOF activities continue to use unique charts of accounts and crosswalks from each activity's general ledger to the USGSGL for preparation of financial statements, increasing the potential for error. We have

Audit Opinion

noted improvements in financial reporting because of corrective actions by management at lower-level DBOF activities. However, these changes do not significantly improve the overall reporting of DBOF financial information at the consolidated statement level. Additionally, DoD has developed an interim migratory strategy to accelerate the consolidation of DoD accounting systems. When the migratory systems become functional, accountability and reporting capabilities should improve.

Compliance With Laws and Regulations

Instances of noncompliance with regulations continue to exist within the DBOF. Accounting systems and internal controls do not completely or accurately disclose the financial position of the DBOF activities as required by title 31, United States Code. Most of DoD's numerous financial systems do not meet the requirements of Office of Management and Budget Circular No. A-127, "Financial Management Systems," July 23, 1993, which requires that accounting systems interface with logical systems and meet other requirements for documentation, audit trails, and general ledger control. Also, a potential Antideficiency Act violation may exist in the Navy DBOF Fund Balance With Treasury account as a result of the use of accounting estimates. Accounting estimates used to report Fund Balance With Treasury activity violate DoD policy and generally accepted accounting principles. Additionally, DBOF activities did not always comply with DoD Regulation 7000.14-R, "DoD Financial Management Regulation," in areas such as the Standard General Ledger; Property, Plant, and Equipment; and Revenue Recognition.

Additional Reports. This report briefly summarizes the major deficiencies affecting the DBOF. We plan to issue reports with further details on internal controls and compliance with laws and regulations. We will also issue a report that details the major deficiencies currently affecting the DBOF.



Robert J. Lieberman
Assistant Inspector General
for Auditing

Appendix C. Prior Audits and Other Reviews

Consolidated DBOF Report Summaries

IG, DoD, Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," August 18, 1995. The IG, DoD, reported that the DBOF had not been able to prepare financial statements that fairly presented the DBOF financial position since its establishment in 1991. The financial statements prepared were untimely, unreliable, inconsistent, and inaccurate. As a result, Congress and DoD managers could not effectively use the DBOF financial statements and underlying systems for management oversight. Additionally, the unauditable financial systems reflected the inadequate internal control structure within DBOF, which negatively affected day-to-day operations.

Major deficiencies identified during the audit were grouped into the accounting systems' characteristics and overall management issues. The DBOF accounting and financial systems compiled information inefficiently. A major obstacle to the development and use of reliable financial statements was the lack of a universally implemented standard general ledger. The DoD Standard General Ledger was partially implemented in a few DoD accounting systems; other systems used crosswalks in an attempt to recategorize data. Insufficient documentation and poor audit trails characterized many DBOF accounting and financial systems. Additionally, inadequate accounting for intrafund transactions contributed to significant distortions on the financial statements. Several DFAS centers either did not have in place, or did not fully use, automated reasonableness and edit checks. Failure to use such checks would result in incorrect financial statements, and excessive time and effort spent in correcting avoidable accounting problems. Also, footnote disclosures to the financial statements issued by the DFAS centers did not provide accurate overviews and supplemental information.

Deficiencies existed in the overall management of the DBOF accounting and financial systems. Many accounting problems at DoD activities and on the DBOF financial statements were attributable to deficient DBOF guidance. The guidance was not always properly distributed or understood, was not up to date, or had not been developed. Additionally, inadequate accounting for many items of Property, Plant and Equipment materially distorted the preparation and presentation of the FY 1994 DBOF financial statements. Also, because of inaccurate valuation in DoD inventory accounts and misclassification in other line-item accounts, preparation of financial statements was flawed, and financial statements were not usable. Finally, development and use of the financial statements were adversely affected by problems with accounting personnel, such as inadequate training, shortages of support personnel, poor communication

between field offices and headquarters, loss of corporate knowledge, and a lack of documented procedures. The Under Secretary of Defense (Comptroller) concurred with the report.

IG, DoD, Report No. 95-267, "Defense Business Operations Fund Consolidated Statement of Financial Position for FY 1994," June 30, 1995. The IG, DoD, was unable to render an opinion on the DBOF FY 1994 Consolidated Statement of Financial Position because of the lack of a sound internal control structure, noncompliance with regulations, and deficiencies in the accounting systems. All of these problems prevented the preparation of accurate financial statements. Material internal control weaknesses were found in each of the accounts reviewed. The Air Force Inventory In-Transit account for business activities had a negative balance. A negative balance in an inventory account would indicate an internal control problem in the accounting system that produces those figures; therefore, the system could not be relied on.

Several conditions were noted in Accounts Receivable of the Defense Logistics Agency Distribution Depot and Air Force Depot Management business areas. For example, misstatements occurred because transactions were unsupported and unverified; the incorrect recording of Accounts Receivable caused overstatements in the account; weak internal controls caused reimbursements to be collected, but not posted or recorded; and funding documents were not received, which prevented the activities from billing customers. The DLA Property, Plant and Equipment account was materially understated. The Navy Property, Plant and Equipment account was overstated because assets could not be located, costs were unsupported, and assets were incorrectly recorded.

The IG, DoD; the Naval Audit Service; and the Air Force Audit Agency found reportable conditions in Accounts Payable that affected the reliability of the balances. The conditions included accounting errors, negative balances, Accounts Payable disbursements that were not posted to the Accounts Payable balance, Accounts Payable disbursements that were not recorded, and a lack of supporting documentation. The Army's Other Intragovernmental Liabilities account contained invalid transactions, but adjustments were made to the financial statements before the year-end account balances were submitted to DFAS Indianapolis Center. The Navy's Other Liabilities account was overstated because of system-wide processing problems. The Navy did not include the required Intrafund Elimination note to the financial statements because the Navy did not have the procedures needed to collect data for the note.

The IG, DoD, reported several instances of noncompliance with laws and regulations. DoD did not comply with the Federal Financial Management Act of 1994, which established a deadline of March 31, 1995, for agencies to provide unaudited FY 1994 financial statements to OMB. This delay was caused in part by the Navy. The IG, DoD, report stated that the systems for accounting and internal controls did not completely or accurately disclose the financial position of the DBOF activities as required by title 31, United States Code. The FY 1994 DFAS Annual Statement of Assurance reported that most of the financial management systems did not meet the requirements of OMB Circular No. A-127. One of the Army Supply Management systems did not use

Appendix C. Prior Audits and Other Reviews

standard general ledger accounts, as required by the "DoD Accounting Manual." Most Army depot maintenance activities did not have an accounting system that allowed them to compute depreciation on separate buildings, as required by the "DoD Financial Management Regulation." The Army did not comply with Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property," July 30, 1993, which states that inventory should be revalued to its latest acquisition cost at year's end. The Navy and two Defense Accounting Offices used estimated figures, contrary to the "DoD Accounting Manual," which prohibits estimates in the Statement of Accountability. The USD(C) generally concurred with the report. The Navy objected to the IG, DoD, statement that the audit was impeded in part because Navy management made repeated adjustments to the Navy DBOF financial statements. The IG, DoD, responded that the Navy's comments failed to consider the requirement in the Federal Financial Management Act of 1994 to submit unaudited FY 1994 DBOF financial statements to OMB by March 31, 1995.

IG, DoD, Report No. 94-161, "Consolidated Statement of Financial Position of the Defense Business Operations Fund for FY 1993," June 30, 1994. The IG, DoD, was unable to render an opinion on the DBOF FY 1993 Consolidated Statement of Financial Position because of significant internal control deficiencies and noncompliance with regulations. The IG, DoD, reported numerous internal control problems associated with four accounts of the DBOF financial statements. The principal problems in the Fund Balance With Treasury account were the definition of the account and the reconciliation of balances. The DoD definition of this account was not consistent with accounting principles, which made the balance misleading. Additionally, the individual activities could not reconcile their own portions of the account because the information was integrated with other information from the DoD Fund Balance With Treasury account. The Defense Logistics Agency and the Navy reported misstatements in this account. The Inventory Held for Sale, Net, account and the Inventory Not Held for Sale account also had a number of problems. In addition to valuation and classification problems, many activities had material discrepancies in these accounts. Specifically, for the Inventory Not Held for Sale account, negative inventory balances were reported, and the accuracy of War Reserve assets could not be verified. The Army and the Air Force did not maintain appropriate source documentation for items included in the Property, Plant and Equipment account, which made those portions of the account unauditible. Also, the Air Force did not report all Property, Plant and Equipment in the DBOF financial statements. Additionally, the Property, Plant and Equipment account for the Joint Logistics Systems Center was misstated because that activity did not implement an effective internal control program.

The IG, DoD, reported numerous instances of noncompliance with regulations. The DFAS Indianapolis Center did not use an integrated general ledger to produce the FY 1993 financial statements, as required by OMB guidance, and several Army DBOF supply systems did not use the standard general ledger system required by the "DoD Accounting Manual." The IG, DoD, also reported that the Defense Logistics Agency did not effectively implement an internal management control program for reporting the results of physical inventories. Also, the Army valued all inventories at standard price, but the

Defense Logistics Agency valued only reutilization and marketing inventories at standard price. Neither of those valuation policies adhered to the Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities," March 30, 1993. The IG, DoD, also reported that most Army Depot Maintenance activities did not have accounting systems that allowed them to compute depreciation for separate buildings, as required by the "DoD Accounting Manual." Finally, the Notes to the FY 1993 DBOF Financial Statements were not in accordance with the "DoD Guidance on Form and Content on Financial Statements for FY 1993 and FY 1994 Financial Activity." The financial statements included 4 notes, not the required 26 notes. No recommendations were made in this report; therefore, management comments were not required, and none were received.

IG, DoD, Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," June 30, 1993. The IG, DoD, was unable to render an opinion on the DBOF FY 1992 Financial Statements because audit trails were inadequate, accounting systems were inadequate, significant internal control deficiencies existed, significant instances of noncompliance with regulations were found, and legal and management representation letters were not received. The IG, DoD, reported numerous material internal control weaknesses that affected the reliability of the DBOF FY 1992 Financial Statements. Transactions were not properly recorded and accounted for because controls over cash were inadequate, transactions by and for others were not recorded in a timely manner, intrafund transactions were not eliminated or reported, and certain accounts were not properly accounted for. The IG, DoD, could not ensure that assets were safeguarded from unauthorized use because supporting documentation was lacking, and because the Capital Asset and Inventory accounts were not correctly valued and the auditors could not determine whether those accounts existed. Transactions were not executed in compliance with existing guidance. Reconciliations, uniform accounting systems, and a standard general ledger were lacking, and the weekly flash cash reports were unreliable.

Several instances of noncompliance with laws and regulations materially affected the reliability of the DBOF FY 1992 Financial Statements. The DBOF accounting systems did not meet the requirements of the Budget and Accounting Procedures Act of 1950 and GAO Title 2, "Policy and Procedures Manual for Guidance of Federal Agencies." The USD(C) was not in full compliance with OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," which implemented the Chief Financial Officers Act. In addition, quarterly and annual reports to the Department of the Treasury on Accounts and Loans Receivable Due From the Public were not accurately prepared. Air Force Supply Management did not follow requirements of the "DoD Accounting Manual." Real properties were improperly reflected as assets on the DBOF financial statements and did not comply with the requirements for Real Property Ownership under title 10, United States Code, section 2682. Also, the DFAS Columbus Center and the Defense Commissary Agency did not meet certain provisions of the Prompt Payment Act. No recommendations were made in this report; therefore, management comments were not required. However, we received comments from the Acting Chief Financial Officer. Management generally agreed with the report, but took exception to our reportable conditions

Appendix C. Prior Audits and Other Reviews

on inadequate audit trails and reported instances of noncompliance with GAO Title 2, the "Budget and Accounting Procedures Act of 1950," OMB Bulletin No. 93-02, and the National Defense Authorization Act. We did not agree with management's comments.

Other Related Prior Audit Reports

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
General Accounting Office		
AIMD-96-54	Defense Business Operations Fund (DBOF)*: DoD Is Experiencing Difficulty in Managing the Fund's Cash (OSD Case No. 1109)	April 1996
AIMD-95-79	DBOF: Management Issues Challenge Fund Implementation (OSD Case No. 9859)	March 1, 1995
AIMD-94-80	Financial Management, Status of the DBOF (OSD Case No. 9339-D)	March 9, 1994
Inspector General, Department of Defense		
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
95-072	Defense Finance and Accounting Service Work on the FY 1993 Air Force DBOF Financial Statements	January 11, 1995
95-067	Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements	December 30, 1994
95-066	Application Controls - Navy Inventories	December 30, 1994
95-034	Development of Property, Plant and Equipment Systems	November 21, 1994

*Acronym used in report titles for brevity.

Appendix C. Prior Audits and Other Reviews

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
95-023	Application Controls Over Selected Portions of the Standard Army Intermediate Level Supply System	November 4, 1994
94-199	Research on Accounting and Financial Reporting at the Defense Information Services Organization	September 30, 1994
94-183	Controls Over Commissary Revenues	September 6, 1994
94-168	Defense Finance and Accounting Service Work on the Army FY 1993 Financial Statements	July 6, 1994
94-167	Selected Financial Accounts on the Defense Logistics Agency DBOF Financial Statements for FY 1993	June 30, 1994
94-163	Management Data Used to Manage the U.S. Transportation Command and Military Department Transportation Organizations	June 30, 1994
94-161	Consolidated Statement of Financial Position of the DBOF for FY 1993	June 30, 1994
94-159	Fund Balances With Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the DBOF	June 30, 1994
94-150	Inventory Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the DBOF for FY 1993	June 28, 1994
94-149	Property, Plant and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the DBOF for FY 1993	June 28, 1994
94-147	Joint Logistics System Center's Financial Statements for FY 1993	June 24, 1994
94-128	Management Data Used to Manage the Defense Logistics Agency Supply Management Division of the DBOF	June 14, 1994
94-082	Financial Management of the DBOF - FY 1992	April 11, 1994

Appendix C. Prior Audits and Other Reviews

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
93-164	Financial Statements of the DLA Supply Management Division of the DBOF (Defense Fuel Supply Center Financial Data) for FY 1992	September 2, 1993
93-153	DBOF Communication Information Services Activity Financial Statements for FY 1992	August 6, 1993
93-151	Compliance With the Federal Managers' Financial Integrity Act at the Defense Commercial Communications Office	July 26, 1993
93-147	Defense Commissary Resale Stock Fund Financial Statements for FY 1992	June 30, 1993
93-134	Principal and Combining Financial Statements of the DBOF for FY 1992	June 30, 1993

Army Audit Agency

NR 95-430	Army DBOF FY 94 Financial Statements	July 19, 1995
NR 94-471	Army DBOF FY 93 Financial Statements: Report of Management Issues	September 29, 1994
NR 94-470	Army DBOF FY 93 Financial Statements: Audit Opinion	June 30, 1994
NR 94-457	DBOF, FY 92 Financial Statements: Common Management Issues	March 30, 1994
NR 94-456	DBOF, Transportation, Army FY 92 Financial Statements: Report of Management Issues	March 30, 1994
NR 94-454	DBOF, Depot Maintenance, Army FY 92 Financial Statements: Report of Management Issues	March 30, 1994
NR 93-463	DBOF Depot Maintenance, Army	June 30, 1993
NR 93-462	DBOF Transportation, Army	June 30, 1993

Naval Audit Service

044-95	FY 1994 Consolidating Financial Statements of the Department of the Navy DBOF	May 30, 1995
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Appendix C. Prior Audits and Other Reviews

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
010-95	Sponsor-Funded Equipment at Selected Navy DBOF Activities	December 2, 1994
053-H-94	FY 1993 Consolidating Financial Statements of the Department of the Navy DBOF	June 29, 1994
053-H-93	FY 1992, Consolidating Financial Statements of the Department of the Navy DBOF	June 30, 1993

Air Force Audit Agency

94068027	Followup Audit--Review of Prior Year DBOF Recommendations	October 25, 1995
94068042	Followup Audit--Review of Prior Year DBOF Recommendations	August 18, 1995
94068039	Review of Selected Accounts, Depot Maintenance Service Business Area, FY 1994	July 28, 1995
94068041	Review of Selected Accounts, Supply Management Business Area, FY 1994	June 27, 1995
93066011	Review of Application Controls Within the Depot Maintenance Equipment Program	November 16, 1994
93066012	Review of Application Controls Over Time and Attendance Reporting in Air Force Materiel Command Depot Maintenance Organizations	November 4, 1994
93066024	Review of Application Controls Within the Financial Inventory Accounting and Billing System	October 3, 1994
94068020	Opinion on Air Force DBOF, FY 1993 Fund Balances With Treasury	June 30, 1994
94068019	Opinion on Air Force DBOF, FY 1993 Property, Plant and Equipment Balances	June 30, 1994
94068018	Opinion on Air Force DBOF, FY 1993 Inventories Not Held for Sale Balance	June 30, 1994
94068017	Opinion on Air Force DBOF, FY 1993 Inventories Held for Sale Balance	June 30, 1994

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<u>Report No.</u>	<u>Title</u>	<u>Date</u>
93066023	Review of Application Controls Within the Depot Maintenance Actual Materiel Cost System	June 10, 1994
94068025	Air Force Depot Maintenance Service, FY 1993 Material In-Transit Balances	April 1, 1994
93068001	Compliance With Laws and Regulations and Management Issues Related to Air Force Supply Management and Distribution Depot, FY 1992 Financial Statements	December 15, 1993
92066008	Review of the Design and Development Activities for the Depot Maintenance Management Information System	August 18, 1993
93068024	Opinion on Air Force Consolidating Statements, DBOF, FY 1992 Financial Statements	June 30, 1993
93068012	Opinion on Air Force Distribution Depot, DBOF, FY 1992 Financial Statements	June 30, 1993
93068011	Opinion on Air Force Supply Management, DBOF, FY 1992 Financial Statements	June 30, 1993
92068003	Opinion on Laundry and Dry Cleaning Service, DBOF, FY 1992 Financial Statements	June 30, 1993
92068002	Opinion on Air Force Depot Maintenance, DBOF, FY 1992 Financial Statements	June 30, 1993
92071002	Opinion on Air Force Transportation, DBOF, FY 1992 Financial Statements	June 29, 1993
92066010	Review of General and Application Controls Within the Contract Depot Maintenance Production and Cost System	April 1, 1993
92066002	Review of General and Application Controls Within the Equipment Inventory, Multiple Status and Utilization Reporting Subsystem	April 1, 1993
92062001	Review of Depot Maintenance Industrial Fund Revenue Accounts, FY 1992 Financial Statements	February 28, 1993

Appendix D. Laws and Regulations Reviewed

Subtitle II, The Budget Process, title 31, United States Code, including the Antideficiency Act provisions of title 31, U.S.C., §1341, "Limitations on Expending and Obligating Amounts;" and title 31, U.S.C., §1517, "Prohibited Obligations and Expenditures"

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

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

Historical and Statutory Notes to title 10, United States Code, §2208, Working-Capital Funds

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

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 5, "Disbursing Policy and Procedures," December 1993

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 8, "Civilian Pay Policies and Procedures," March 18, 1993

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

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 14, "Administrative Control of Funds and Antideficiency Violations," August 1995

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 15, "Security Assistance Policy and Procedures," March 1993

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

DoD Directive 7200.1, "Administrative Control of Appropriations," as revised July 27, 1987

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987

Appendix D. Laws and Regulations Reviewed

Joint Financial Management Improvement Program Core Financial System
Requirements FFMSR-1,* as revised April 1994

Treasury Financial Manual, June 12, 1990

GAO "Policy and Procedures Manual for Guidance of Federal Agencies," Title 2,
"Accounting," May 18, 1988

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

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

OMB Circular No. 123, "Internal Control Systems," August 4, 1986

OMB Statement of Federal Financial Accounting Standards Number 1, "Accounting for
Selected Assets and Liabilities," March 30, 1993

OMB Statement of Federal Financial Accounting Standards Number 2, "Accounting for
Direct Loans and Loan Guarantees," August 23, 1993

OMB Statement of Federal Financial Accounting Standards Number 3, "Accounting for
Inventory and Related Property," October 27, 1993

OMB Statement of Federal Financial Accounting Standards Number 4, "Managerial
Cost Accounting Concepts and Standards," July 31, 1995

OMB Statement of Federal Financial Accounting Standards Number 5, "Accounting for
Liabilities of the Federal Government," September 1995

OMB Statement of Federal Financial Accounting Concepts Number 1, "Objectives of
Federal Financial Reporting," September 2, 1993

OMB Statement of Federal Financial Accounting Concepts Number 2, "Entity and
Display," June 6, 1995

"DoD Guidance on Form and Content of Financial Statements for FY 1994/1995
Financial Activity," October 20, 1994

*Federal Financial Management Systems Requirements

Appendix E. Summary of Work Performed by Others

Component	Business Area	FY 1995 Reported Assets	FY 1995 Reported Expenses	Scope of Audit Work Performed	Organizations Performing Audit Work	Audit Report Number
Army	Supply Management	\$11,696,253,000	\$10,388,443,000	Limited ¹	Army Audit Agency	AA 96-185 AA 96-177
	Depot Maintenance-Ordnance	800,980,000	586,045,000	None	Army Audit Agency	Unaudited AA 96-186
	Depot Maintenance-Other	1,746,781,000	1,688,041,000	Limited ¹		AA 96-177 Unaudited
	Corporate Level Consolidating	330,612,000 14,504,221,000 ²	0 10,710,652,000 ²	None Limited ³	Army Audit Agency	AA 96-177 AA 96-100 AA 96-178
Navy	Supply Management	14,396,045,000	5,792,895,000	Limited ⁴	Naval Audit Service	035-96
	Distribution Depot	95,848,000	109,279,000	None	Naval Audit Service	Unaudited 035-96
	Depot Maintenance-Shipyards	2,154,940,000	2,788,386,000	Limited ⁴		035-96
	Depot Maintenance-Aviation	1,553,340,000	1,140,792,000	Limited ⁴	Naval Audit Service	Unaudited
	Depot Maintenance-Ordnance	586,389,000	606,552,000	None	Naval Audit Service	Unaudited Unaudited
	Depot Maintenance-Other (Marine Corps)	17,397,000	185,122,000	None		035-96
	Transportation-Military Sealift Command	1,406,898,000	1,069,353,000	Limited ⁴	Naval Audit Service	Unaudited
	Base Support	1,047,026,000	1,969,462,000	Limited ⁵	Naval Audit Service	035-96
	Logistics Support Activities	124,156,000	350,512,000	None	Naval Audit Service	Unaudited 035-96
	Research and Development	3,286,319,000	8,106,654,000	Limited ⁵		Unaudited
	Information Services	69,524,000	280,823,000	None	None	Unaudited Unaudited
	Defense Printing Service	128,472,000	402,079,000	None		Unaudited
	Component	795,746,000	0	None	None	Unaudited Unaudited
	Consolidating	27,716,168,000 ²	22,801,909,000 ²	None		Unaudited
Air Force	Supply Management	29,100,391,000	15,710,552,000	Limited ⁶	Air Force Audit Agency	95068020
	Depot Maintenance	2,927,212,000	4,277,333,000	Limited ⁶	Air Force Audit Agency	95068021
	Transportation-Air Mobility Command	(205,707,000)	0	None	None	Unaudited Unaudited
	Base Support	315,000	819,000	None		Unaudited
	Consolidating	31,787,708,000 ²	16,116,957,000 ²	None	Unaudited	
Defense Logistics Agency	Supply Management	13,091,728,000	14,845,552,000	None	IG, DoD	Unaudited
	Distribution Depots	1,020,792,000	1,604,201,000	None		Unaudited
	Reutilization and Marketing Service	633,854,000	367,538,000	None		Unaudited
	Industrial Plant and Equipment Center	138,778,000	10,870,000	None		Unaudited
	Clothing Factory	7,775,000	(606,000)	None		Unaudited
	Consolidating	13,091,728,000	14,845,552,000	Limited ⁷		5FD-2020.01

¹The audit was limited to a review of selected accounts on the Statement of Operations and follow-up work on previously identified problems related to the Statement of Financial Position.

²Amounts do not agree with the sum of the sub-parts.

³Same as Footnote ¹ for Supply Management and Depot Maintenance, Other; and summary-level review of the draft (consolidating and business area) financial statements for compliance with form and content guidance.

⁴The audit was limited to a review of selected accounts on the Statement of Financial Position.

⁵The audit was limited to a review of selected accounts on the Statement of Financial Position and the Statement of Operations.

⁶The audit was limited to a review of selected internal controls for selected accounts on the Statement of Financial Position and the Statement of Operations.

⁷The audit was limited to a review of Revenue elimination entries.

⁸The audit was limited to a review of the internal controls of selected accounts within the Airlift Services Division for the Statement of Financial Position and the Statement of Operations.

<u>Component</u>	<u>Business Area</u>	<u>FY 1995 Reported Assets</u>	<u>FY 1995 Reported Expenses</u>	<u>Scope of Audit Work Performed</u>	<u>Organization Performing Audit Work</u>	<u>Audit Report Number</u>
Defense Technical Information Center	Consolidating	\$ (19,064,000)	\$ 12,506,000	None		Unaudited
Defense Information Systems Agency	Communications Information Services Activity	466,809,000	1,820,181,000	None		Unaudited
	Defense Megacenters	355,320,000	713,221,000	None		Unaudited
	Consolidating	822,129,000	2,533,402,000	None		Unaudited
Defense Finance and Accounting Service	DFAS Financial Operations	805,192,000	1,804,686,000	None		Unaudited
Defense Commissary Agency	Commissary Operations	(506,314,000)	1,073,422,000	None		Unaudited
	Resale Stocks	705,884,000	5,541,875,000	None		Unaudited
	Consolidating	199,570,000	6,615,297,000	None		Unaudited
Joint Logistics Service Center	Consolidating	845,841,000	29,755,000	None		Unaudited
U.S. Transportation Command	Consolidating	2,620,144,000	4,666,010,000	Limited ⁸	Air Force Audit Agency	95068001
Corporate Account	Consolidating	137,019,000	0	None		Unaudited
Departmental	Consolidating	<u>0</u>	<u>0</u>	None		Unaudited
Total		\$93,464,936,000²	\$80,136,989,000²			

¹The audit was limited to a review of selected accounts on the Statement of Operations and follow-up work on previously identified problems related to the Statement of Financial Position.

²Amounts do not agree with the sum of the sub-parts.

³Same as Footnote ¹ for Supply Management and Depot Maintenance, Other; and summary-level review of the draft (consolidating and business area) financial statements for compliance with form and content guidance.

⁴The audit was limited to a review of selected accounts on the Statement of Financial Position.

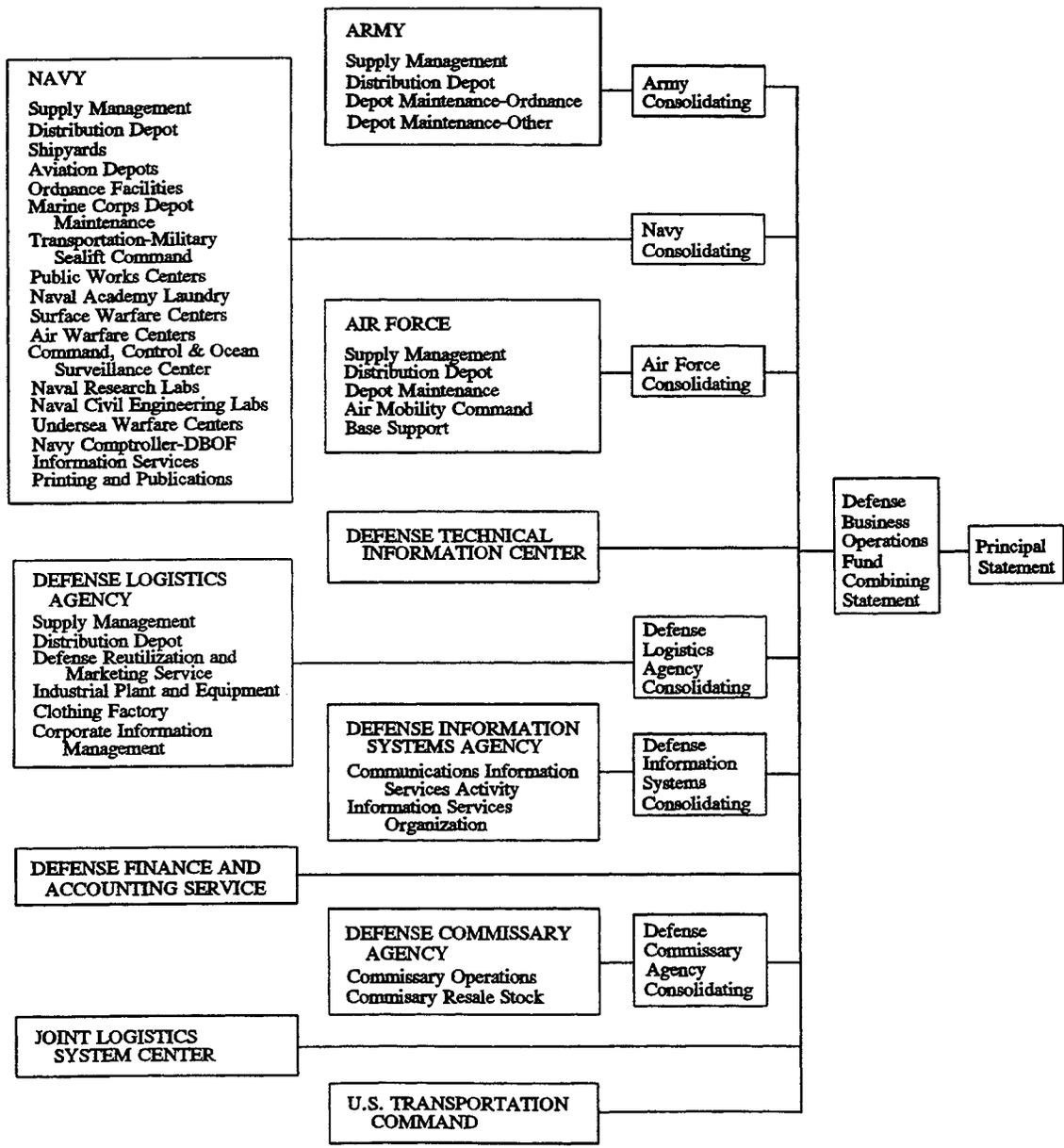
⁵The audit was limited to a review of selected accounts on the Statement of Financial Position and the Statement of Operations.

⁶The audit was limited to a review of selected internal controls for selected accounts on the Statement of Financial Position and the Statement of Operations.

⁷The audit was limited to a review of Revenue elimination entries.

⁸The audit was limited to a review of the internal controls of selected accounts within the Airlift Services Division for the Statement of Financial Position and the Statement of Operations.

Appendix F. Financial Statement Reporting Structure for the Defense Business Operations Fund



Appendix G. Management Representation Letter



COMPTROLLER

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

FEB 23 1996



MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Management Representation Letter for the Defense Business Operations Fund
Financial Statements for FY 1995

Reference is made to the FY 1995 Principal Financial Statements for the Defense Business Operations Fund (Project No. 5FH-2006). For the purpose of expressing an opinion on whether those statements are presented fairly and in accordance with generally accepted accounting principles and Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, I confirm, to the best of my knowledge and belief, the following representations:

- I am responsible for the fair presentation of the Defense Business Operations Fund financial statements in accordance with generally accepted accounting principles or OMB Bulletin 94-01.
- All financial records and related data have been made available to you.
- 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.
- I have no knowledge of irregularities involving management or employees who have significant roles in the internal control structure that are not a matter of public record.
- 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.
- 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.
- Related third-party transactions and related amounts receivable or payable of interested participants, including assessments, loans, and guarantees, are not applicable.
- 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.

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- I have no knowledge of other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Financial Accounting Standards Board Statement No. 5, "Accounting for Contingencies," March 1975.

- 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 Financial Accounting Standards Board Statement No. 5, beyond those that may be reported in the legal representation letter for the Defense Business Operations Fund that will be furnished shortly to you by the General Counsel of the Department.

- 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.

- Provisions, for material amounts, have been made to reduce excess or obsolete inventories to their estimated net realizable value.

- To my knowledge, the Federal Government 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.

- I have no knowledge of noncompliance with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

- 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.

Attached are identified procedural and systemic deficiencies that may prevent an auditor from expressing an unqualified opinion on the financial statements.

My staff contact for this matter is Mr. Oscar G. Covell. He may be reached at (703) 697-6149.


John J. Hamre

Attachment

IDENTIFIED PROCEDURAL AND SYSTEMIC DEFICIENCIES

Part 1. Departures from Published Accounting Policies and Procedures

Systemic and procedural deficiencies existed in the Department's accounting and financial management systems during FY 1995. The following list summarizes the known deficiencies within the accounting and financial management systems used to account for and report on financial activity for the Defense Business Operations Fund (DBOF).

A. **General Ledger Control/Lack of Uniform Accounting Systems.** The accounting systems in use by the Department do not provide consistency in financial reporting or comparability of information on operations for the DBOF. The Chief Financial Officers (CFO) Act requires the CFO of each covered agency to develop and maintain an integrated agency accounting and financial management system. Such systems are to provide for complete, reliable, consistent, and timely information prepared on a uniformed basis and responsive to the financial information needs of agency management. However, the Department must rely on existing accounting systems--systems that often provide DoD Component-unique information, although the DBOF reporting requirements are similar for each DoD Component. Many of the DBOF activities are supported by unique computer programs used to summarize information for reporting to the DBOF. The summarized information must be collected from several DoD Component-unique sources, which results in a further lack of comparability for data received for the DBOF.

In general, DBOF activities do not have an effective reporting system that systematically summarizes financial information and, in some cases, documented procedures do not exist to determine which general ledger accounts were used to develop the various account classifications on the financial statements. Additionally, the U.S. Government Standard General Ledger (USGSL) accounts have not been incorporated into the Defense Finance and Accounting Service (DFAS) accounting systems. Consequently, for the FY 1995 financial statements, preparers had to crosswalk general ledger accounts to the DoD uniform chart of accounts, then crosswalk the DoD accounts to the account classifications on the financial statements. In addition, integrated general ledger systems were not always available to be used to produce the FY 1995 financial statements. Instead, reports from departmental budget and reporting systems sometimes were relied on to prepare financial reports. Similarly, some DBOF business areas did not have a fully integrated double-entry accounting system. In those instances, information was gathered from automated and manual systems to create a consolidated general ledger. The procedures used to create the general ledgers were not fully documented, and there are no procedures in place to assure that all transactions were recorded. Automated accounting systems were not always in place to collect and report expenses as required, and the accounting systems did not always generate sufficient and suitable accounting data to permit the review and certification of fiscal year financial statements.

B. **Integrated General Ledger.** Not all of the Department's accounting systems use an integrated general ledger double-entry type system, from which financial statements can be produced. Not all the accounting activities or reporting entities have controls in place to ensure

Appendix G. Management Representation Letter

that all valid transactions are properly recorded, processed, and summarized in order to always provide accurate financial information to fund managers. Rather than using the general ledger to account for major assets, most reporting entities frequently rely on information derived from operational and logistics systems. In addition, there is a lack of assurance that source data always is accurate because some discrepancies in the operational and logistics systems are not investigated in a timely manner. The absence of a fully integrated general ledger system for all DoD assets limits the Department's capability to ascertain whether all assets are included in financial statement amounts, and consequently there is no standard financial control over the amounts reported.

C. Standard General Ledger. The USGSGL has not been fully implemented for the DBOF business areas. During FY 1995, at least seven different general ledger structures were in use by DBOF activities. The USGSGL is intended to standardize Federal accounting and meet the basic Federal financial statement and budget execution reporting requirements. The DoD Components are using Component-unique charts of accounts and are crosswalking the financial data from the activities' general ledger accounts to the USGSGL for preparation of management reports and financial statements. The lack of a uniform general ledger within the DBOF increases the potential for accounting errors and increases the level of effort required to prepare and audit financial statements or management reports for the use of other government offices, such as the Treasury Department and the Office of Management and Budget (OMB). Since the crosswalks in use do not always have a one-for-one relationship to accounts in the USGSGL, transactions may not always be recorded and accounted for in a manner permitting the preparation of reliable financial statements in accordance with OMB guidance.

In addition, the absence of a standard general ledger accounting system makes it difficult to ascertain whether like items are reported in similar general ledger balances. The Department has developed an interim migration strategy to accelerate the consolidation of DoD accounting systems. Once the interim migratory systems become functional, the Department expects to improve its accountability and reporting capabilities and save resources by using fewer systems and consolidating accounting functions. Interim migratory systems for the DBOF have been designated in the DoD Chief Financial Officer Financial Management 5-Year Plan dated October 1995. These systems will be used in the future as the transition is made from many accounting systems to fewer and standard accounting systems that are, transaction driven, integrated, and use the USGSGL.

D. Integrated Systems. The issue of integrating accounting systems with personnel, logistics, acquisition, and other systems has been a long-standing problem for the Department. The Department has initiated some actions to address this area. For example, the DFAS is continuing the process of selecting interim migration systems for broader application and standardization within the Department. The DFAS also is evaluating the interface of systems and the sharing of data bases both within accounting and finance functional areas and with other functional areas such as personnel, logistics, and acquisition.

E. Inadequate Systems. In the preparation of the DBOF financial statements for FY 1995, some functional systems that feed data to the accounting systems were not reviewed adequately

Appendix G. Management Representation Letter

for conformance with applicable accounting requirements. Internal controls were inadequate in these feeder systems to ensure that items were inventoried or accounted for properly.

F. Inadequate Coding Structure. The Department's coding structure within the accounting and financial management systems employed by DBOF activities have not been developed to capture and report adequately the data necessary for preparing DBOF financial statements. For example, a coding structure does not exist to capture and report on (1) interfund transactions within the DoD Components and (2) primary and secondary areas within the DBOF.

Part 2. Internal Controls

A. Fund Balances With Treasury Not Reconciled. Unreconciled differences in disbursement and collection transactions resulted in billions of accounting discrepancies between DBOF business area control accounts and installation level subsidiary accounting records.

B. Inadequate Internal Controls. The internal controls governing the processes for preparing financial statements still aren't adequate for significant portions of the adjustment and financial statement preparation processes.

C. Unmatched Disbursements. The auditors have reported that, contrary to policy, procedures don't ensure, necessarily, that disbursements are always posted to the correct obligation, or possible duplicate payments are prevented.

D. Negative Unliquidated Obligations. Auditors have concluded that Defense Accounting Offices and the supported installations do not always effectively monitor or accurately report negative unliquidated obligation balances.

E. Inaccurate Reporting of Plant, Property and Equipment. Although the auditors have noted some progress over prior years, overall procedures and controls were not adequate to ensure that plant, property and equipment are accurately reported in the Statement of Financial Position.

F. Unsupported Adjustments Made to General Ledger Accounts. Adjusting entries are sometimes made without required supporting documents. As a result, accounting adjustments or related account balances reported in the financial statements may not be substantiated. Some program managers may make incorrect or unsupported entries to year-end accounts on the financial statements because effective procedures for making adjusting entries have not yet been implemented or adhered to.

G. Property Records Not Fully Reconciled. Additional improvements were needed in accounting for equipment, and reconciling equipment values with subsidiary records.

H. Subsidiary Records Not Fully Reconciled. Some required monthly reconciliations of disbursement and collection transactions in the disbursing system were not performed or only partially performed.

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I. Inadequate Accounting for Receivables and Payables. Accounts Receivable and Accounts Payable are not always recorded in the proper accounting period or reconciled to general ledger account balances. Weak internal controls may cause reimbursements to be collected but not posted or recorded; also, some funding documents were not received, which prevented the activities from billing customers. Overstatements in Accounts Receivable may lead management to make decisions based on a false assumption that the activities have more resources than they actually have. Also, errors in recording Accounts Receivable may cause activities to be delayed or unable to bill customers.

J. Misclassification of Assets. Some equipment, inventories held for sale and inventories not held for sale were misclassified.

K. Inadequate Analytical Review of Account Balances. The reasonableness of amounts reported in the accounting records and financial statements is not always adequately reviewed.

L. Intrafund Eliminations. Auditors have found that the consolidated financial statements for the DBOF do not always include the required Intrafund Eliminations note to the financial statements. Those statements should include billions of dollars of transactions relating to collections and disbursements in the Intrafund Eliminations note.

M. Lack of Supporting Documentation. Adequate documentation to support the validity and accuracy of fund control transactions is not always obtained or maintained.

N. Misstated Accounts. The DBOF consolidated financial statements misstate liability account balances due to the inability to recoup credits given to retail customers who fail to return assets; as well as due to other system-wide processing problems.

O. In-Transit Accounts not Reconciled. During FY 1994, the Air Force Audit Agency reported a negative balance in an in-transit account. The auditors concluded that the existence of a negative balance in an inventory account is a physical impossibility, and the large misstatement indicates that one may not be able to rely on the systems that produced those figures.

P. Incorrect Valuation of Inventory. The auditors have reported incorrectly valued inventory, resulting in misstatements of the inventory account. They also have found that some maintenance activities valued all inventory at standard price, regardless of condition, which results in overvalued excess and unserviceable inventory.

Q. Excess Material Valued Incorrectly. Excess material may be valued at latest acquisition cost vice the prescribed percent of latest acquisition cost.

R. Inaccurate Recording and Reporting of Equipment and Depreciation. Department of the Navy consolidated financial statements for DBOF activities may not disclose sponsor-funded property and equipment.

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S. Accrual Accounting Procedures Not Followed. General ledger and subsidiary accounts may not always be established as required and, in some cases, miscellaneous revenues may either not have been recorded when earned or not recorded at all. Reporting entities do not always promptly process all receipt information. Consequently, expenses frequently are not recorded prior to disbursements.

T. Inadequate or Nonexistent Audit Trails. Some reporting entities may have not established adequate audit trails to enable managers or auditors to verify disbursements. In some cases, due to inadequate system capabilities, payments posted to records may not be traceable to the records of the DoD Components that recorded the payments.

Part 3. Compliance

A. Accounting Systems (Inadequate Interfacing Systems). OMB Circular A-127, "Financial Management Systems," requires that accounting systems interface with logistical systems and meet other requirements such as system documentation, audit trails, and general ledger control. The majority of the Department's 261 financial management systems do not meet the requirements of OMB Circular A-127. The auditors have in the past, concluded that many of the systems perform similar functions, which results in inefficiencies and disparate business practices.

B. Standard General Ledger (Inadequate Accounting Systems). The DoD Financial Management Regulation, Volume 1, "General Financial Management Information, Systems and Requirements," requires that activities use the DoD standard general ledger chart of accounts. The Under Secretary of Defense (Comptroller) (USD(C)) acknowledges that the standard general ledger has not been completely implemented in the DBOF business areas. Most of the noncompliant systems have a conversion program that crosswalks obsolete general ledger accounts or data bases to the standard general accounts.

C. Property, Plant, and Equipment (Inadequate Accounting Systems). The "DoD Financial Management Regulation" requires activities to depreciate each building separately. However, existing accounting systems generally preclude determination of depreciation expense. For example, most Army depot maintenance activities do not have an accounting system that allows them to compute depreciation on separate buildings. The Army Materiel Command is addressing this issue.

D. Inventory Valuation (Incorrect Valuation of Inventory). DoD policy requires that inventory be revalued to its latest acquisition cost at year end. This policy also requires that excess, obsolete, and unserviceable material be valued at its net realizable value. Existing procedures are not comprehensive and maintenance activities sometimes value all inventory at standard price, regardless of condition, which results in overvalued excess and unserviceable inventory. Some Navy DBOF activities do not report excess inventories correctly because disposal of excess items could negatively affect operating results. In addition, local policies do not allow material to be excessed unless credit was received from the supply system.

E. Cash Reconciliation (Fund Balances With Treasury Not Reconciled). Before FY 1995, the USD(C) was responsible for managing the Fund's cash. As of February 1, 1995, the USD(C) transferred responsibility for management of the Fund's cash to the cognizant DoD Components. Amounts reported as collected and disbursed on the some DBOF financial statements do not agree with individual activities' records, even after cash reconciliations are performed. These amounts represent the value of collections and disbursements that were successfully processed through the Components' finance network. Preparers of consolidated financial statements rely on information processed through the Army, Navy, and Air Force finance networks, while activities used additional information and omitted some information from those finance networks.

F. Accounting Estimates (Lack of Supporting Documentation). The "DoD Financial Management Regulation" requires that financial transactions be adequately supported with source records and pertinent documents, and prohibits estimates in the Statement of Accountability. The Navy finance network permitted estimates for collection figures when ships and activities did not report figures in sufficient time to be incorporated into reports to the Treasury Department. Beginning in FY 1996, the DFAS advised the Navy to discontinue the practice immediately.

Appendix H. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Under Secretary of Defense (Comptroller), Washington, DC
Office of the Deputy Comptroller (Program and Budget), Director for Revolving Funds, Washington, DC
Office of the Deputy Chief Financial Officer, Director for Accounting Policy, Washington, DC

Department of the Army

Army Audit Agency, Arlington, VA
Army Audit Agency, Chambersburg Field Office, Letterkenny Army Depot, PA

Department of the Navy

Naval Audit Service, Arlington, VA
Naval Audit Service, Southeast Region, Virginia Beach, VA

Department of the Air Force

Air Force Audit Agency, Wright-Patterson Air Force Base, OH

Other Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
Defense Logistics Agency, Fort Belvoir, VA

Appendix I. 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)
Office of the Deputy Chief Financial Officer
Deputy Comptroller (Program and Budget)
Assistant to the 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
Dudley Knox Library, Naval Postgraduate School

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Cleveland Center
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Finance and Accounting Service Indianapolis Center

Other Defense Organizations (cont'd)

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations

Office of Management and Budget
Office of the Inspector General, U.S. Department of Education
National Security and International Affairs Division, Technical Information Center,
U.S. 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 National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

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

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