Audit Report

OFFICE OF THE INSPECTOR GENERAL

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND REGULATIONS FOR THE DOD CONSOLIDATED FINANCIAL STATEMENTS FOR FY 1996

Report No. 97-182 June 30, 1997

Department of Defense

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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
OMB	Office of Management and Budget
USD(C)	Under Secretary of Defense (Comptroller)
USGSGL	U.S. Government Standard General Ledger

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June 30, 1997

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

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and Regulations for the DoD Consolidated Financial Statements for FY 1996 (Report No. 97-182)

We are providing this audit report for your information and use. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD and 23 other Federal agencies to prepare agency-wide financial statements beginning in FY 1996. The 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 DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations.

We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1996 because the DoD accounting systems produced unreliable and unauditable financial statements. Our opinion and the financial statements are in Part II, Appendix B. Part I discusses material weaknesses in internal controls and noncompliance with laws and regulations. Part II contains appendixes for management's use, including the "DoD Consolidated Financial Statements for FY 1996 and Auditor Opinion."

We appreciate the courtesies extended to the audit staff. If you have any questions, please contact Mr. David F. Vincent, Audit Program Director, at (703) 604-9109 (DSN 664-9109 or e-mail DVincent@DODIG.OSD.MIL), or Mrs. Saundra G. Elion, Audit Project Manager, at (703) 604-8929 (DSN 664-8929 or e-mail Selion@DODIG.OSD.MIL). See Part II, Appendix G, for the report distribution. The audit team members are listed inside the back cover.

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Report No. 97-182 **June 30, 1997**
(Project No. 5FH-2026.02)

Internal Controls and Compliance With Laws and Regulations for the DoD Consolidated Financial Statements for FY 1996

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD and 23 other Federal agencies to prepare agency-wide audited financial statements beginning in FY 1996. The DoD Consolidated Financial Statements for FY 1996 consist of the financial statements of the Army, the Navy, and the Air Force general funds; the Defense Business Operations Fund; the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; the U.S. Army Corps of Engineers (Civil Works); and Other Defense Organizations. In FY 1996, DoD reported assets of $1,311.5 billion and revenues of $301.9 billion.

Related Reports. This audit report is the second in a series of reports related to the DoD Consolidated Financial Statements for FY 1996. IG, DoD, Report No. 97-117, "Eliminating Entries," March 31, 1997, discusses the reporting of eliminating entries on the FY 1995 financial statements of the entities included in the DoD Consolidated Financial Statements for FY 1996.

Audit Objectives. The primary audit objective was to determine whether the DoD Consolidated Financial Statements for FY 1996 were presented fairly in accordance with the other comprehensive basis of accounting described in OMB 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 DoD consolidated financial statements were free of material error. We also assessed DoD compliance with laws and regulations for transactions and events that had a direct and material effect on the financial statements.

Disclaimer of Opinion. We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1996. The opinion report was included in the published financial statements that the Under Secretary of Defense (Comptroller) transmitted to the Office of Management and Budget (OMB) on June 11, 1997. See Part II, Appendix B, for the financial statements and the audit opinion.

Internal Controls. Although progress has been made, the internal control structure for DoD was not adequate to ensure that resources were properly managed and accounted for, and that financial statements were free of material misstatements. DoD accounting systems did not meet the requirements to interface with other financial management systems or to provide adequate documentation, audit trails, and general ledger controls. In addition, control procedures over adjusting entries and assets were not adequate and caused inaccurate reporting of real property, capital leases, construction in progress, inventory, and preparation of footnotes to the principal statements. The Secretary of Defense and the Defense Finance and Accounting Service, in the FY 1996 Annual Statements of Assurance, conceded that the weaknesses we had previously identified were material. Part I.A. is our report on internal controls.

Compliance With Laws and Regulations. Instances of noncompliance with laws and regulations continued to exist in DoD accounting systems. Although required by Title 31, United States Code, financial statements did not completely or accurately disclose the financial condition of DoD. In addition, DoD did not always comply with OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, in areas such as the Overview, Accounts Receivable, Operating Materials and Supplies, Accounts Payable, Contingent Liabilities, and Prior Period Adjustments. Part I.B. is our report on compliance with laws and regulations. Part II, Appendix D, lists the laws and regulations we tested.

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

Management Comments. A draft of this report was provided to the Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service, on May 16, 1997. Because the report contains no recommendations, written comments are not required, and none were received.

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Part I. - Audit Results

Audit Background

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD and 23 other Federal agencies to prepare agency-wide audited financial statements beginning in FY 1996. The DoD Consolidated Financial Statements for FY 1996 consist of the financial statements of the Army, the Navy, and the Air Force general funds; the Defense Business Operations Fund; the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; the U.S. Army Corps of Engineers (Civil Works); and Other Defense Organizations. The Under Secretary of Defense (Comptroller) (USD[C]) is the CFO of DoD and is responsible for overseeing the preparation of agency-wide financial statements. This responsibility includes segmenting the agency into reportable entities and determining which issues will be reported in the consolidated statements. Day-to-day operations of the reporting entities are the responsibilities of the Military Departments, the Defense agencies, and the DoD field activities.

Disclaimer of Opinion. We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1996. The opinion report was included in the published financial statements the Under Secretary of Defense (Comptroller) transmitted to the Office of Management and Budget (OMB) on June 11, 1997. See Part II, Appendix B, for the financial statements and the audit opinion.

Related Reports. This audit report is the second in a series of reports related to the DoD Consolidated Financial Statements for FY 1996. IG, DoD, Report No. 97-117, "Eliminating Entries," March 31, 1997, discusses the reporting of eliminating entries on the FY 1995 financial statements of the entities included in the DoD Consolidated Financial Statements for FY 1996.

DoD Size. In employment and discretionary spending authority, DoD is the largest U.S. Government agency. In FY 1996, DoD employed about 2.3 million active duty military and civilian personnel and had a budget authority of about $253.1 billion. Comparatively, DoD employed 53 percent of the 4.36 million employees in the Federal work force and was responsible for 51 percent of the estimated $495.9 billion in discretionary Federal budget authority. DoD also employed about 930,000 reservists and had responsibility for 16 percent of the estimated $1,571.8 billion in the total Federal budget. In FY 1996, DoD reported assets of $1,311.5 billion and revenues of $301.9 billion.

Accounting Functions and Responsibilities. The Defense Finance and Accounting Service (DFAS) performs accounting functions and prepares financial statements for DoD. DFAS operates under the control and direction of the USD(C). The Office of the USD(C) and DFAS jointly prepare the DoD consolidated financial statements. DFAS is responsible for entering information from DoD entities into financial systems, operating and maintaining the

financial systems, and ensuring the continued integrity of the information entered. The DoD entities are responsible for providing accurate financial information to DFAS.

Audit Objectives

The primary audit objective was to determine whether the DoD Consolidated Financial Statements for FY 1996 were presented fairly in accordance with the other comprehensive basis of accounting described in Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993 (OMB Bulletin No. 94-01).* We determined whether controls were adequate to ensure that the DoD consolidated financial statements were free of material error. We also assessed DoD compliance with laws and regulations for transactions and events that had a direct and material effect on the financial statements. Part I.A. is our report on internal controls, and Part I.B. is our report on compliance with laws and regulations. Part II, Appendix A, gives the audit scope and methodology, auditing standards, and accounting principles. Appendix A also discusses the assistance we received from the Military Department audit organizations.

*As part of the other comprehensive basis of accounting, the Under Secretary of Defense (Comptroller) issued the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" in October 1996.

Part I. A. - Review of Internal Control Structure

Introduction

Management Responsibilities. As the CFO, the USD(C) maintains control over DoD resources and oversees the accounting functions of DFAS. The Military Departments, Defense agencies, and DoD field activities are responsible for managing their operations. Managing includes establishing controls over program, operational, and administrative areas, as well as accounting and financial management. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that:

o transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets;

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

o transactions, including those related to obligations and costs, are:

- executed in compliance with laws and regulations that could have a direct and material effect on the financial statements; and

- comply with any laws and regulations that OMB, DoD, or the Inspector General (IG), DoD, have identified as being significant and for which compliance can be objectively measured and evaluated.

Control Structure Elements. 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 the emphasis placed on it within the entity. Accounting and related systems are the methods and records established to identify, assemble, analyze, classify, record, and report on the entity's transactions and to maintain accountability for the related assets and liabilities. Control procedures are the policies and procedures, in addition to the control environment and the accounting and related systems, which management has established to provide reasonable assurance that specific objectives will be achieved.

The purpose of our review of the internal control structure was to render an opinion on the financial statements.

Reportable Conditions. 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, and would not be detected in a timely manner by employees in the normal course of performing their functions.

Material weaknesses in the management control structure added to the difficulty in producing timely, accurate, and fairly presented financial statements. Because DoD did not have an adequate internal control structure, we were unable to apply other auditing procedures to overcome these deficiencies and satisfy ourselves as to the fairness of data presented in the DoD Consolidated Financial Statements for FY 1996. The Secretary of Defense and DFAS identified, in the FY 1996 Annual Statements of Assurance, the material weaknesses we identified.

Conditions Noted in Each Area. Although progress has been made, material internal control weaknesses existed in accounting and related systems and in control procedures for adjusting entries, real property, capital leases, construction in progress, inventory, and footnotes. In the 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.

Accounting and Related Systems

DoD accounting systems were unable to produce auditable and timely financial statements for FY 1996, primarily because the accounting and related financial management systems were not designed for financial reporting. As a result, the financial condition of DoD and its operating results for FY 1996 are not verifiable, and DoD has no assurance that it is properly managing its resources.

The primary deficiencies were that most DoD accounting systems:

o did not use a transaction-driven general ledger to account for and manage resources;

o did not have audit trails to trace general ledger account balances back to supporting documentation or specific accounting transactions to the general ledger;

o did not have a process for accurately identifying and reporting transactions that should be eliminated during consolidation; and

o did not accurately report Government property in the custody of contractors.

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

Consequently, $64.7 billion of expenses reported by the Army (20 percent of DoD expenses) could not be audited. Army accounting systems did not produce subsidiary ledgers showing the transactions that made up the summary numbers reported in the Army financial statements. In another case, the Navy understated military equipment by at least $23.6 billion and overstated other equipment by at least $3 billion because the Navy did not have an integrated accounting system.

Audit Trails. The DoD accounting systems used to consolidate data did not always have audit trails to verify the $321.1 billion of DoD expenses and other account balances reported in FY 1996. An adequate audit trail allows transactions to be traced from the source document to the resulting accounting record or report. An adequate audit trail also allows summary accounting data to be traced back through subsidiary ledgers to the source document. Audit trails are critical to the financial statements because those statements comprise data that originates with base-level transactions from worldwide locations. Without adequate audit trails, account balances cannot be traced to source documents through successive levels of summarization to the financial statements. This process is necessary for determining whether all transactions are properly recorded and supported.

Eliminating Entries. DoD accounting systems did not permit DoD entities to adequately identify and report reimbursable transactions that should have been eliminated from the consolidated financial statements. As a result, the DoD Consolidated Financial Statements for FY 1996 were overstated by $40.9 billion ($36.6 billion in revenues and expenses and $4.3 billion in receivables and payables). In addition to the reimbursable transactions, DoD did not eliminate $11.2 billion that the Military Departments contributed to the DoD Military Retirement Trust Fund in FY 1996.

To compensate for the deficient accounting systems, DoD managers used budgetary systems to identify specific customers. However, those systems did not adequately identify sellers or provide customer information in sufficient

detail to be useful. IG, DoD, Report No. 97-117, "Eliminating Entries," March 31, 1997, gives details and makes recommendations to correct conditions regarding reimbursable transactions.

Government Property in the Custody of Contractors. The Contract Property Management System, which DoD used to track, record, and report Government property in the custody of contractors, was not accurate and was not designed to support financial statements. Therefore, some DoD reporting entities used contractors' property reports as the source for reporting Government property assigned to contractors. However, contractors reported property that:

- did not belong to DoD,
- was already accounted for by DoD elsewhere,
- was not valued correctly, or
- was not supported by complete records.

In addition, some contractors who had Government property did not submit property reports. Therefore, we could not attest to the accuracy of the $92 billion of Government property in the custody of contractors, as reported in the consolidated financial statements for FY 1996.

Control Procedures

Control procedures throughout DoD were not adequate to properly report assets on the financial statements. Unclear guidance allowed unsupported adjusting entries to be made, and caused real property to be inconsistently reported, capital leases to be misclassified, construction in progress to be overstated, inventory to be misclassified, and the Notes to the Principal Statements to be inconsistently reported.

Adjusting Entries. DoD did not have adequate controls to ensure that adjustments to account balances were properly supported before such transactions were entered into the accounting system. Specifically, the DFAS Denver Center allowed 111 unsupported adjusting entries, valued at $217.5 billion, to be made to the FY 1996 Defense Business Operations Fund Financial Statements. As a result, DoD financial statements were subject to higher risk for material misstatement.

Real Property. DoD used inaccurate valuation methods to record real property. Property management systems did not record property at historical costs, as required by DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 11, 1995. Instead, the systems recorded the values at their latest acquisition cost. This occurred because the existing accounting systems did not capture the historical costs.

DoD inconsistently reported, omitted, and underreported real property. DoD 7000.14-R does not give clear guidance on reporting real property owned or occupied by tenants. Real property includes, but is not limited to, commissaries, exchanges, and medical treatment facilities. As a result, some installations included tenant-owned facilities in their property records, but others did not. Although each Service reported this condition, we could not determine the over- or understatement of real property.

Capital Leases. The DoD inconsistently reported overseas real estate holdings in the financial statements. Specifically, the Army reported $5 billion of overseas real estate holdings as capital leases, while the Air Force reported $244 million of overseas real estate holdings as Air Force-owned property. This inconsistency occurred because DoD 7000.14-R does not meet the criteria for capital leases. Neither the Army nor the Air Force agreed with the DoD requirements to treat the overseas real estate holdings as capital leases because:

- o overseas holdings were funded by DoD appropriations, and
- o a capital lease liability had not been established.

DoD is also unable to properly account for these overseas assets because they are subject to treaty considerations and are not free of encumbrances. The USD(C) has asked the Federal Accounting Standards Advisory Board for an interpretation of this issue.

DoD did not report other leases that met the criteria for capital leases. Excluded from capital leases were family housing leased at Andrews Air Force Base, Maryland, and Goodfellow Air Force Base, Texas. Since the net value of the lease payments during the term of the lease exceeded 90 percent of the fair market value, the bases should have reported these properties as capital leases. Failure to report and record these capital leases resulted in an understatement of over $113 million in real property values.

Construction in Progress. DoD did not accurately report construction in progress for the year ended September 30, 1996. In some instances, DoD did not properly transfer completed construction projects out of the construction in progress account to a capital asset account. In other instances, DoD transferred completed construction projects to a capital asset account, but did not remove those projects from the construction in progress account; or DoD recorded the entire estimated contract cost as construction in progress before any work was performed and before progress payments were made. These conditions occurred because DoD did not reconcile the general ledger with the actual work in progress, as determined by civil engineering records. Construction in progress was overstated by an undetermined amount.

Inventory. Inventory was overstated by $73.7 billion because DoD misclassified War Reserves as Inventory on the financial statements. War Reserves are materiel amassed during peacetime to meet the requirements of war and may be transferred to other DoD Components. Inventory should include only property held for sale or transfer, primarily to provide a product for a fee. The primary reason for holding or transferring War Reserves is to

sustain operations, not to provide a product for a fee. The misclassification of War Reserves as Inventory was a primary reason that Ending Inventory, reported in Note 24, Cost of Goods Sold, to the financial statements, disagreed with the amount shown for Inventory on the Statement of Financial Position. We also addressed War Reserves in IG, DoD, Report No. 97-100, "Asset Presentation on Military Department General Fund Financial Statements," February 25, 1997.

Footnotes to the Principal Statements. The Footnotes to the Principal Statements contained inconsistencies, incorrect classifications, and abnormal balances. Inconsistencies existed between the Notes and line items, and between Notes. These problems primarily occurred because the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996, did not give adequate instructions for preparing the Notes. As a result, the financial statements often were misleading or not fully informative.

Consistency With Line Items. DoD did not ensure that the Notes agreed with line items. As a result, inconsistencies appeared in the financial statements of DoD reporting entities, and DoD did not address those inconsistencies when preparing the consolidated financial statements. Examples follow.

Note 17, Other Liabilities. DoD did not report all environmental liabilities in the same subcategory. While the note specifically identified $4.2 billion as Accrued Environmental Cleanup Costs, DoD also included an additional $13.4 billion of environmental liabilities in the subcategory entitled Other. Therefore, readers were not aware that DoD had reported $17.6 billion of environmental liabilities.

Note 25, Other Expenses. DoD reporting entities did not consistently report Other Expenses. Subcategories of Other Expenses included $378.2 million of shrinkage, fire, theft, and losses; $136.4 million of accrued annual leave; and $2.9 million of lost discounts. Although all DoD reporting entities except the DoD Military Retirement Trust Fund normally incur those types of expenses, most entities did not report them as Other Expenses. DoD entities either reported those expenses as Operating Expenses or did not report them at all.

Note 29, Intrafund Eliminations. Material differences existed between the amounts disclosed in Note 29 and related line items in the financial statements. For example, the $2.3 billion of intragovernmental revenue shown in Note 29 did not agree with the related line item in the Statement of Operations and Changes in Net Position, which showed $45 billion. DoD did not note or explain the $42.7 billion difference.

Since DoD did not consistently report information in the financial statements and the Notes, the financial statements were misleading. Specifically, readers may believe that DoD had only $4.2 billion of environmental liabilities,

$378.2 million of losses, and $136.4 million of annual leave expenses, and failed to take $2.9 million of discounts. Also, the financial statements do not tell readers the extent of intragovernmental account balances.

Consistency Between Notes. The Notes were not always consistent with information contained in other Notes. For example, Note 1, Summary of Significant Accounting Policies, stated that DoD valued Inventory at a standard sales price; however, Note 24, Cost of Goods Sold, reported that Inventory was valued at the latest acquisition cost. Note 17, Other Liabilities, reported $3 billion of advances from other Government agencies, although Note 29 reported only $0.3 billion of those liabilities.

Reporting inconsistencies can confuse readers and lead to a lack of credibility. In the examples provided, readers could question the ability of DoD to accurately report the results of operations and how resources are valued.

Classification of Expenses and Assets. The Notes did not always classify expenses correctly. For example, Note 24 misclassified the cost of material sold from the National Defense Stockpile Transaction Fund, totaling $155.8 million, as Cost of Services Sold. Also, Note 17 included $88.1 million of non-entity accounts receivable as assets, although that note should have included only Other Liabilities. Those misclassifications overstated the amount of services provided by DoD and may understate the Accounts Receivable that DoD should have reported in its Statement of Financial Position.

Abnormal Account Balances. The Notes disclosed $8.2 billion of abnormal account balances, in addition to the $2.8 billion of abnormal account balances reported in the consolidating statements. Those abnormal balances included negative losses, negative transfers-in, and negative expense adjustments made by the USD(C). Accounting reports that show abnormal account balances indicate that errors have probably occurred in the recording or processing of accounting transactions. Abnormal balances indicate questionable controls over the accounting process.

Conclusions

Although progress has been made, the DoD internal control structure was not adequate to ensure that resources were properly managed and accounted for, and that financial statements were free of material misstatements. DoD accounting systems did not meet OMB requirements to interface with other financial management systems or to provide adequate documentation, audit trails, and general ledger controls. Weak control procedures caused inaccurate reporting of adjusting entries, real property, capital leases, construction in progress, inventory, and the Footnotes to the Principal Statements. Until control procedures are strengthened, DoD will continue to produce unreliable, untimely, and inaccurate financial statements.

DoD Position on Systems. DoD conceded that its financial management systems have significant procedural and systemic deficiencies, and discussed those deficiencies in the FY 1996 Annual Statement of Assurance and the management representation letter for the consolidated financial statements (see Appendix F). The management representation letter stated that most DoD financial management systems did not meet the requirements of OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, for documentation, audit trails, and general ledger controls, and that DoD systems did not always generate sufficient and suitable accounting data to permit the review and certification of financial statements at the fiscal year's end.

DoD has established a Defense Accounting System Program Management Office to consolidate and modernize all migratory, interim migratory, and legacy accounting systems. The goals of that office are compliance with applicable laws and regulations and improvement of DoD financial reporting. We believe this centralized approach will help improve accountability and reporting capabilities.

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

Introduction

As part of the audit of the DoD Consolidated Financial Statements for FY 1996, we tested compliance with laws and regulations that directly and materially affected those financial statements. Such tests, which are required by the CFO Act of 1990, as amended by the Federal Financial Management Act of 1994, were performed to obtain reasonable assurance that the principal statements are free of material misstatements. Our objective, however, was not to render an opinion on DoD compliance with laws and regulations.

The USD(C) is responsible for compliance with laws and regulations applicable to the DoD consolidated financial statements.

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

Material Noncompliances

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

DoD did not comply with several laws and regulations related to the DoD Consolidated Financial Statements for FY 1996. Material noncompliances included inadequate accounting systems, improper accounting, and inadequate disclosure in the financial statements. Because many of these noncompliances related to basic financial requirements, we were unable to fully evaluate DoD compliance with laws and regulations. Also because of the noncompliances, DoD financial statements are of limited use to DoD and other Government managers.

Except for noncompliance issues related to the consolidated financial statements, the noncompliances included in this report have been previously reported by the IG, DoD; by the Military Department audit organizations; or by the General Accounting Office in previous audit reports. DoD has also reported many of the issues in its FY 1996 Annual Statement of Assurance.

Title 31, United States Code (U.S.C.), Section 3515, "Requirements for Preparing Financial Statements." DoD did not prepare and issue audited financial statements for FY 1996 by the March 1, 1997, deadline required by 31 U.S.C. 3515. DoD did not submit its final financial statements to OMB until June 11, 1997, over 3 months after the statutory deadline and 8 months after the fiscal year ended. In addition to being late, the statements were unauditable because DoD had inadequate accounting systems and control procedures. Those deficiencies, which were the primary reasons that we disclaimed an opinion on the DoD Consolidated Financial Statements for FY 1996, prevented DoD from completely and accurately disclosing timely financial results; obtaining the financial information needed for managing; and using accounting results to prepare and support budget requests, control its budget, and provide adequate financial information to the President to prepare the budget for the Government.

31 U.S.C. 3512, "Requirements for Establishing and Maintaining Accounting and Internal Control Systems." DoD accounting systems did not ensure that DoD controlled its budget, as required by 31 U.S.C. 3512. The inability of DoD to control its budget led to $8.1 billion of disbursements that DoD reported as not matched with appropriations, and $3.3 billion of disbursements that exceeded the amounts obligated. These problem disbursements may have resulted in potential Antideficiency Act violations.

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

OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements." DoD did not always follow the accounting principles required by OMB Bulletin No. 94-01 when accounting for resources and preparing the Overview and the Footnotes to the Principal Statements. Material noncompliances with accounting principles included the methods used to prepare the Overview and to account for Accounts Receivable, Operating Materials and Supplies, Accounts Payable, Contingent Liabilities, and Prior Period Adjustments. Because of inadequate accounting systems, we were unable to determine the over- or understatements caused by the noncompliances.

Overview. OMB Bulletin No. 94-01 requires DoD to include information about accomplishments, financial results, and financial condition, however, DoD limited the Overview to a discussion of its organizational

structure. Therefore, readers of the financial statements may not be able to evaluate how well DoD is accomplishing its mission or understand what DoD should do to improve its program performance or financial performance.

Accounts Receivable. DoD misclassified Accounts Receivable due from Federal agencies, totaling $2.1 billion, as Accounts Receivable due from the public. The misclassification would overstate receivables on Government-wide financial statements.

Operating Materials and Supplies. DoD improperly expensed much of its operating materials and supplies before distributing it to end users. Expensed Operating Materials and Supplies included items at base supply centers and on ships, including supply ships. Those locations did not meet the definition of "end user" in DoD 4140.1-R, "DoD Materiel Management Regulation," January 1993. That Regulation defines end users as the individuals or organizations authorized to use supply items. An end user is normally the terminal point in the logistics system at which action is initiated to obtain materiel required to accomplish a mission or task. Recording Operating Materials and Supplies as expenses before distributing to end users overstates expenses and understates assets.

Accounts Payable. DoD did not always record Accounts Payable when it received goods and services, and did not classify holdbacks of contract progress payments as Accounts Payable. In particular, the DFAS Columbus Center, which processes contract payments for major DoD contracts, did not report about $4.9 billion of contract holdbacks and did not accurately report other Accounts Payable to accounting offices.

Contingent Liabilities. DoD did not recognize or disclose at least $34.2 billion of Contingent Liabilities. Federal agencies are required to report Contingent Liabilities in the principal statements when assets are likely to have been impaired or if the liabilities have occurred and the amount can be estimated. Contingent Liabilities include claims against the Government that are being adjudicated. Contingent Liabilities should be disclosed in the footnotes when there is a reasonable possibility that a loss may have been incurred.

Unrecognized liabilities included $7.1 billion of accrued environmental cleanup costs. Those liabilities, disclosed only as Contingent Liabilities, will probably occur and can be estimated. DoD also did not report or disclose at least $27.1 billion of Contingent Liabilities for legal cases reported in the Navy and Air Force financial statements.

Prior Period Adjustments. Although FY 1996 was the first year that DoD prepared agency-wide financial statements, DoD reported $11.1 billion of Prior Period Adjustments. Prior Period Adjustments are accounting changes or corrections of errors in previously issued financial statements. DoD should have reflected its accounting changes and corrections only in the beginning balance of the Net Position. Including Prior Period Adjustments in first-year financial statements may mislead readers.

Conclusion

DoD noncompliances with fundamental requirements affected the DoD Consolidated Financial Statements for FY 1996. Although many noncompliances related to deficient financial systems are not expected to be corrected for many years, others can be corrected sooner. Through policy changes and better planning, DoD can correct some noncompliances, such as failure to use the USGSGL, improper reporting of Operating Materials and Supplies, and preparing an Overview that does not describe DoD performance. Those improvements should lead to better resource management and to financial statements that DoD and other Government managers can use to make informed decisions.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Statements Reviewed. We examined the Principal Statements, the Footnotes to the Principal Statements, and the Overview in the DoD Consolidated Financial Statements for FY 1996. The Principal Statements included the Consolidated and the Consolidating Statements of Financial Position and the Statements of Operations and Changes in Net Position. We received the final consolidated financial statements on May 13, 1997.

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

Accounting Principles. Accounting principles and standards for the Federal Government are under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to three officials: the Director, OMB; the Secretary of the Treasury; and the Comptroller General. The Director, OMB, and the Comptroller General issue standards approved by these three officials. To date, seven accounting standards and two accounting concepts have been published in final form. Another accounting standard (Standard No. 8) has been recommended by the Federal Accounting Standards Advisory Board, but it must undergo a congressional review before it is approved by OMB. The standards constitute generally accepted accounting principles for the Federal Government and will be used by Federal agencies to prepare their financial statements. The following table lists the Statements of Federal Financial Accounting Standards and Concepts.

Statements of Federal Financial Accounting Standards and Concepts

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

Through FY 1996, agencies were required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. A summary of the FY 1996 hierarchy follows:

o standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller General;

o form and content requirements of OMB Bulletin No. 94-01;

o accounting standards contained in agency accounting policy, procedures, or other guidance as of March 29, 1991; and

o accounting principles published by other authoritative sources.

Because only three accounting standards and two accounting concepts were effective in FY 1996, most accounting standards for the "other comprehensive basis of accounting" were taken from DoD accounting guidance. Previously, DoD 7220.9-M, the "DoD Accounting Manual," was the primary DoD accounting guidance. Since FY 1992, the USD(C) has updated sections of DoD

7220.9-M and has incorporated those sections into new volumes of the DoD 7000.14-R. The USD(C) had issued 14 volumes as of April 1997 and plans to issue 1 additional volume. DoD 7000.14-R, 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. However, after FY 1996, neither DoD 7220.9-M nor DoD 7000.14-R will be the authoritative basis for preparing financial statements.

Beginning in FY 1997, agencies are required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. A summary of the FY 1997 hierarchy follows:

- standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller General;
- interpretations of the standards issued by OMB;
- requirements of the current OMB Bulletin 94-01; and
- accounting principles published by other authoritative sources.

Audit Assistance. We relied on the Military Department audit organizations to audit various reporting entities and accounts. See Part II, Appendix E, for specific areas and the scope of information reviewed by those organizations. Except for deficiencies unique to the consolidation process, the information in this report is a summary of the most significant deficiencies reported by the IG, DoD, and the Military Department audit organizations. Refer to the IG, DoD, audit reports and the Military Department audit reports listed in Part II, Appendix C, for detailed explanations of the findings summarized in this report.

Scope of Review of Internal Controls. We examined the internal control structure of DoD for the year ended September 30, 1996, as those controls related to the consolidated financial statements. We obtained an understanding of the internal control policies and procedures and assessed the level of control risk relevant to the consolidation process and account balances.

Our review of the internal control structure disclosed material internal control weaknesses as defined by DoD Directive 5010.38, "Management Control Program," August 26, 1996.* 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. Those conditions prevented us from rendering an opinion on the financial statements.

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

*This directive was effective immediately and applied to all FY 1996 activity.

Scope of the Review of Compliance With Laws and Regulations. As part of our examination to obtain reasonable assurance that the 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 OMB and DoD. See Appendix D for a list of laws and regulations we reviewed.

We did not review management's implementation of DoD Directive 5010.38, "Management Control Program," August 26, 1996, because DoD did not have a sound internal control structure. Instead, we revised our audit approach to focus on specific internal controls.

Computer-Processed Data. The management representation letter stated that computer-processed data were not accurate, and audit work confirmed that statement. Therefore, we did not rely on computer-processed data.

Audit Period and Locations. We conducted the audit from July 1995 through April 1997 at various DoD activities, including DFAS and the Military Departments.

Representation Letters. We received management and legal representation letters from DoD. The management representation letter from the USD(C) acknowledged that significant procedural and systemic deficiencies exist, and discussed internal control weaknesses and compliance problems for many accounts. See Appendix F for the management representation letter.

The legal representation letter from the General Counsel of the Department of Defense disclosed material cases involving DoD entities, the nature of the litigation, the progress of the cases, and management's intended response to the litigation.

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

Appendix B. DoD Consolidated Financial Statements for FY 1996 and Auditor Opinion

DEPARTMENT OF DEFENSE

AGENCY-WIDE
FINANCIAL STATEMENTS

FOR FY 1996
FINANCIAL ACTIVITY

May 1997

DEPARTMENT OF DEFENSE
AGENCY-WIDE FINANCIAL STATEMENTS
FOR FY 1996 FINANCIAL ACTIVITY

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

COMPTROLLER

MAR 21 1997

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

I am very pleased to present the Department of Defense (DoD) agency-wide financial statements for FY 1996. These are the Department's first agency-wide financial statements required by the Chief Financial Officers (CFOs) Act and the Government Management Reform Act (GMRA). Those financial statements are expected to provide information to DoD program managers, the Congress and the public, thereby facilitating both effective allocation of resources and assessment of management performance and stewardship. The objective is to produce statements that are accurate, consistent and meaningful--statements that can and will be used to improve the management of the Department.

The Department has made the reform of financial management a major initiative. Reform is essential to correct long-standing financial management problems. Inefficient financial management systems and practices waste money that is needed now, more than ever, to sustain sufficient combat power.

The Department has made significant strides in the past year, and, consistent with the objectives of the CFO Act, the Department continues to work toward the integration of program and financial information in order to provide for more effective program management at all levels. Standard systems have been generally designated and ambitious deployment schedules have been established. Several functional areas already are reaping the benefits from migrating to standard systems, consolidating organizations and streamlining operations. The FY 1997-1998 time frame will continue to show substantive progress in the Department's effort to clearly demonstrate good stewardship in financial management systems and reporting practices.

John J. Hamre

OVERVIEW OF THE REPORTING ACTIVITY

DEPARTMENT OF DEFENSE

AGENCY-WIDE
FINANCIAL STATEMENTS

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Description of the Reporting Activity

There are eight reporting entities within the Department of Defense. Those reporting entities are the Departments of the Army, Navy, and the Air Force; the Defense Business Operations Fund (DBOF), the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; a reporting entity entitled "Other Defense Organizations;" and the U.S. Army Corps of Engineers (Civil Works). Additionally, a consolidated financial statement will be prepared for the "Total Department of Defense."

Stand alone financial statements will be prepared for seven of the reporting entities with the exception being Defense Agencies included in "Other Defense Organizations" which will be included as a column on the consolidated Department of Defense financial statement. While the Inspector General, DoD, will not issue an opinion on the column entitled "Other Defense Organizations," the principal statements of the various Defense Agencies and accounts will be subject to audit, and the results of those audits will be incorporated into the audit opinion expressed on the consolidated statement for the entire "Department of Defense."

Stand alone financial statements include the Overview of the Reporting Activity, Principal Statements and Related Notes, Consolidating Financial Statements (where required), and Supplemental Financial and Management Information. The stand alone financial statements will include Component level adjustments and eliminating entries. Component level totals are included in these overall Department of Defense totals.

Organizational Structure of the Department of Defense (DoD). The Department of Defense (DoD) is responsible for providing the military forces needed to deter war and protect the security of the United States. The major elements of these forces are the Army, Navy, Air Force, and Marine Corps. Under the President, who is also Commander-in- Chief, the Secretary of Defense exercises authority, direction, and control over the Department which includes the Office of the Secretary of Defense, the Chairman of the Joint Chiefs of Staff and the Joint Staff, three Military Departments, nine Unified Combatant Commands, the DoD Inspector General, fifteen Defense Agencies, and nine DoD Field Activities.

The Secretary of Defense is the principal defense policy advisor to the President and is responsible for the formulation of general defense policy and policy related to all matters of direct and primary concern to the DoD, and for the execution of approved policy. Under the direction of the President, the Secretary exercises authority, direction, and control over the Department of Defense.

The Deputy Secretary of Defense is delegated full power and authority to act for the Secretary of Defense and to exercise the powers of the Secretary on any and all matters for which the Secretary is authorized to act pursuant to law.

The Office of the Secretary of Defense (OSD). The Office of the Secretary of Defense (OSD) is the principal staff element of the Secretary in the exercise of policy development, planning, resource management, fiscal, and program evaluation responsibilities. OSD includes the

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immediate offices of the Secretary and Deputy Secretary of Defense, Under Secretary of Defense for Acquisition and Technology, Under Secretary of Defense for Policy, Under Secretary of Defense for Personnel and Readiness, Under Secretary of Defense (Comptroller), Director of Defense Research and Engineering, Assistant Secretaries of Defense, General Counsel, Director of Operational Test and Evaluation, Assistants to the Secretary of Defense, Director of Administration and Management, and such other staff offices as the Secretary establishes to assist in carrying out assigned responsibilities.

- **Under Secretary of Defense (Acquisition and Technology).** Under the direction of the Secretary of Defense, the USD(A&T) is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense for all matters relating to the DoD Acquisition System; research and development; advanced technology; test and evaluation; production; logistics; military construction; procurement; economic security; and atomic energy.

- **Under Secretary of Defense (Policy).** Under the direction of the Secretary of Defense, the USD(P) is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense for all matters concerning the formulation of national security and defense policy and the integration and oversight of DoD policy and plans to achieve national security objectives.

- **Under Secretary of Defense (Personnel and Readiness).** Under the direction of the Secretary of Defense, the USD(P&R) is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense for Total Force management as it relates to readiness; National Guard and Reserve component affairs; health affairs; training; and personnel requirements and management, including equal opportunity, morale, welfare, and quality of life matters.

- **Under Secretary of Defense (Comptroller/Chief Financial Officer).** Under the direction of the Secretary of Defense, the USD(C/CFO) is the principal advisor and assistant to the Secretary and Deputy Secretary of Defense for budgetary and fiscal matters (including financial management, accounting policy and systems, budget formulation and execution, and contract audit administration and organization), DoD program analysis and evaluation, and general management improvement programs. In addition, the USD(C) is the Chief Financial Officer of the Department of Defense.

- **Assistant Secretary of Defense (Command, Control, Communications, and Intelligence).** Under the direction of the Secretary of Defense, the ASD(C3I) is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense for C3I, information management (IM), information operations (IO), counter-intelligence (CI), and security countermeasures (SCM) matters, including warning, reconnaissance, and intelligence and intelligence-related activities conducted by the Department of Defense.

- **Assistant Secretary of Defense (Legislative Affairs).** Under the direction of the Secretary of Defense, the ASD(LA) is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense for DoD relations with the members of Congress.

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- **Assistant Secretary of Defense (Public Affairs).** Under the direction of the Secretary of Defense, the ASD(PA) is the principal staff advisor and assistant to the Secretary and Deputy Secretary of Defense for DoD public information, internal information, the Freedom of Information Act, mandatory declassification review and clearance of DoD information for public release, community relations, information training, and audiovisual matters.

- **General Counsel of the DoD (GC, DoD).** Under the direction of the Secretary of Defense, the GC, DoD serves as chief legal officer of the Department of Defense. The GC, DoD is responsible for providing advice to the Secretary and Deputy Secretary of Defense regarding all legal matters and services performed within, or involving, the Department of Defense; and for providing legal advice to OSD organizations and, as appropriate, other DoD Components.

- **Director of Operational Test and Evaluation (DOT&E).** Under the direction of the Secretary of Defense, the DOT&E is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense on OT&E in the DoD and the principal OT&E official within the senior management of the DoD.

- **Assistant to the Secretary of Defense (Intelligence Oversight).** Under the direction of the Secretary of Defense, the ASD(IO) is responsible for the independent oversight of all intelligence activities in the Department of Defense. In this capacity, the ASD(IO) shall ensure that all activities performed by intelligence units and all intelligence activities performed by non-intelligence units, are conducted in compliance with Federal law and other laws as appropriate, Executive Orders and Presidential Directives, and DoD Directives System issuances.

- **Director of Administration and Management (DA&M).** Under the direction of the Deputy Secretary of Defense, the DA&M is the principal staff assistant and advisor to the Secretary and Deputy Secretary of Defense on DoD-wide organizational and administrative management matters.

Department of the Army. The Army includes land combat and service forces and such aviation and water transport as may be organic therein. It will be organized, trained, and equipped primarily for prompt and sustained combat incident to operations on land. It is responsible for the preparation and sustainment of land forces necessary for the effective prosecution of war except as otherwise assigned and, according to integrated joint mobilization plans, for the expansion of the peacetime components of the Army to meet the needs of war. The Army is a total force, comprised of both active and reserve forces.

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The U.S. Army Mission is to:

- Preserve the peace and security, and provide for the defense of the United States, the Territories, Commonwealths, and possessions, and any areas occupied by the United States.
- Support national policies.
- Implement national objectives.
- Overcome any nations responsible for aggressive acts that imperil the peace and security of the United States.

America's Army serves the nation every day in numerous ways, with high quality soldiers and civilian employees working effectively at home and abroad. The Army's fundamental purpose is to fight and win the nation's wars. The Army also executes a variety of dangerous missions around the world and assists on the home front. These endeavors require the same well trained, disciplined soldiers that the nation relies upon for combat. When the nation calls -- and it has more and more frequently -- the Army is ready. The Army is the ultimate symbol of American will. It is an indispensable component of the National Security Strategy, and it is essential to deterring or defeating any adversary. An American soldier on the ground demonstrates our nation's determination to prevail in any situation.

Wars are won on the ground. Only the Army has the assets and staying power to operate over an entire battlefield and bring a conflict to a successful conclusion, against any opponent in any region of the world. Successful military operations require control of the air, sea, and land, but America's ability to impose its will ultimately depends on its ability to control the land through prompt and sustained land-combat operations. The application of military force on land is an action no opponent can ignore. The Army, with its ability to provide long-term presence, effects lasting change.

The Army also plays an essential role in joint warfighting while readily acknowledging the contributions of its sister Services. As the joint force provider of land combat and sustainment forces, the Army is dedicated to enhancing its capabilities to operate in a joint environment. Future success will undoubtedly require the complementary capabilities of all the Services. America's Army, fully integrated with the Air Force, Navy, and Marines, will dominate any enemy in war and successfully execute other military operations.

The Army is designed to compel, deter, reassure, and support. The Army deters others from actions inimical to our interests by maintaining a trained and ready force, as demonstrated by our long-standing presence in Europe and Korea. The Army reassures friends and allies: we are a visible symbol of U.S. commitment to stand firm against any external threat to their sovereignty.

Finally, the Army supports communities within the United States. For decades, the Army has provided military support to civil authorities during natural disasters and civil disturbances. In the recent past, American soldiers have assisted local authorities in fighting fires in the Pacific Northwest; aided flood victims in the South and Midwest; provided relief supplies, logistical support, a hospital, and other equipment in the aftermath of Hurricane Marilyn; contributed substantially to the counterdrug activities of federal, state, and local drug law enforcement

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agencies; and provided health care to underserved populations in the United States through the National Guard's Operation Guard Care.

Department of the Navy. The Department of the Navy consists of two uniformed Services: the United States Navy and the United States Marine Corps. The Navy' success in meeting today's operational challenges can be attributed to thorough planning and innovative execution. Three years ago the Navy-Marine Corps Team introduced a new strategic vision--From the Sea--which updated and expanded its strategic concept to specifically address the unique contributions of naval expeditionary forces in peacetime operations, in responding to crises, and in regional conflicts. The Navy-Marine Corps team complements the other Services as part of an overall joint strategy. Within that strategy, naval forces provide the capability to position credible combat power overseas without the consent or imposed limitations of foreign governments, while providing the enabling force for larger operations utilizing joint forces if required.

The United States Navy. The Department of the Navy's primary task is to provide the nation combat-ready, sea-based, forward-deployed, and forward-engaged naval forces. The Department of the Navy (DoN) is committed to ensuring that naval forces can continue to immediately respond to national security tasking, when and wherever required. The Department understands that the responsive, adaptable, and combat credible naval expeditionary forces of tomorrow depend upon the correct programmatic and acquisition decisions of today. To achieve that end, Navy is addressing tomorrow's challenges in a variety of ways, including closer Navy and Marine Corps coordination and the reengineering of our acquisition process. These two efforts in particular have benefited from work already accomplished in support of the congressionally mandated Commission on the Roles and Missions of the Armed Forces and the Federal Acquisition Streamlining Act.

Naval forces are built to fight and win wars. But an equally important role is to be positioned forward to prevent conflict. On any given day, 40-50 percent of the fleet is underway. Half of those units and over 23,000 Marines are deployed overseas, taking part in a broad spectrum of military operations. These forward naval forces provide:

- Deterrence of aggression.
- Enhancement of regional stability, including countering the proliferation of weapons of mass destruction.
- Protection and promotion of U.S. interests.
- Improvement of interoperability with key allies.
- Readiness to provide a timely initial crisis response.

In cooperation with our friends and allies, naval forces are deployed near potential flashpoints to prevent the emergence of dangers to shared interests. Partnership is developed and enhanced when we promote interoperability at the operational and tactical levels with the naval, air, and ground forces of the most likely coalition partners. Exercises that reassure friends and build coalitions are the stock-in-trade of Navy and Marine Corps units.

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The United States Marine Corps. The Marine Corps was created on November 10, 1775, in Philadelphia, PA, by a resolution of the Continental Congress which (authorized) "raised two battalions of Marines." In 1834 the Marines became part of the Department of the Navy. The National Security Act of 1947, amended in 1952, states the present structure, missions, and functions of the Marine Corps. The United States Marine Corps, within the Department of the Navy, shall be so organized as to include not less than three combat divisions and three air wings, and such other land combat, aviation and other services as may be organic therein. The Marine Corps shall be organized, trained, and equipped to provide fleet marine forces of combined arms, together with supporting air components, for service with the fleet in the seizure or defense of advanced naval bases and for the conduct of such land operations as may be essential to the prosecution of a naval campaign.

In addition, the Marine Corps shall provide detachments and organizations for service on armed vessels of the Navy, shall provide security detachments for the protection of naval property at naval stations and bases, and shall perform such other duties as the President may direct. However, these additional duties may not detract from or interfere with the operations for which the Marine Corps is primarily organized.

The Marine Corps shall develop, in coordination with the Army and the Air Force, those phases of amphibious operations that pertain to the tactics, techniques, and equipment used by landing forces. The Marine Corps is responsible, in accordance with integrated joint mobilization plans, for the expansion of peacetime components of the Marine Corps to meet the needs of war.

Department of the Air Force. The mission of the U.S. Air Force is to defend the United States through control and exploitation of air and space. Teamed with the Army, Navy and Marine Corps, the Air Force is prepared to fight and win any war if deterrence fails. The Air Force is responsible for providing:

- aircraft and missile forces necessary to prevent or fight a general war.
- land-based air forces needed to establish air superiority, interdict the enemy and provide air support of ground forces in combat.
- the primary aerospace forces for the defense of the United States against air and missile attack.
- the primary airlift capability for use by all of the nation's military services.
- major space research and development support for the Department of Defense.
- assistance to the National Aeronautics and Space Administration in conducting our nation's space program.

The United States Air Force remains the world's premier air and space force and is a critical contributor to our national security. The U.S. Air Force exists as a separate Service to project air and space power -- and American influence -- over long distances. That capability has improved over the years and today we are a decisive global force. The Air Force mission is "To Defend the United States Through the Control and Exploitation of Air and Space." Since 1990, the most difficult challenge to that mission has been managing the shift in our strategic posture.

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The United States Air Force has worked through the drawdown and preserved its core competencies, supported its people, and improved its readiness. The Air Force made some tough choices early on, targeting force reductions that brought us swiftly to an optimum level. At the same time, the Air Force sustained credible forces that consistently met the challenge of the National Military Strategy. The Air Force succeeded because it started with a clear vision that emphasized its primary responsibility -- to fight and win our nation's wars. That vision, Global Reach -- Global Power, remains its fundamental strategy for building the future Air Force. Global Reach -- Global Power is a living strategy that was first put to the test during Operation Desert Storm. It proved sound. Since Operation Desert Storm, that strategy has been more rigorously tested by global involvement in operations involving tens of thousands of flying hours and an operating tempo far beyond our Cold War norm. Global Reach -- Global Power met this challenge; and the Air Force is are confident the basic principles of Global Reach -- Global Power will continue to serve the Air Force and our nation well into the next century.

While Global Reach -- Global Power provides the blueprint for a technologically superior force, expertly trained, highly skilled men and women are the backbone of that force. The sustained readiness, as well as future viability of the Service, demands that the Air Force continue to attract and retain quality people -- the very foundation of the Air Force. Today, the nation's Air Force is over 400,000 strong; and at any given moment, more than 14,000 airmen are temporarily deployed in support of global contingency operations, exercises, or humanitarian relief missions. We are proud of our men and women -- more than anything else, people are our future.

The Joint Chiefs of Staff (JCS). The Joint Chiefs of Staff, headed by the Chairman of the Joint Chiefs of Staff, consists of the Chairman; the Vice Chairman, JCS; the Chief of Staff, U.S. Army; the Chief of Naval Operations; the Chief of Staff, U.S. Air Force; and the Commandant of the Marine Corps, and supported, subject to the authority, direction, and control of the Chairman, by the Joint Staff, constitute the immediate military staff of the Secretary of Defense. The Chairman of the JCS is the principal military advisor to the President, the National Security Council, and the Secretary of Defense. The Chiefs of Service are the senior military officers of their respective Services and are responsible for keeping the Secretaries of the Military Departments fully informed on matters considered or acted upon by the JCS, and are military advisers to the President, the National Security Council, and the Secretary of Defense. The Vice Chairman of the JCS performs such duties as may be prescribed by the Chairman with the approval of the Secretary of Defense. When there is a vacancy in the Office of the Chairman or in the absence or disability of the Chairman, the Vice Chairman acts as Chairman and performs the duties of the Chairman until a successor is appointed or the absence or disability ceases.

The Unified Commands. The Unified Combatant Commands are responsible to the President and the Secretary of Defense for accomplishing the military missions assigned to them. Commanders of the Unified Combatant Commands exercise command authority over forces assigned to them as directed by the Secretary of Defense. The operational chain of command runs from the President to the Secretary of Defense to the Commanders of the Unified Combatant Commands. The Chairman of the Joint Chiefs of Staff functions within the chain of command by transmitting to the Commanders of the Unified Combatant Commands the orders of the President or the Secretary of Defense. Unified Combatant Commands include the European Command, Pacific Command, Atlantic Command, Southern Command, Special Operations

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Command, Strategic Command, Central Command, Transportation Command, and Space Command.

The Inspector General of the Department of Defense (IG, DoD). The Inspector General of the Department of Defense serves as an independent and objective official in the Department of Defense who is responsible for conducting, supervising, monitoring, and initiating audits, investigations, and inspections relating to programs and operations of the Department of Defense. The Inspector General provides leadership and coordination and recommends policies for activities designed to promote economy, efficiency, and effectiveness in the administration of, and to prevent and detect fraud and abuse in, such programs and operations. The Inspector General is also responsible for keeping the Secretary of Defense and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for, and progress of, corrective action.

The Defense Agencies. The Defense Agencies, authorized by the Secretary of Defense pursuant to the provisions of Title 10, United States Code, perform selected support and service functions on a Department-wide basis. Defense Agencies that are assigned wartime support missions are designated as Combat Support Agencies.

- **Advanced Research Projects Agency (ARPA).** The Defense Advanced Research Projects Agency (DARPA), under the authority, direction, and control of the Director for Defense Research and Engineering, serves as the central research and development organization of the DoD with a primary responsibility to maintain U.S. technological superiority over potential adversaries. The DARPA pursues imaginative and innovative research and development projects offering significant military utility; manages and directs the conduct of basic and applied research and development that exploits scientific breakthroughs and demonstrates the feasibility of revolutionary approaches for improved cost and performance of advanced technology; and, stimulates a greater emphasis on prototyping in defense systems by conducting prototype projects that embody technology that might be incorporated in joint programs, programs in support of deployed U.S. Forces (including the Unified Combatant Commands), or selected Military Department programs, and on request, assist the Military Departments in their own prototyping programs.

- **Ballistic Missile Defense Organization (BMDO).** The Ballistic Missile Defense Organization (BMDO), under the authority, direction, and control of the Under Secretary of Defense (Acquisition and Technology), is responsible for managing and directing DoD's Ballistic Missile Defense acquisition programs, which include theater missile defense and a national missile defense for the United States. BMDO also is responsible for the continuing research and development of follow-on technologies that are relevant for long-term ballistic missile defense. These programs will build a technical foundation for evolutionary growth in future ballistic missile defenses. In developing these acquisition and technology programs, BMDO utilizes the services of the Military Departments, the Department of Energy, private industries, and educational and research institutions.

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Ballistic Missile Defense (BMD) plays a central role in U.S. national security strategy by supporting our defense and counter-proliferation objectives. The requirement for BMD flows from a strategy that requires the U.S. to maintain a credible overseas presence and the capability to respond to major regional conflicts despite the increasing danger posed by the proliferation of ballistic missiles. In a world of regional threats to the U.S., BMD affords the U.S. greater freedom of action to protect its interests and uphold its security commitments without fear of coercion. BMD can bolster the solidarity of coalitions and alliances (as it did in Desert Storm), and provide a response to crises without having to resort to offensive measures. Finally, BMD can strengthen the credibility of our deterrent forces and provide an essential hedge against the failure of deterrence.

- **Defense Commissary Agency (DeCA).** The Defense Commissary Agency (DeCA), under the authority, direction, and control of the Assistant Secretary of Defense (Force Management Policy) is responsible for providing an efficient and effective worldwide system of commissaries for the resale of groceries and household supplies at the lowest practical price (consistent with quality) to members of the Military Services, their families, and other authorized patrons, while maintaining high standards for quality, facilities, products, and service.

- **Defense Contract Audit Agency (DCAA).** The Defense Contract Audit Agency (DCAA), under the authority, direction, and control of the Under Secretary of Defense (Comptroller), is responsible for performing all contract audits for the Department of Defense, and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration. These services are provided in connection with negotiation, administration, and settlement of contracts and subcontracts. DCAA also provides contract audit services to other Government agencies, as appropriate.

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  The Agency is dedicated to providing timely and responsive audits and financial advisory services. In fiscal year 1995, DCAA returned $2.9 billion in savings to the Government on an operating budget of $379.1 million. In other words, DCAA returned $7.60 in savings for every $1 of operating cost.

- **Defense Finance and Accounting Service (DFAS).** The Defense Finance and Accounting Service (DFAS), under the authority, direction, and control of the Under Secretary of Defense (Comptroller), is responsible for standardizing financial and accounting information that will be accurate, comprehensive, and timely. To accomplish this, the Director, DFAS shall direct finance and accounting requirements, systems, and functions for all appropriated,

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nonappropriated, working capital, revolving, and trust fund activities, including security assistance; establish and enforce requirements, principles, standards, systems, procedures, and practices necessary to comply with finance and accounting statutory and regulatory requirements applicable to the DoD; provide finance and accounting services for DoD Components and other Federal activities, as designated by the Under Secretary of Defense (Comptroller); and, direct the consolidation, standardization, and integration of finance and accounting requirements, functions, procedures, operations, and systems within the DoD and ensure their proper relationship with other DoD functional areas (e.g., budget, personnel, logistics, acquisition, civil engineering, etc.).

The Defense Finance and Accounting Service (DFAS) is the accounting firm of the Department of Defense (DoD). DFAS was activated on January 15, 1991, to improve the overall effectiveness of DoD financial management through the consolidation, standardization and integration of finance and accounting procedures, operations and systems. Finally, DFAS is responsible for identifying and implementing finance and accounting requirements, systems and functions for appropriated and non-appropriated funds, as well as working capital, revolving funds and trust fund activities--including security assistance.

The agency employs approximately 26,000 people and consists of a small headquarters located in Arlington, Virginia, and five core finance and accounting centers located at:

DFAS - Cleveland Center Cleveland, OH
DFAS - Columbus Center Columbus, OH
DFAS - Denver Center Denver, CO
DFAS - Indianapolis Center Indianapolis, IN
DFAS - Kansas City Center Kansas City, MO

Nearly 300 field finance and accounting sites located nation-wide report to these five centers. However, as a result of two related decisions by the Deputy Secretary of Defense, DFAS has begun consolidating operations into the five centers and 21 operating locations (OPLOCs). This process is expected to take five to seven years.

- **Defense Information Systems Agency (DISA).** The Defense Information Systems Agency (DISA) is a Combat Support Agency of the Department of Defense (DoD) under the authority, direction, and control of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence). DISA is responsible for planning, developing and supporting command, control, communications (C3) and information systems that serve the needs of the National Command Authorities (NCA) under all conditions of peace and war. It provides guidance and support on technical and operational C3 and information systems issues affecting the Office of the Secretary of Defense (OSD), the Military Departments, the Chairman of the Joint Chiefs of Staff, the Unified Combatant Commands, and the Defense Agencies. It ensures the interoperability of the Worldwide Military Command and Control System (WWMCCS), the Defense Communications System (DCS), theater and tactical command and control systems, NATO and/or allied C3 Systems, and those national and/or

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international commercial systems that effect the DISA mission. It supports national security emergency preparedness (NSEP) telecommunications functions of the National Communications System (NCS) as prescribed by Executive Order 12472, Assignment of National Security and Emergency Preparedness Telecommunications Functions, April 3, 1984.

- **Defense Intelligence Agency (DIA).** The Defense Intelligence Agency (DIA), is a Combat Support Agency of the Department of Defense (DoD) under the authority, direction, and control of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence). Under its Director, DIA shall collect, produce, or, through tasking and coordination, provide military and military-related intelligence for the Secretary of Defense, the Chairman of the Joint Chiefs of Staff, other Defense components, and, as appropriate, non-Defense agencies; collect and provide military intelligence for national foreign intelligence and counterintelligence products; coordinate all DoD intelligence collection requirements; manage the Defense Attaché system; provide foreign intelligence and counterintelligence staff support to the Chairman of the Joint Chiefs of Staff; and, manage the General Defense Intelligence Program.

  As a Combat Support Agency of the Department of Defense, the DIA's mission is to provide timely, objective and cogent military intelligence to the warfighters--soldiers, sailors, airmen, marines--and to the decisionmakers and policymakers of the U.S. Department of Defense and the U.S. Government.

- **Defense Investigative Service (DIS).** The Defense Investigative Service (DIS), under the authority, direction, and control of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), conducts all Personnel Security Investigations (PSI's) for DoD Components and, when appropriate, also conducts PSI's for other U.S. Government activities. These PSI's include investigation of allegations of subversive affiliations, adverse suitability information, or any other situation that requires resolution to complete the PSI. DIS is also responsible for the four major programs involving industrial security: the Defense Industrial Security Program; the Key Assets Protection Program; the Inspection Program for Contractors with conventional arms, ammunition and explosives, and the Certification Program for Contractors with very high speed integrated circuits.

- **Defense Legal Services Agency (DLSA).** The Defense Legal Services Agency, under the authority, direction, and control of its Director, who also serves as the General Counsel of the Department of Defense, provides legal advice and services for the Defense Agencies, DoD Field Activities, and other assigned organizations. This includes technical support and assistance for development of the DoD Legislative Program; coordinating DoD positions on legislation and Presidential Executive Orders; providing a centralized legislative document reference and distribution point for the DoD; maintaining the Department's historical legislative files; developing DoD policy for standards of conduct and administering the Standards of Conduct Program for the OSD and other assigned organizations; and administering the Defense Industrial Security Clearance Review Program.

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- **Defense Logistics Agency (DLA).** The Defense Logistics Agency (DLA), is a Combat Support Agency of the Department of Defense (DoD) under the authority, direction, and control of the Under Secretary of Defense (Acquisition and Technology). DLA provides worldwide logistics support for the missions of the Military Departments and the Unified Combatant Commands under conditions of peace and war. Also provides logistics support to other DoD Components and certain Federal agencies, foreign governments, international organizations, and others as authorized. Provides materiel commodities and items of supply that have been determined, through the application of approved criteria, to be appropriate for integrated management by DLA on behalf of all DoD Components, or that have been otherwise specifically assigned by appropriate authority. Furnishes logistics services directly associated with the supply management function and other support services including scientific and technical information, federal cataloging, industrial plant equipment, reutilization and marketing and systems analysis, design, procedural development and maintenance for supply and service systems, industrial plant equipment storage and issuance, DLA logistics systems development, and the National Defense Stockpile Program. Maintains a wholesale distribution system for assigned items. Provides contract administration service in support of the Military Departments, other DoD Components, Federal civil agencies and, when authorized, to foreign governments and others.

- **Defense Special Weapons Agency (DSWA).** The Defense Special Weapons Agency (DSWA), under the authority, direction, and control of the Assistant to the Secretary of Defense (Nuclear and Chemical and Biological Defense Programs (NCB)), supports the DoD and other Federal Agencies on matters concerning nuclear weapons, nuclear weapons system acquisitions, nuclear weapons effects on weapons systems and forces, and nuclear weapons safety and security. During wartime and international crisis, in accordance with national priorities and, as directed by the ATSD (NCB), the DSWA shall redirect its resources to support the Chairman of the Joint Chiefs of Staff and the Commanders of the Unified Combatant Commands in analyzing nuclear weapons planning and action options, and reconstituting nuclear forces.

  The Defense Special Weapons Agency (DSWA) serves as the Department of Defense's (DoD) center for nuclear and advanced weapons effects expertise. The Agency's mission is to research and develop technologies to support military systems development and operational requirements. DSWA also manages the military nuclear weapons stockpile and conducts programs associated with Cooperative Threat Reduction (Nunn-Lugar), arms control technology and counter-proliferation support. Through the use of simulators and computer models, DSWA maintains the scientific expertise and develops data necessary to ensure advanced conventional systems, nuclear systems and command and control assets will continue to operate in potential nuclear environments. This expertise is also used to provide commanders with options for effective targeting against underground or hardened structures, as well as enhanced capabilities to assess battle damage.

  As the oldest defense agency, DSWA traces its history to World War II, when the Manhattan Project was formed to oversee development of the world's first atomic bomb. After the war, two organizations--one civilian and one military--emerged to concentrate on nuclear weapons

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research and development. The civilian organization, the Atomic Energy Commission (forerunner of the Department of Energy), developed and produced nuclear weapons. The military organization, the Armed Forces Special Weapons Project, was created in 1947. The Armed Forces Special Weapons Project conducted nuclear weapon effects research and provided nuclear technical, logistical and training support for DoD. In a 1959 reorganization, the Armed Forces Special Weapons Project became the Defense Atomic Support Agency. The Defense Atomic Support Agency became the Defense Nuclear Agency in 1971. The Defense Nuclear Agency was renamed Defense Special Weapons Agency in 1996, as a result of a new charter and an expanded mission.

- **Defense Security Assistance Agency (DSAA).** The Defense Security Assistance Agency, under the authority, direction, and control of the Assistant Secretary of Defense (International Security Affairs), serves as the DoD focal point and clearinghouse for the development and implementation of security assistance plans and programs, monitoring major weapon sales and technology transfer issues, budgetary and financial arrangements, legislative initiatives and activities, and policy and other security assistance matters through the analysis, coordination, decision, and implementation process. DSAA directs and supervises the organization, functions, training, administrative support, and staffing of DoD elements in foreign countries responsible for managing security assistance programs and supports the development of cooperative programs with industrialized nations. To accomplish its mission, the DSAA shall develop and manage the security assistance program so as to gain maximum benefit for the foreign policy and national security of the United States.

- **National Imagery and Mapping Agency(NIMA)/Defense Mapping Agency (DMA).** The National Imagery and Mapping Agency (NIMA) is a Combat Support Agency of the Department of Defense under the authority, direction, and control of the Secretary of Defense and the overall supervision of the Assistant Secretary of Defense for Command, Control, Communications, and Intelligence (ASD(C3I)). The mission of the NIMA is to provide timely, relevant, and accurate imagery, imagery intelligence, and geospatial information in support of the national security objectives of the United States. The NIMA carries out this responsibility by advising the Secretary and Deputy Secretary of Defense, the ASD(C3I), the Chairman of the Joint Chiefs of Staff, the Combatant Commanders, and, for national intelligence purposes, the Director of Central Intelligence and other Federal Government officials, on imagery, imagery intelligence, and geospatial information; and by supporting the imagery, imagery intelligence, and geospatial requirements of the Departments and Agencies of the Federal Government, to the extent provided by law.

  NIMA provides timely, relevant, and accurate imagery, imagery intelligence, and geospatial information in support of national security objectives. NIMA guarantees the information edge-ready access to the world's imagery, imagery intelligence, and geospatial information. part of NIMA's professional development college, the Defense Mapping School provides instruction in preparation and use of geospatial information.

- **National Security Agency** (NSA). The National Security Agency/Central Security Service (NSA/CSS), is a Combat Support Agency of the Department of Defense (DoD) under the

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authority, direction, and control of the Secretary of Defense, and is responsible for centralized coordination, direction, and performance of highly specialized intelligence functions in support of U.S. Government activities. NSA carries out the responsibilities of the Secretary of Defense to serve as Executive Agency for U.S. Government signals intelligence, communications security, computer security, and operations security training activities. The Central Security Service provides the Military Services a unified cryptologic organization within the Department of Defense designed to assure proper control of the planning, programming, budgeting, and expenditure of resources for cryptologic activities.

- **On-Site Inspection Agency (OSIA).** The United States On-Site Inspection Agency (OSIA), formed in 1988, under the authority, direction, and control of the Assistant to the Secretary of Defense (Nuclear and Biological and Chemical Defense Programs (NCB)), is responsible for managing and coordinating on-site inspections used to collect information for monitoring the Intermediate-Range Nuclear Forces (INF) Treaty; the Threshold Test Ban Treaty (TTBT); the Conventional Armed Forces in Europe (CFE) Treaty when it enters into force; the Vienna Document of 1990; and, planning for the Strategic Arms Reduction Treaty (START), Peaceful Nuclear Explosion Treaty (PNET), and Chemical Weapons (CW) agreements.

  The Agency's work is not limited to supporting the treaty verification process. The U.S. government also relies upon OSIA's inspection experiences and linguistic capabilities to perform a variety of other missions. To date, these include supporting the United Nations Special Commission (UNSCOM) on Iraq, providing humanitarian assistance through Operation Provide Hope, leading and supporting the Defense Treaty Inspection Readiness Program (DTIRP), supporting U.S. Forces Korea (USFK), assisting implementation of the Cooperative Threat Reduction (CTR) program and working towards peace by supporting the multilateral inspection activities in Bosnia and Herzegovina under the Dayton Peace Accords.

DoD Field Activities. The DoD Field Activities are established by the Secretary of Defense, under the provisions of Title 10, United States Code, to perform selected support and service functions of a more limited scope than Defense Agencies.

- **American Forces Information Service (AFIS).** The American Forces Information Service (AFIS), under the authority, direction, and control of the Assistant to the Secretary of Defense (Public Affairs): (1) advises and acts for the ASD(PA) in managing DoD internal information programs; (2) develops policies, guidelines, and standards for the management of DoD visual information (VI) activities and programs; (3) develops policies, guidelines, and standards for the management of Armed Forces Radio and Television Service (AFRTS) outlets and activities; and (4) provides joint-interest print, radio, film, and television materials for use in the internal information programs of the Military Departments and other DoD organizations.

  The Armed Forces Radio and Television Service (AFRTS) provides radio and television programs to 1 million service members and their families overseas, to include Navy members aboard ships at sea. AFRTS's programming hub is located at its Broadcast Center at March Air Force Base, Calif., which obtains radio and television programs from commercial

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networks and syndicators - or specially produces them - and sends them out worldwide. AFRTS has outlets in about 140 countries. Outlets range in size and capability from large radio and TV facilities like those found in U.S. metropolitan areas - to small, unmanned repeater stations - to simply video monitors and videocassette players.

- **Defense Medical Program Activity (DMPA).** The Defense Medical Programs Activity (DMPA), under the authority, direction, and control of the Assistant Secretary of Defense (Health Affairs), is designed to help support the resources planning, programming, budgeting, execution, program review and evaluation of the Defense Unified Medical Program; and the information systems development and management, facility planning, programming, budgeting, and review requirements of the Military Health Services System (MHSS).

- **Defense Prisoner of War/Missing in Action Office (DPMO).** The Defense Prisoner of War/Missing in Action Office under the authority, direction, and control of the Assistant Secretary of Defense (International Security Affairs), provides centralized management of prisoner of war/missing in action (POW/MIA) affairs within the Department of Defense.

- **Defense Technology Security Administration (DTSA).** The Defense Technology Security Administration, under the authority, direction, and control of the Assistant Secretary of Defense (International Security Policy), serves as the focal point within DoD for administering the DoD Technology Security Program. It is responsible for reviewing the international transfer of defense-related technology, goods, and services consistent with U.S. foreign policy and national security objectives.

- **Defense Civilian Personnel Management Service (DCPMS).** The Department of Defense Civilian Personnel Management Service (CPMS), under the authority, direction, and control of the Assistant Secretary of Defense (Force Management Policy) (ASD(FMP)), provides civilian personnel policy support, functional information management, and centralized administration of common civilian personnel management services to the DoD Components and their activities.

- **DoD Education Activity (DODEA).** The Department of Defense Education Activity (DoDEA), under the authority, direction, and control of the Assistant Secretary of Defense (Force Management Policy), serves as the principal staff advisor to the ASD(FMP) on all Defense education matters relative to overseas, domestic, and continuing adult and post-secondary education activities and programs.

- **Office of Civilian Health and Medical Program of the Uniformed Services (OCHAMPUS).** OCHAMPUS, under the authority, direction, and control of the Assistant Secretary of Defense (Health Affairs), administers civilian health and medical programs for retirees, and for spouses and children of active duty, retired, and deceased members of the Uniformed Services. The Uniformed Services include the Army, Navy, Air Force, Marine Corps, Coast Guard, and the Commissioned Corps of the National Oceanographic and Atmospheric Administration (NOAA) and the Public Health Service (PHS).

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- **Office of Economic Adjustment (OEA).** OEA, under the authority, direction, and control of the Deputy Under Secretary of Defense (Industrial Affairs and Installations (DUSD (IA&I)), serves as the principal staff advisor to the DUSD(IA&I) on economic adjustment, joint land use studies, and intergovernmental coordination program matters.

- **Washington Headquarters (WHS).** WHS provides administrative and operational support to specified Department of Defense activities in the National Capital Region (NCR).

Readiness

U.S. Defense Strategy. Since the founding of the Republic, the U.S. government has always sought to secure for the American people a set of basic objectives:

- The protection of their lives and personal safety, both at home and abroad.

- The maintenance of the nation's sovereignty, political freedoms, and independence, with its values, institutions, and territory intact.

- Their material well-being and prosperity.

On the eve of the 21st century, the international environment is more complex and integrated than at any other time in history. The number and diversity of nations, organizations, and other actors vying for influence continue to grow. At the same time, the global economy is increasingly interdependent. Not only does this offer the United States the promise of greater prosperity, it also ties the security and well-being of Americans to events beyond their borders more than ever before. Today, incidents formerly considered peripheral to American security -- the spread of ethnic and religious conflict, the breakdown of law and order, or the disruption of trade in faraway regions -- can pose real threats to the United States. Likewise, new opportunities have arisen for the United States, in concert with other like-minded nations, to advance its long-term interests and promote stability in critical regions.

In order to shape the international security environment in ways that protect and advance U.S. interests, the United States must remain engaged and exert leadership abroad. U.S. leadership can deter aggression, foster the peaceful resolution of dangerous conflicts, underpin stable foreign markets, encourage democracy, and inspire others to create a safer world and to resolve global problems. Without active U.S. leadership and engagement abroad, threats to U.S. security will worsen and opportunities will narrow. If the United States chooses not to lead in the post-Cold War world, it will become less able to secure the basic objectives outlined above.

Keeping U.S. Forces Ready. The number one priority of the Department of Defense is maintaining the readiness and sustainability of U.S. forces. The United States must have highly capable forces that are prepared to rapidly respond to the diverse demands of a post-Cold War world. Managing this goal is one of the Department's most aggressive and ambitious undertakings. A fundamental challenge rests in understanding what readiness really means in terms of national policy goals and what the Department is doing to assess, measure, correct, and

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project the readiness of U.S. forces today, tomorrow, and in the future. The U.S. National Military Strategy outlines a broad spectrum of commitments, specifically that U.S. forces must be prepared to fight and win the nation's wars, deter aggression and prevent conflict, and conduct peacetime engagements Maintaining readiness is an essential component in virtually all of the Department's activities. In general terms, readiness is the overall ability of forces to arrive on time where needed and prepared to effectively carry out assigned missions. The ability of units to be ready on time to carry out their missions, in turn, is a function of having the equipment, supplies, logistics, intelligence, and experienced people with the skills to accomplish assigned tasks.

U.S. forces are ready to meet these missions. To maintain the readiness of the force, the Department has encountered these challenges: develop and retain high quality people, ensure adequate readiness funding, and develop and manage a system of measuring and assessing readiness. Challenges to maintaining readiness rest primarily with six variables: personnel, equipment, training, logistics, professional development, and the financial resources to support these elements. A deficit in any one will degrade readiness. It takes resources and time to develop and sustain ready forces. Readiness is cumulative; it takes 20 years to develop senior level individual military leaders, 7-11 years to develop and field technologically superior equipment, and 1-2 years to develop a sustainment program to provide trained and ready units. A decline in resources or adequately educated and trained people will lengthen the amount of time it takes to rebuild readiness. Through its efforts to ensure a highly capable force, DoD has encountered these challenges to readiness: people, readiness funding, and staying on top of readiness. The following discussion characterizes these challenges and describes how the Department is addressing these issues.

- **Quality Personnel - Attracting/Retaining Quality People.** The first challenge to keeping a ready force is attracting and keeping high quality people. This is becoming increasingly difficult, given the attractiveness of nonmilitary careers in an improving economy and demanding pace of military operations. Today, the all-volunteer force includes some of the most skilled men and women ever to wear the uniform. High quality people are the foundation of today's high quality force. The challenge to readiness is to keep it that way. A weapon system will be only as effective as the people who operate and maintain it. Recruiting and retaining quality people significantly affect readiness. The Department is meeting its recruiting goals, including quality goals, and currently enjoys high retention rates among service members. The Department has taken several steps to improve quality of life so that the Services can continue these positive trends.

  Quality of life programs support readiness in three ways. First, quality of life helps the Department recruit good people by offering attractive incentives for education, health care, career advancement, and retirement, among others. Second, quality of life programs provide assurance to service members that their families will be taken care of during deployments -- an important consideration with a more mature and family oriented all-volunteer force. Third, they help to retain the best people -- well-trained people who are competent in their skills and who have high morale. The Secretary of Defense's initiative to add $2.7 billion over six years (FY 1996-2001) recognizes the importance of the quality of life of service members and its

relation to the readiness of the force. The $2.7 billion for these initiatives will improve compensation, living accommodations, and family and community support.

- **Readiness Funding.** The second challenge is to make sure the Department has the right resources allocated to the right purposes in support of readiness. Many of the assumptions on funding become inaccurate due to shifting priorities and the lengthy budget and execution cycle. Structuring the budget to ensure readiness involves a rigorous, multistep process. For the FY 1997 budget request sent to Congress, this process began over a year ago with the Secretary's guidance to the Services and other defense components. The Secretary directed the Services to provide enough funding in future programs and budgets to ensure their forces were ready to carry out missions at acceptable levels of risk. Underscoring the strength of this priority, the Secretary allowed the Services to break his guidance elsewhere if required to maintain readiness.

  The budget development process included two other important steps to ensure that U.S. forces had sufficient readiness to carry out joint operations. The first involved direct discussions between the Secretary and the Commanders in Chief to ensure that their readiness concerns were met. Second, the Joint Staff, under the leadership of the Vice Chairman, undertook a detailed review of readiness-related funding. The results, reflected in the Chairman's Program Assessment, led to the incorporation of several important enhancements in the final budget submission.

  The results of DoD's approach to getting readiness funding right from the start were incorporated into the FY 1995 budget, which involved many changes from the previous year and corrected some unrealistic assumptions. The FY 1996 budget also reflected robust readiness funding. The Department's FY 1997 budget request offers further refinements in readiness, building on progress made in the previous fiscal year. For example, levels of funding for operations and maintenance -- the major, but not sole, source of readiness funding -- indicate that DoD has maintained historic levels of readiness. In light of the improvements made, the FY 1995-1997 budgets are balanced and realistic. Indeed, the funding provided in the FY 1997 budget will maintain adequate readiness levels in the Services, with one important provision -- the Department must receive timely funding for unbudgeted contingency operations.

- **Staying on Top of Readiness.** Even with the best plans for people and resources to support readiness, the third challenge is to watch closely what happens as plans are executed and to make timely adjustments when problems arise. The Department has improved its ability to assess readiness to ensure that it has a clear picture of the health of the force. When costs were incurred for unfunded contingency operations during FY 1994, the Department knew there would be some pockets of unreadiness, but the effect that reallocating O&M funds had on force readiness could not be accurately projected. When readiness declines did occur, the readiness reporting system informed senior leaders in the Department only after many weeks had passed, which was an inherent weakness in the readiness reporting methodology in effect at the time. To correct these deficiencies, especially the ability to uncover readiness

problems quickly and correct them as fast as possible, DoD implemented a number of initiatives to improve its assessment and correctional capability.

Financial Performance Measures

Financial performance measures summarize significant indicators of financial results and financial condition and are included in each of the DoD reporting entity financial statements. The stand alone financial statements for DoD reporting activities identify and discuss material changes and significant trends in financial results or condition for those funds and appropriations they receive.

The emerging requirements of Public Law 103-62, "The Government Performance and Results Act of 1993," scheduled for implementation in FY 1999, will complement and expand the framework for linking financial and program performance established by the CFO Act.

Financial Management Issues

The "cold war" has been won and, as a result, the infrastructure and overhead of the Department of Defense (DoD) is being reduced. The DoD financial management community is an active participant in the downsizing and has some 100 projects underway to improve and streamline financial management, as well as the timeliness and accuracy of accounting data. As a result, the Department is in the midst of the most comprehensive reform of financial management systems and practices in its history. These reform efforts are driven by two pressing needs: first, the need to overcome decades-old problems in financial management systems and procedures; and second, the need to lower administrative costs by redesigning fundamentally the Department's fiscal operations.

Underlying Causes of DoD Financial Management Problems. Prior to January 1991, the Department of Defense had a totally decentralized mode of operations. Reflecting that reality, the three Military Departments and the major Defense Agencies had, until recent major reforms began, managed their own budget, finance, and accounting systems. As a result, they developed their own processes and business practices, geared to their particular mission, with little incentive to achieve compatibility with other DoD activities. As DoD missions became more complicated and organizations were required to interact more with each other, the incompatibility of systems and lack of standardization took a toll. Rather than redesigning its organization or standardizing its multitude of systems, the Department developed increasingly complex business practices to link its systems. Such complexity left DoD financial systems prone to error or to demands that could not be met with the platforms, personnel, or time available. No matter how good the people operating those systems, problems were inevitable. Moreover, there was an inherent inefficiency in having scores of incompatible organizations that performed virtually identical functions.

Financial Management Reform Initiatives. Following is a brief description of the specific tactics that are being employed by the Department to reform its entire financial management process and achieve compliance with statutory and other regulatory requirements by Fiscal Year 2003. These actions are consistent with, and in direct support of, the Department's 1996 Chief Financial Officer's Financial Management Status Report and Five-Year Plan.

OVERVIEW OF THE REPORTING ACTIVITY

A. Consolidate Finance and Accounting Operations

The Department is reducing the number of sites that perform finance and accounting functions--from 343 to not more than 26 by Fiscal Year 1998. To date, 230 of the 343 sites have been closed.

The new organizational structure is expected to facilitate standardized and streamlined operations, improve accountability, reduce data reconciliation, enhance flexibility, improve contingency capabilities, complement the use of integrated systems, promote economy and efficiency, and focus on service to the customer. Savings are expected to result from eliminating redundant activities and unnecessary intermediate offices; reducing unnecessary management levels, overhead, and support personnel; and eliminating redundant systems and the support staffs that maintain them. Streamlining organizations, together with standardizing systems and employing more successful business practices, also should result in better financial management services. In particular, streamlining should promote consistency in operations, a singular interpretation of policies and procedures, and the strengthening of internal controls. A new structure also is expected to improve, substantially, the integrity of financial information throughout the Department, thereby enhancing service to defense contractors, military and civilian employees and DoD and other federal managers at all levels, and improving responsiveness to the Congress, other regulatory organizations and the American taxpayer.

All of this, of course, does not come inexpensively or without substantial involvement from both users and providers of information. The application of substantial resources, as well as increased training and education, will be required to achieve these objectives. A failure to make the required investment is likely to perpetuate current financial management deficiencies and problems. In adopting this Plan, the Department intends both to apply the necessary resources and vigorously exercise its financial stewardship.

B. Business Process Reengineering

The success of the Department's financial management reform depends upon a reengineering of its business practices. Fundamental change is essential; merely automating current practices only would speed the handling of data that is incapable of being integrated into useful results. Although a difficult, time-consuming process, the Department must conduct baseline studies of current procedures, eliminate needless or duplicative processes, and standardize and consolidate the many systems and processes used in DoD financial management. This process now is underway--with the overriding objective of providing timely, consistent and accurate financial information.

Business process reengineering efforts include simplifying, standardizing, and improving financial management regulations and procedures. The "DoD Financial Management Regulation," is expected to replace some 70,000 pages of separate DoD Component regulations with most of the target 15 volumes already in use. Initiatives to simplify, standardize, and improve policy and procedures include both traditional guidance and the standardization of financial management data elements, formats and specifications to facilitate greater use of

modern technologies. The use of technologies such as electronic commerce, electronic document management and teleservices are expected to drive significant business process improvements.

Business process reengineering extends beyond financial management into other functional areas such as personnel, logistics and acquisition. The financial management community cannot operate in isolation from other functions. In fact, it has been estimated that the financial community is reliant on the data captured in other communities for some 80 percent of the data used in its processes. Data needed to support financial functions is expected to be captured once, at the source, and transmitted to various using functions (both financial and non-financial) via electronic media. A greater degree of automated information exchange also must occur between the Department and its trading partners. The huge volume of paper associated with financial management today must be eliminated—replaced by electronic transfers of vendor invoices and receiving reports, payments via electronic funds transfer, on-line financial reports, and the like. All aspects of improving DoD financial management will be explored through a variety of business process reengineering initiatives.

C. Improve Financial Management Systems

By Fiscal Year 2003, the Department expects to have a financial management architecture in place that is capable of producing auditable financial statements. The Department currently is analyzing how system improvements, new technology and modifications to work processes can together enhance the Department's financial operations and improve program and financial management. Financial management systems improvement efforts will seek cost effective and efficient solutions and--where applicable--will employ the use of off-the-shelf software solutions.

1. Target Architecture

The DoD target systems architecture (see Appendix I) is expected to be comprised of a minimum number of finance and accounting applications to support core accounting and business requirements that are integrated into the broader DoD functional and technical architecture. The following are the features of the target systems architecture:

- standard processes and information classification structure that is consistent with the U.S. Government Standard General Ledger;
- accounting data captured at the source and at the level of detail necessary to support budgetary and financial requirements;
- employ open system environment concept;
- use standard data elements;
- integration to share standardized data between unique functional areas;
- global edit tables to ensure data integrity;
- standard interfaces to update subsidiary and general ledger accounts;

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- consistent internal controls to insure resource use is consistent with laws, regulations and DoD policies;
- accounting data maintenance to permit reporting in accordance with federal accounting standards;
- conform with applicable functional requirements for the design, development, operation and maintenance of financial management systems;
- performance measurement capability to support budgeting, program management and financial statement presentation; and
- use of security controls.

2. *Systems Consolidation*

The myriad of existing, duplicative financial systems must be substantially reduced to decrease cost and achieve standardization. To accomplish this, the Department's strategy aims to eliminate unneeded systems by consolidating finance and accounting functions to a select set of migration systems. The migration systems will be implemented in three concurrent stages (see Appendix II) at the conclusion of which the process is expected to culminate in a financial management system comprised of a suite of standard integrated applications that are CFO and Year 2000 compliant (see Appendix III).

Stage 1: *Improve Core Accounting Systems*

During this stage, systems will be consolidated generally along DoD Component lines. Enhancements to comply with CFO and Year 2000 requirements will be made along with standardized processes and data. This includes implementing the U.S. Government Standard General Ledger and a standard budget and accounting coding structure.

Stage 2: *Integrate Accounting Systems*

This stage integrates the accounting systems architecture through the development of a corporate database that links the accounting applications and performs functions that cross accounting and finance systems such as prevalidation, cross disbursement, departmental accounting and cash accountability. A warehouse capability to store and share data for financial management analysis also will be established.

Stage 3: *Integrate/Interface Accounting and Business Environments*

Complete transition to the DoD-wide system architecture and interface with the DoD non-financial business environments in a shared data environment to achieve accountability and auditability to source data.

3. *Data Standardization*

The Department views data as a resource and is committed to the efficient and effective use of standard data across functional communities. The Department's strategy for data administration

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is based on high level planning with a top-down modeling approach to achieve data standardization. Standard data will be used to facilitate the consolidation of financial management systems, enhance compatibility between financial management and non-financial management systems, and support the reengineering of business practices.

D. Management Control Mechanisms

Strong internal controls are essential to effectively controlling and accounting for DoD assets. Without effective internal controls, the Department could not ensure that assets are protected against fraud, waste and mismanagement. The Department's senior managers will play an active role in identifying, reporting and correcting management control deficiencies. Additionally, the management control process is expected to be integrated into the daily management practices of DoD managers.

E. Management Framework

The success of meaningful financial management reform requires the sustained attention, cooperation and commitment from top management across the Department. Collaboration among financial and non-financial organizations will be improved and expanded to better ensure successful implementation of financial management reform initiatives. Additionally, a cross-functional oversight structure will be used to ensure the involvement of the Department's senior leaders in the financial reform process.

Limitation of the Financial Statements

- The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of the CFO Act of 1990 and the Government Management Reform Act of 1994 (GMRA).

- While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements are different from the financial statements used to monitor and control budgetary resources that are prepared from the same books and records.

- The statements should be read with the realization that they are for a Federal entity, that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

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Consolidated Statements

Department of Defense
Statement of Financial Position
As of September 30, 1996
(Thousands)

ASSETS	1996	Prior Year *
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$184,244,796	
(2) Investments, Net (Note 4)	132,776,006	
(3) Accounts Receivable, Net (Note 5)	7,607,765	
(4) Interest Receivable	4,202,116	
(5) Advances and Prepayments	(704,752)	
(6) Other Federal (Intragovernmental) (Note 6)	941,882	
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	297	
(2) Accounts Receivable, Net (Note 5)	7,475,327	
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	
(4) Interest Receivable, Net	28,296	
(5) Advances and Prepayments	8,654,608	
(6) Other Non-Federal (Governmental) (Note 6)	37,560	
c. Cash and Other Monetary Assets (Note 3)	113,973	
d. Inventory, Net (Note 8)	177,558,965	
e. Work in Process (Note 9)	2,531,554	
f. Operating Materials/Supplies, Net (Note 10)	1,546,695	
g. Stockpile Materials, Net (Note 11)	3,696,491	
h. Seized Property (Note 12)	0	
i. Forfeited Property, Net (Note 13)	0	
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	
k. Property, Plant and Equipment, Net (Note 15)	772,884,804	
l. Other Entity Assets	7,113,685	
m. **Total Entity Assets**	$1,310,710,068	
2. Non-Entity Assets:		
a. Transactions With Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	($583,053)	
(2) Accounts Receivable, Net (Note 5)	118,917	
(3) Interest Receivable, Net	0	
(4) Other (Note 6)	375,620	

The accompanying notes are a integral part of these statements.

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Consolidated Statements

Department of Defense
Statement of Financial Position
As of September 30, 1996
(Thousands)

ASSETS, Continued	1996	Prior Year *
2. Non-Entity Assets:		
b. Transactions With Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	$539,546	
(2) Interest Receivable, Net	52,674	
(3) Other (Note 6)	7,851	
c. Cash and Other Monetary Assets (Note 3)	277,305	
d. Other Non-Entity Assets	38,362	
e. Total Non-Entity Assets	$827,222	
3. Total Assets	$1,311,537,290	
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$5,838,587	
(2) Interest Payable	0	
(3) Debt (Note 16)	1,382,763	
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	6,300,591	
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	15,132,961	
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	4,592,069	
(b) Annual Accrued Leave	978,934	
(c) Severance Pay and Separation Allowance	751,198	
(3) Interest Payable	251	
(4) Liabilities for Loan Guarantees (Note 7)	0	
(5) Lease Liabilities (Note 18)	3,622	
(6) Pensions and Other Actuarial Liabilities (Note 19)	132,787,893	
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	3,970,143	
c. Total Liabilities Covered by Budgetary Resources:	$171,739,012	

The accompanying notes are a integral part of these statements.

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Department of Defense
Statement of Financial Position
As of September 30, 1996
(Thousands)

LIABILITIES, Continued	1996	Prior Year *
5. Liabilities Not Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	($48,917)	
(2) Debt (Note 16)	0	
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	770,760	
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	5,254	
(2) Debt (Note 16)	0	
(3) Lease Liabilities (Note 18)	0	
(4) Pensions and Other Actuarial Liabilities (Note 19)	421,930,934	
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	24,250,042	
c. Total Liabilities Not Covered By Budgetary Resources	$446,908,073	
6. Total Liabilities	$618,647,085	
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$171,465,546	
b. Invested Capital	1,005,978,667	
c. Cumulative Results of Operations	(31,026,936)	
d. Other	(6,618,999)	
e. Future Funding Requirements	(446,908,073)	
f. Total Net Position	$692,890,205	
8. Total Liabilities and Net Position	$1,311,537,290	

The accompanying notes are a integral part of these statements.

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Consolidated Statements

Department of Defense
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1996
(Thousands)

	1996	Prior Year *
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used	$212,942,585	
2. Revenues from Sales of Goods and Services		
a. To the Public	8,556,044	
b. Intragovernmental	44,997,100	
3. Interest and Penalties, Non-Federal	9,564	
4. Interest, Federal	11,385,085	
5. Taxes (Note 21)	0	
6. Other Revenues and Financing Sources (Note 22)	24,657,414	
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	(651,633)	
8. Total Revenues and Financing Sources	$301,896,159	
EXPENSES		
9. Program or Operating Expenses (Note 23)	$257,418,213	
10. Cost of Goods Sold (Note 24)		
a. To the Public	7,730,102	
b. Intragovernmental	31,266,410	
11. Depreciation and Amortization	1,558,025	
12. Bad Debts and Writeoffs	122,485	
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	
b. Federal Securities	0	
c. Other	6,509	
14. Other Expenses (Note 25)	23,024,177	
15. Total Expenses	$321,125,921	
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	(19,229,762)	
17. Plus (Minus) Extraordinary Items (Note 26)	428,252	
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($18,801,510)	

The accompanying notes are a integral part of these statements.

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Consolidated Statements

Department of Defense
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1996
(Thousands)

	1996	Prior Year *
EXPENSES, Continued		
19. **Net Position, Beginning Balance, as Previously Stated**	$726,220,581	
20. Adjustments (Note 27)	(9,001,015)	
21. Net Position, Beginning Balance, as Restated	$717,219,566	
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(18,801,510)	
23. Plus (Minus) Non Operating Changes (Note 28)	(5,527,851)	
24. **Net Position, Ending Balance**	$692,890,205	

The accompanying notes are a integral part of these statements.

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Consolidated Statements

The accompanying notes are a integral part of these statements.

DEPARTMENT OF DEFENSE

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

NOTES TO THE DEPARTMENT OF DEFENSE PRINCIPAL STATEMENTS

Note 1. Summary of Significant Accounting Policies:

A. Basis of Presentation:

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

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

B. Reporting Entity:

Fiscal year 1996 represents the first year the Department of Defense prepares and has audited an agency-wide set of financial statements. The reporting entities within the Department have been changed to facilitate this new reporting requirement. Auditors will be issuing reports on the financial statements of the following reporting entities: 1) Army; 2) Navy; 3) Air Force; 4) Defense Business Operations Fund; 5) DoD Military Retirement Trust Fund; 6) National Defense Stockpile Transaction Fund; and 7) U.S. Army Corps of Engineers (Civil Works). In addition to the preceding seven entities, a new reporting entity - "Other Defense Organizations" - has been added to incorporate all remaining DoD agencies.

Auditors will not issue a separate report on the "Other Defense Organizations" but will be issuing reports on selected agencies within this reporting entity group. Consequently, since all of the DoD reporting entities comprising the DoD Consolidated Report have separate audit reports - with the exception of "Other Defense Organizations" - readers of this consolidated report may refer back to the underlying CFO Report for more specific financial statement presentations and disclosures. These consolidated statements account for all funds for which the Department of

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Defense is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that the information is no longer classified.

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

C. Budgets and Budgetary Accounting:

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

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

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

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

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

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

D. Basis of Accounting:

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

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

E. Revenues and Other Financing Sources:

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

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

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

F. Accounting for Intragovernmental Activities:

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

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

These financial statements do not reflect any portion of the public debt or interest thereon, nor do the statements reflect the source of public financing (e.g. debt issuance, tax revenues). The related interest costs incurred in the construction of DoD facilities are also not capitalized since Treasury does not allocate interest costs to the benefiting agencies.

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

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

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

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

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

Retirement Contributions
(Thousands)

CSRS	$856,674
FERS	1,075,077
MRS	10,141,764
Social Security	1,888,791
Total	$13,962,306
TSP	$361,631

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

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

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

Fund Balance With Treasury is adjusted for the amount of undistributed disbursements and collections reported in the departmental expenditure systems. A corresponding adjustment is also processed to both accounts payable and accounts receivable respectively. These adjustments represent DoD's in-float (undistributed) disbursements/collections for transactions that have been

FOOTNOTES TO THE PRINCIPAL STATEMENTS

reported by a disbursing station but not recorded by the appropriate accountable station. See Note 2, "Fund Balance with Treasury."

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

H. Foreign Currency:

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

I. Accounts Receivable, Net:

As presented in the Statement of Financial Position, accounts receivable includes accounts, claims, and refunds receivable from other entities. Allowances for uncollectible accounts are based on an analysis of collection experience by fund type. See Note 5, "Accounts Receivable, Net."

J. Loans Receivable:

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

FOOTNOTES TO THE PRINCIPAL STATEMENTS

K. Inventory, Net:

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

L. Investments in U.S. Government Securities:

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

M. Property, Plant and Equipment, Net:

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

Valuations for weapons systems are to be based on historical procurement costs, however, most of the Department's tracking systems were not designed to record and perpetuate individual acquisition costs. Instead they assign standard costs to like items. Standard cost is normally the latest acquisition costs for specific Federal stock categories. Engineering and modification costs incurred subsequent to approval of the basic procurement contracts are valued at the contract price of the engineering change order, value engineering, or modification which extends the life of the asset or capability of the system, and any other cost of materials or services not included in the contract cost.

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

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

original records supporting the property acquisition cost are no longer available. The DoD has requested that the Federal Accounting Standards Advisory Board endorse the above policy until such time as other applicable accounting standards are issued by the Board.

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

N. Prepaid and Deferred Charges:

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

O. Leases:

As of September 30, 1996, the DoD was committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for the rental of equipment, space, rights of way, and operating facilities. The DoD owns substantially all of the facilities and real property used in its domestic operations. Capital assets overseas are purchased with appropriated funds; however, title is retained by the host country.

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

P. Contingencies:

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

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Q. Accrued Leave:

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

R. Equity:

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

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

S. Aircraft/Ship Crashes:

An operating loss of $1.1 billion has been recognized in fiscal year 1996 for aircraft/ships which were either destroyed or damaged beyond repair due to aviation/navigation mishaps. No loss has been separately recognized for aircraft/ships that were damaged by accidents but were repairable. Costs associated with repair of such aircraft/ships are recorded as operating expenses and generally funded from operation and maintenance appropriations.

T. Treaties for Use of Foreign Bases:

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

FOOTNOTES TO THE PRINCIPAL STATEMENTS

U. Comparative Data:

No comparative data is provided since FY 1996 represents first year of the DoD agency-wide statements.

V. Undelivered Orders:

DoD was obligated to pay for goods and services that have been ordered but not yet received. No liability for payment has been recognized in the financial statements because goods/services have yet to be delivered. As of September, 30, 1996, the following undelivered orders were reported:

(Billions)

Army	Air Force	Navy	Defense Agencies
$ 27.9	$ 40	$ 45	$ 50.4

W. Accounts Payable:

Accounts payable and operating expenses are understated by the accrual amount that should be recorded for contractor services/goods that have been performed/delivered but not yet paid. Since current contractor payment systems were not designed to provide this accrual data for entry to the accounting systems, a reasonable accrual estimate has not been determined. Work is ongoing to develop this reporting capability in order that future financial statements reflect all accrued expenses/liabilities.

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

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

FOOTNOTES TO THE PRINCIPAL STATEMENTS

A. Business Operations Fund (USD(C)) and All Other Funds and Accounts:

Entity Assets

	Trust Funds	Revolving Funds	Appro-priated Funds	Other Fund Types	Total
Unobligated Balance Available:					
Available	$237,548	$1,478,159	$32,109,508	$212,671	$34,037,886
Restricted	53,957		4,204,847		4,258,804
Reserve for Anticipated Resources		(11,821)	372,032		360,211
Obligated (but not expensed)	679,808	1,702,876	138,861,271	65,273	141,309,228
Unfunded Contract Authority			(122,999)		(122,999)
Unused Borrowing Authority					
DBOF Fund Balance		4,401,666			4,401,666
Treasury Balance	$ 971,313	$7,570,880	$175,424,659	$277,944	$184,244,796

B. Defense Business Operations Fund Activities Below (USD(C)) Level:

Entity Assets

	Funds Collected	Funds Disb	Total
Beginning Balance	$ 7,146,350		$ 7,146,350
Trans of Cash to Others		$ 9,630,275	(9,630,275)
Trans of Cash from Others	8,072,098		8,072,098
Funds Collected	68,458,440		68,458,440
Funds Disbursed		69,644,947	(69,644,947)
Ending Balance	$83,676,888	$79,275,222	$4,401,666

C. All Funds and Accounts:

Non-Entity Assets

	Funds Collected	Funds Disb	Total
Beginning Balance	$1,394,765		$1,394,765
Funds Collected	(3,358,811)		(3,358,811)
Funds Disbursed		1,380,994	1,380,993
Ending Balance	($1,964,046)	$1,380,994	($ 583,053)

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

	Entity Assets	Non-Entity Assets
A. Cash	$91,765	$265,668
B. Foreign Currency	22,208	11,637
C. Other Monetary Assets:	0	0
D. Total Cash, Foreign Currency and Other Monetary Assets (FY 96)	$113,973	$277,305

Other Information: During FY 96, DoD changed guidance relating to the classification of Disbursing Officers Cash. Disbursing Officer's Cash (with the exception of Imprest Funds that cite an entity appropriation) will now be shown as a Non-Entity asset.

Note 4. Investments (in thousands):

	(1) Cost	(2) Market Value	(3) Amortization Method	(4) Amortized Premium/ (Discount)	(5) Investment Net
A. Intragovernmental Securities:					
(1) Marketable	$1,422,345	$0		$0	$1,422,345
(2) Non-Marketable Par Value	9,472	0		(9)	9,463
(3) Non-Marketable Market Based	136,833,313	146,579,624	EI*	(5,482,703)	131,344,198
Subtotal	$138,265,130	$146,579,624		($5,482,712)	$132,776,006

	(1) Cost	(2) Market Value	(3) Amortization Method	(4) Amortized Premium/ (Discount)	(5) Investment Net
B. Governmental Securities:					
(1) Commercial paper	$297	$0		$0	$297
Subtotal	$297	$0		$0	$297
Total	$138,265,427	$146,579,624		($5,482,712)	$132,776,303

* EI = Effective Interest

FOOTNOTES TO THE PRINCIPAL STATEMENTS

C. Other Information: The majority of the Department of Defense entity investments of $ 136.8 billion are non-marketable/market based securities invested for the DoD Military Retirement Trust Fund. The Fund uses the same method that conforms to the prevailing practice in the financial community to determine amount amortized, book value of investments currently held and the related Effective Interest (i.e. EI) yield on investments. These calculated yields match up with yields in published security tables of U. S. Treasury securities. Also there was approximately $ 1.4 billion in invested marketable securities reported by Other Defense Organizations; with an additional $ 9.0 million investments in non-marketable securities reported by the varied Military Departments Trust funds. These types of investments are normally recorded at cost, and if applicable, net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment. It is the intent of the Departments to hold their trust fund investments to maturity unless they are needed to finance claims or otherwise sustain operations. Therefore, no provisions are made for unrealized gains or losses on these securities.

The small non-entity value is reported by the Department of the Navy and represents short term investments with Nations Bank.

Note 5. Accounts Receivable (in thousands):

	Gross Amount Due	Allowance For Estimated Uncollectibles	Allowance Method Used	Net Due
A. Entity Receivables				
Intragovernmental, Net	$10,853,012	$11,597	See Item C	$10,841,415 *
Governmental, Net	7,828,200	352,873	See Item C	7,475,327
B. Non-Entity Receivables				
Intragovernmental, Net	$118,917	$0	N/A	$118,917
Governmental, Net	815,701	276,155	N/A	539,546

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

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

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

The Department of the Navy has disclosed that under their appropriation 4557, National Defense Sealift Fund, there was an erroneously recorded Entity Receivable, Governmental balance of $2,081,109,000. The DFAS and the Naval Audit Service are working to resolve this error.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

A. Other Entity Assets:

1. Federal (Intragovernmental)	
(1) Supply Management	$858,338
(2) Other	83,544
(3)_____	0
Total	$941,882
2. Non-Federal (Governmental)	
(1) Other	(43,873)
(2) Other Related Property, Net	81,433
Total	$37,560

B. Other Information.

C. Other Non-entity Assets:

1. Federal (Intragovernmental)	
(1) IMRL Equipment	$375,620
Total	$375,620
2. Non-Federal (Governmental)	
(1) Cash Advances to Contractors	$7,851
(2)_____	0
(3)_____	0
Total	$7,851

D. Other Information: The majority of "Other Assets" was reported by the DBOF. The $375,620 in Note 6.C.1(a) above reflects the FY 1996 gross value of Individual Material Readiness List (IMRL) Equipment for the Department of Navy. Naval Audit Service has questioned the inclusion of these items as Non-Entity Assets. USD(C) will be issuing clarifying guidance on the appropriate financial statement treatment for these items.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

Note 8. Inventory, Net (in thousands):

	(1) Inventory Amount	(2) Allowance For Losses	(3) Inventory, Net	(4) Valuation Method*
A. Inventory Categories:				
(1) Held for Current Sale	$54,164,853	$7,071,256	$47,093,597	
(2) Held in Reserve for Future Sale	41,923,219	0	41,923,219	a
(3) War Reserve Material	73,737,928	0	73,737,928	
(4) Excess, Obsolete and Unserviceable	16,718,490	11,646,875	5,071,615	a
(5) Held for Repair	12,087,484	2,354,878	9,732,606	
Total	$198,631,974	$21,073,009	$177,558,965	

B. Restrictions on Inventory Use, Sale, or Disposition: Effective with the FY 1996 DoD Form and Content guidance and subsequent changes, increases to the Inventory, Net value under entity assets on the Statement of Financial Position result from new guidance to include secondary and principal items purchased with Defense Business Operations Funds and procurement funds. Additionally, inventory items categorized as "War Reserve Material" are also required to be presented on this financial statement line. Some of these inventory values were previously reported as "Operating Materials and Supplies (OM&S), Net" and/or "Stockpile Materials, Net" by the Departments of the Air Force and Army, and varied Defense Agencies. However, the Department of the Army did indicate that their prior year CFO financial statements did report the majority of their secondary and principal items purchased with procurement dollars as "Property, Plant and Equipment." Also, the Department of the Air Force has included the values of their War Reserve Material and War Readiness Spare Kits inventories in their "Inventory, Net," but they are presently unable to separately identify the dollar amount of their War Reserve Material from their inventory categories.

C. Other Information: The majority of the Inventories held for Current Sale, $ 50.8 billion is attributed to the Defense Business Operation Fund and does include an allowance account value of approximately $ 7.0 billion. However, the residual value reported for this category by the other military departments does not include allowance account values.

The Department of the U.S. Air Forces has separately reported an increase in their ammunition value in excess of $ 8.5 billion due, in part, to a correction of a major cataloging error in a U.S. Air Force system. The system now correctly handles the unit price on high dollar items and can perform a worldwide reconciliation of inventory at all Air Force depots and bases.

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

For its first year reporting, the Department of the U.S. Navy's inventory, net value, was taken from the Supply System Inventory Report for the period ending September 30, 1995. The data for the period ending September 30, 1996 will not be available until early 1997.

Note 9. Work in Process (in thousands):

	Work In Process Amount
A. Work in Process:	
In House	$1,993,255
Contractor	488,391
Other Government Activities	26,382
Government Furnished Materials	23,526
Total	$2,531,554

B. Other Information: Work in Process represents labor, material, and overhead cost incurred during the period but not recognized as revenue. The DBOF reported $2.5 billion dollars of the total balance.

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

	OM&S Amount	Allowance For Losses	OM&S, Net
A. OM&S Categories:			
(1) Held for Use	$1,496,799	$10,898	$1,485,901
(2) Held in Reserve for Future Use	34,265	0	34,265
(3) Excess, Obsolete and Unserviceable	26,529	0	26,529
Total	$1,557,593	$10,898	$1,546,695

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

Note 11. Stockpile Materials Net (in thousands):

A. Stockpile Materials:

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

	Stockpile Materials Amount	Allowance For Losses	Stockpile Materials Net	Valuation Method
A. Stockpile Material:				
(1) Held for Sale	$0	$0	$0	
(2) Held in Reserve for Future Sale	3,696,491	0	3,696,491	Historic
Total	$3,696,491	$0	$3,696,491	

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

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

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

C. Other Information: The estimated market value of the total inventory as of 30 September 1996 is $6.1 Billion. The financial statements report the recorded historical cost in accordance with the lower of cost or market principle.

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 12. Seized Property: Not applicable

Note 13. Forfeited Property: Not applicable

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

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

	Acquisition Value	Accumulated Depreciation	Net Book Value (FY 96)
Classes of Fixed Assets			
A. Land	$8,793,430	$0	$8,793,430
B. Structures, Facilities, & Leasehold Improvements	132,368,834	9,400,379	122,968,455
C. Military Equipment	587,701,767	1,252,325	586,449,442
D. ADP Software	1,057,487	547,741	509,746
E. Equipment	11,501,488	5,334,660	6,166,828
F. Assets Under Capital Lease	5,012,059	3,701	5,008,358
G. Other	9,934,341	26,242	9,908,099
H. Natural Resources	2,245,483	0	2,245,483
I. Construction-in-Progress	30,837,028	2,065	30,834,963
Total	$789,451,917	$16,567,113	$772,884,804

Other Information: Approximately $5 Billion of the Capital Lease balance represents real property assets at overseas locations. These assets do not represent "true" capital leases and are classified as such to segregate overseas assets (which are subject to the agreements made with the host country) from those assets that are located within the jurisdiction of the United States. Since these overseas assets don't fit the criteria for capital lease treatment, no offsetting lease liability has been established. The National Defense Stockpile Transaction Fund understated their reported net book value for equipment by $443 million due to system interface problems.

The increase in capitalization criteria from $50,000 to $100,000, as required by the Department of Defense Appropriation Act of 1996, resulted in "decapitalization" of various property, plant, and equipment assets. Consequently, items of property and equipment failing to meet the new

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

$100,000 capitalization threshold are no longer reflected in the Statement of Financial Position. Depreciation of property and equipment is calculated on the straight line basis.

Note 16. Debt (in thousands):

Liabilities Covered by Budgetary Resources	Beginning Balance	New Borrowings	Repay-ments	Ending Balance
A. Intragovermental Debt:				
(1) Borrowing from the Treasury	$0	$0	$0	$0
(2) Borrowing from Federal Financing Bank	1,432,108	0	49,345	1,382,763
(3) Borrowing from Other Federal Agencies	0	0	0	0
Total Intragovermental Debt	$1,432,108	$0	$49,345	$1,382,763
Liabilities Not Covered by Budgetary Resources				
B. (1) Public Debt:				
(a) Held by Government Accounts	$0	$0	$0	$0
(b) Held by the public	0	0	0	0
(c) Total Public Debt	$0	$0	$0	$0
(2) Agency Debt:				
(a) Held by Government Accounts	$0	$0	$0	$0
(b) Held by the public	0	0	0	0
(c) Total Agency Debt	$0	$0	$0	$0
C. Total Liabilities For Debt: Not Covered by Budgetary Resources	$0	$0	$0	$0
D. Total Debt:	$1,432,108	$0	$49,345	$1,382,763

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

E. Other Information: The debt balance was reported by the DBOF (Navy Transportation - Military Sealift Command) and represents the outstanding principal balance on the Maritime Prepositioning Ships (MPS) equipment. The MPS program provided ships for time charter to Military Sealift Command (MSC) to meet requirements not available in the marketplace. The program was approved by the Congress. The ships were built/converted by private Interim Vessel Owners using private, non-government financing obtained from various banking institutions. No payments were made by the government during the building/conversion phase. The interim financing was replaced by permanent financing, and vessel ownership was transferred to the permanent vessel owners (a trust company acting for the benefit of equity investors). The ships were financed with approximately 30% equity investments and 70% debt borrowings. The debt is in the form of loans from the Federal Financing Bank (FFB) to the vessel owners. The Time Charter Party requires MSC to make semi-annual payments to cover the repayment of the interest and principal on the FFB loans.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 17. Other Liabilities (in thousands):

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

A. Other Liabilities Covered by Budgetary Resources:	Non-Current Liability	Current Liability	Total
1. Intragovermental			
(a) Unearned Revenue, Advances from Gov't Agencies	$66,449	$2,923,577	$2,990,026
(b) Treasury Cash Advances to Disbursing Officers	0	399,948	399,948
(c) Deposit Fund Liabilities	0	(134,337)	(134,337)
(d) Unearned Revenue, Intra-DoD	0	784,624	784,624
(e) Liability for Property Furnished by Others	0	588,138	588,138
(f) Progress Billings to Others	0	609,449	609,449
(g) Non-entity Accounts Receivable	87,688	371	88,059
(h) Miscellaneous	1,434,383	601,073	2,035,456
Total FY 96	$1,588,520	$5,772,843	$7,361,363 *

	Non-Current Liability	Current Liability	Total
2. Governmental			
(a) Unearned Revenue, Advances from Public	$0	$381,534	$381,534
(b) Deferred Credits	64,124	14,332	78,456
(c) Accrued Expenses	0	0	0
(d) Deposit Fund Liabilities	0	357	357
(e) Miscellaneous	46,219	3,463,577	3,509,796
Total	$110,343	$3,859,800	$3,970,143

B. Other Information: Abnormal balance in the deposit fund liabilities is caused by unsupported- cross disbursing charges. These charges were placed in a suspense account pending identification of the correct appropriation.

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

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

C. Other Liabilities Not Covered by Budgetary Resources:

	Non-Current Liability	Current Liability	Total
1. Intragovernmental			
Total FY 96	$0	$770,760	$770,760
2. Governmental			
(a) Cancelled Budget Authority	$0	$571,871	$571,871
(b) Accrued Annual Leave, Military Unfunded	197,903	1,773,722	1,971,625
(c) Accrued Annual Leave, Civilian Unfunded	0	2,615,643	2,615,643
(d) Accrued Closed Years Accounts Payable	0	225,054	225,054
(e) Accrued Environmental Cleanup Costs	3,800,360	393,640	4,194,000
(f) Other	14,630,199	41,650	14,671,849
Total FY 96	$18,628,462	$5,621,580	$24,250,042

D. Other Information: Part C.2(f) includes $13.4 Billion of estimated environmental clean-up costs reported by Army.

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 18. Leases (in thousands):

A. Entity As Lessee:

Capital Leases

Summary of Assets Under Capital Lease:

Land and Buildings	$0
Machinery and Equipment	$3,281
Other	$2,746
Accumulated Amortization	$2,405

Description of Lease Arrangements:

Future Payments Due

	Asset Category			
Fiscal Year	(1)	(2)	(3)	Totals
Year 1	$0	$1,084	$528	$1,612
Year 2	0	596	538	1,134
Year 3	0	165	347	512
Year 4	0	151	33	184
Year 5	0	151	29	180
After 5 Years	0	0	0	0
Total Future Lease Payments	$0	$2,147	$1,475	$3,622
Less: Imputed Interest	0	0	0	0
Executory Costs (e.g., taxes)	0	0	0	0
Total Capital Lease Liability	$0	$2,147	$1,475	$3,622

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Operating Leases

Description of Lease Arrangements

Future Payments Due

	Asset Category			
Fiscal Year	(1)	(2)	(3)	Totals
Year 1	$472	$0	$0	$472
Year 2	472	0	0	472
Year 3	0	0	0	0
Year 4	0	0	0	0
Year 5	0	0	0	0
After 5 Years	0	0	0	0
Total Future Lease Payments	$944	$0	$0	$944

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

FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

Major Program Activities	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	Assets Available to Pay Benefits	Unfunded Actuarial Liability
A. Pensions and Health Plans	$547,700,033	6.75%	$132,787,893	$414,912,140
B. Insurance/Annuity Programs:				
(1) Voluntary Separation Incentive Benefits	691,462	0.00%	0	691,462
(2)_____	0	0.00%	0	0
(3)_____	0	0.00%	0	0
Total	$691,462		$0	$691,462
C. Other:				
(1) Workmen's Comp	4,517,332	7.00%	0	4,517,332
(2) DoD Educ Benefits	1,810,000	0.00%	0	1,810,000
(3)_____	0	0.00%	0	0
Total	$6,327,332		$0	$6,327,332
D. Total	$554,718,827		$132,787,893	$421,930,934

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

Starting in FY 1995 and future years, the Military Retirement Trust Fund financial statements will present the unfunded actuarial liability which was determined at the beginning of the fiscal year. This change is in accordance with FAS 35 which permits pensions plans to present actuarial data calculated at the beginning of the plan year. This change is needed because of the lengthy time required to develop an accurate end of year actuarial estimate and the accelerated deadlines for financial statements. The amount shown as "Assets Available to Pay Benefits" represents assets available as of October 1 (beginning) of the fiscal year reported whereas, the amount shown on line 4, b, (6) of the "Statement of Financial Position" represents the amount available as of September 30, end of the fiscal year reported. Actuarial Cost Method: The

FOOTNOTES TO THE PRINCIPAL STATEMENTS

financial statements present the actuarial liability as of the beginning of the fiscal year using the "accumulated benefit obligation" (ABO) cost method as opposed to the "projected benefit obligation" (PBO) cost method required by OMB Statement of Federal Financial Accounting Standards No.5 "Accounting for Liabilities of the Federal Government." The ABO cost method presumes no future salary increases.

Legal actions brought by employees of DoD for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the Department of Labor (DOL). DOL bills DoD annually as DOL claims are paid. However, payment on these bills is deferred two years to allow for funding through the budget process. Using actuarial estimates provided by DOL, DoD has recorded FECA liabilities for balances billed to DoD by DOL, and for estimates of the present value, using a 7.00 percent discount rate, of the long-term payments related to cases on hand at the end of the fiscal year. The amount of unfunded FECA liability accrued as of September 30, 1996 was $4.5 billion. A corresponding amount has been established as a future funding requirement.

Note 20. Net Position (in thousands):

	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended Appropriations:				
(1)Unobligated,				
a. Available	$2,522,300	$166,331	$32,322,148	$35,010,779
b. Unavailable	(237,260)	53,957	5,032,872	4,849,569
(2)Undelivered Orders	3,550,614	219,204	127,835,380	131,605,198
B. Invested Capital	117,828,662	1,232,016	886,917,989	1,005,978,667
C. Cumulative Results of Operations	(32,916,379)	1,820,521	68,922	(31,026,936)
D. Other	(6,675,332)	281	56,052	(6,618,999)
E. Future Funding Requirements	(139,510)	(417,414,883)	(29,353,680)	(446,908,073)
Total	$83,933,095	($413,922,573)	$1,022,879,683	$692,890,205

G. Other Information: Within DoD $414,912,250 thousand pertains to the future funding requirements of the Military Retirement Trust Funds.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Net Position is comprised of the following components:

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

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

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

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

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

Note 21. Taxes: Not applicable

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

	1996
A. Other Revenues and Financing Sources:	
(1) Inventory Gains	$457,944
(2) Investment Gains	212
(3) Cost Contributions from Services	11,174,163
(4) Unfunded Liability Payment from Treasury	10,699,000
(5) Miscellaneous Reimbursements	1,169,388
(6) Other Miscellaneous Gains	101,935
(7) Benefit Program Revenue	397,902
(8) Gain on Disposition of Assets	5,566
(9) Donations	2,257
(10) Other Revenues	649,047
Total	$24,657,414

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

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

	1996
A. Operating Expenses by Object Classification:	
(1) Personal Services and Benefits	$102,079,103
(2) Travel and Transportation	9,126,777
(3) Rental, Communication and Utilities	4,340,683
(4) Printing and Reproduction	254,578
(5) Contractual Services	81,700,850
(6) Supplies and Materials	12,694,438
(7) Equipment not Capitalized	4,175,490
(8) Grants, Subsidies and Contributions	504,683
(9) Insurance Claims and Indemnities	29,139,922
(10) Other	13,401,689
(11) Total Expenses by Object Class	$257,418,213

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

A. Cost of Services Sold:	
(1) Beginning Work-in-Process	$6,618,303
(2) Plus: Operating Expenses	52,842,369
(3) Minus: Ending Work-in-Process	2,640,067
(4) Minus: Completed Work for Activity Retention	3,717,936
Cost of Services Sold	$53,102,669
B. Cost of Goods Sold from Inventory (using Latest Acquisition Cost):	
(1) Beginning Inventory - L.A.C.	$70,833,762
(2) Less: Beginning Allowance for Unrealized Holding Gains (Losses)	9,836,989
(3) Plus: Purchases at Cost	29,427,849
(4) Plus: Customer Returns - Credit Given	3,962,549
(5) Plus: DLR Exchange Credits	3,269,423
(6) Less: Inventory Losses Realized	3,019,826
(7) Less: Ending Inventory - L.A.C.	81,378,904
(8) Plus: Ending Allowance for Unrealized Holding Gains (Losses)	21,073,010
(9) Less: Equity Transfers of Inventory to Others	274,894
(10) Plus: Equity Transfers of Inventory from Others	1,174,256
(11) Equals: Cost of Goods Sold from Inventory	$35,230,236
C. Cost of Goods Sold from Inventory (using Historical Cost):	
(1) Beginning Inventory	$0
(a) Plus: Purchases at Cost	0
(b) Plus: Inventory Gains	0
(c) Minus: Inventory Losses	0
(2) Less: Ending Inventory	0
D. Intra eliminations	
DBOF Consolidated	5,079,662
DoD Wide Consolidated	44,256,731
E. Cost of Goods Sold	$38,996,512

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

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 25. Other Expenses (in thousands):

	1996
A. Other Expenses:	
(1) Inventory Losses or Adjustments	$736,572
(2) Transfer to Property Disposal	9,995,780
(3) Potential Excess Inventory Loss	(331,655)
(4) Shrinkage, Fire, Theft, Losses, Etc.	378,178
(5) Payroll Variances	4,171
(6) Accrued Annual Leave	136,350
(7) Real Property Maintenance	0
(8) Losses on Sale of Fixed Assets	21,382
(9) Discounts on Material Returns	2,945
(10) Unfunded Depreciation Expense	0
(11) Prior Year Expense Adjustment	(2,113)
(12) Supply	(2,814,889)
(13) Sum of USD(C) Model Entries	(3,868,016)
(14) Depot Maintenance	45,837
(15) Operating Materials and Supplies Variance	(3,152)
(16) Losses on Disposition of Assets	0
(17) Other Expenses	218,881
(18) Changes in Actuarial Liabilities	18,595,615
(19) Other Miscellaneous Losses	(91,709)
Total Other Expenses	$23,024,177

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 26. Extraordinary Items (in thousands):

A. Extraordinary Items:

(1) Inventory losses from fire and theft	($13,664)
(2) Surcharges	(112,262)
(3) Passthroughs	593,917
(4) Depot Maintenance	(33,127)
(5) Changes in Actuarial Liability	0
(6) Death Payment Contingency - (Decrease)	(7)
(7) Other Items	(6,605)
Total	$428,252

Note 27. Prior Period Adjustments (in thousands):

A. Prior Period Adjustments:

(1) Accounting Changes	($31,238)
(2) Adjustments to Operating Materials and Supplies	0
(3) Adjustments to Property & Equipment	(1,051,858)
(4) Adjustments to future funding requirements	(5,389,575)
(5) Adjustments to reclassify account balances	548,071
(6) Prior year contract adjustments	(152,871)
(7) Write-off of prior year accounts payable and receivables	75,996
(8) Inventory adjustments	8,805,203
(9) Other adjustments	(11,804,743)
Total	($9,001,015)

Military Retirement Trust Fund reported approximately <$11 Billion> as reflected in line (9), "Other Adjustments." This amount is comprised of a "Change in Actuarial Liability" <$18.6 Billion> for expenses applicable to the period October 1, 1994 through October 1, 1995, but were not known until May 1996 and approximately $7 Billion is represented by a reversal of prior year Non-Operating Changes.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

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

A. Increases:	1996
(1) Transfers-In	$3,667,568
(2) Unexpended Appropriations	82,609,261
(3) Donations Received	35,136
(4) Other Increases	24,394,815
(5) Total Increases	$110,706,780

B. Decreases:	1996
(1) Transfers-Out	$20,080,375
(2) Donations	0
(3) Other Decreases	96,154,256
(4) Total Decreases	$116,234,631

C. Net Non-Operating Changes (Transfers):	($5,527,851)

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 29. Intrafund Eliminations (in thousands):

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

Schedule A: Not applicable.

Schedule B: Not applicable.

Schedule C: Not applicable.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Schedule D: Presents the sales or services between DoD reporting entities according to general ledger amounts for accounts receivable, revenue, unearned revenue, and collections. It is presumed that an equal amount of accounts payable, expenses, advances and disbursements have been entered on the accounting records of the purchasing activity. DoD estimates that eliminating entries for revenue and expenses to be $80 billion. DoD continues efforts to identify and report seller activity for eliminating entries required to prepare the DoD consolidated statements.

Selling Activity:	Column A	Column B	Column C	Column D
	Accounts Receivable	Revenue	Unearned Revenue	Collections
Department of the Army	$475,326	$4,244,715	$605,946	$4,226,035
Department of the Navy	1,443,895	4,105,056	(45,700)	6,935,055
Department of the Air Force	903,630	2,422,768	309,876	2,061,587
Defense Business Operations Fund	410,799	33,484,192	190,650	23,854,399
National Defense Stockpile	0	0	0	0
Other Defense Organizations	0	0	0	0
U.S. Army Corps of Engineers	0	0	0	0
Total	$3,233,650	$44,256,731	$1,060,772	$37,077,076

Customer Activity	Column A	Column B	Column C	Column D
	Accounts Payable	Expenses	Advances	Disbursement
Department of the Army	$173,555	$6,238,861	$0	$6,117,467
Department of the Navy	156,087	16,467,050	0	16,243,410
Department of the Air Force	333,459	9,267,904	0	1,177,386
Defense Business Operations Fund	313,881	1,078,964	0	993,031
National Defense Stockpile	0	0	0	0
Other Defense Organizations	2,256,668	11,203,952	1,060,772	12,545,782
U.S. Army Corps of Engineers	0	0	0	0
Total	$3,233,650	$44,256,731	$1,060,772	$37,077,076

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

Schedule E: This schedule presents the value of sales and services between the Department of Defense and other U.S. Government entities. This information is needed by the Department of the Treasury to prepare U.S. Government-wide consolidated financial statements. The transactions are based on the accounting records of the Department of Defense. It is presumed that an equal amount of accounts payable, expenses, advances, and disbursements have been entered on the accounting records of the purchasing entity.

Selling Activity:	Column A Accounts Receivable	Column B Revenue	Column C Unearned Revenue	Column D Collections
Department of the Army	$113,618	$218,144	$16,716	$169,394
Department of the Navy	160,127	230,972	0	299,420
Department of the Air Force	377,734	569,231	258,275	1,082,892
Defense Business Operations Fund	76,942	1,232,455	0	562,235
National Defense Stockpile Transaction Fund	0	0	0	0
Other Defense Organizations	0	0	0	0
U.S. Army Corps of Engineers	0	0	0	0
Total	$728,421	$2,250,802	$274,991	$2,113,941

Customer Activity	Column A Accounts Payable	Column B Expenses	Column C Advances	Column D Disbursement
National Aeronautics and Space Administration	$121,645	$218,230	$0	$183,137
General Services Administration	47,986	262,797	0	224,895
Executive Office of the President / Defense Security Assistance Agency	125,159	802,439	0	803,627
Other U.S. Government Entities	433,631	967,336	274,991	902,282
Total	$728,421	$2,250,802	$274,991	$2,113,941

Other information:

The Other Defense Organizations and the U.S. Army Corps of Engineers do not capture the detail of information needed in order to comply with this footnote.

Adjusted note 29 by moving from the supporting Air Force general funds note 29, schedule D, $124,757 in accounts receivable and accounts payable, $464,355 in revenue and expenses, and $468,933 collections and disbursements to schedule E. This presents on schedule E, the sales and customer activity reported between DoD, Air Force and the Defense Security Assistance Agency on the appropriate schedule.

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FOOTNOTES TO THE PRINCIPAL STATEMENTS

The reported sales to the National Aeronautics and Space Administration equals 10% of DoD sales activity with other U.S. government agencies, the General Service Administration accounted for 10% of DoD sales activity, and the Executive Office of the President/Defense Security Assistance Agency accounted for an additional 32% of sales activity. DoD continues efforts to specifically identify sales to other U.S. government agencies and to separately report in schedule E eliminating amounts needed to prepare U.S. government wide consolidated financial statements.

Note 30. Contingencies:

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

The DoD is subject to various asserted claims for over $100 million. These claims are in various phases ranging from investigation to appeal. While no opinion has been expressed regarding the likely outcome for specific claims or possible associated loss, experience indicates that many such claims are settled for less than claimed, dismissed altogether, or the possibility of the contingency materializing is remote. The DoD is responsible for costs associated with environmental cleanup. Navy estimates possible environmental cleanup costs at $7 Billion for FY 97. The total estimated cost to the Air Force and Army to complete environmental cleanup is $4.194 Billion and $13.4 Billion respectively. These liabilities have been included in the financial statements for the first time and are reflected in line 5.b(5) as Other Non-Federal (Governmental) Liabilities as a part of Liabilities Not Covered by Budgetary Resources on the statement of financial position and in line 7.e, Future Funding Requirements on the statement of financial position. A prior period adjustment was recorded in the applicable statements for the same amounts to recognize the liability existing as of September 30, 1995.

The DoD is subject to various asserted contract claims for over $100 Million. These claims are in various phases ranging from investigation to appeal. While no opinion has been expressed regarding specific claims' likely outcome or possible associated loss, experience indicates that many such claims are settled for less than claimed, dismissed altogether, or the possibility of the contingency materializing is remote. Contractor claims are funded primarily from DoD appropriations. As of September 30, 1996 Air Force was a party to 261 contract appeals. The total dollar value of these claims was approximately $813.9 Million. Similarly, Navy was a party to approximately 650 contract appeals with an approximate total of $1.25 Billion.

It is uncertain that claims under $100 million will ever accrue to the DoD and thus are not reflected in the financial statements. In addition to the fact that many cases simply lack merit, most claims, even if successful, will not be paid from DoD accounts. Rather, judgments are ordinarily paid from the GAO Judgment Fund. In many cases involving attorney fees, the amounts are not known until the last appeal is taken.

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Note 31. Other Disclosures (in thousands):

A. Problem Disbursements:

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

	Sep. 1996
Unmatched Disbursements	$8,089,105
Negative Unliquidated Obligations	3,261,641
Totals:	$11,350,746

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

Consolidating Statements

Department of Defense
Statement of Financial Position
As of September 30, 1996
(Thousands)

ASSETS	Army	Navy	Air Force	Defense Business Operations Fund
1. Entity Assets:				
a. Transactions with Federal (Intragovernmental) Entities:				
(1) Fund Balance with Treasury (Note 2)	$31,343,151	$64,801,567	$50,663,271	$4,401,666
(2) Investments, Net (Note 4)	1,068	7,532	863	0
(3) Accounts Receivable, Net (Note 5)	953,735	1,928,010	1,378,292	5,165,568
(4) Interest Receivable	0	0	0	0
(5) Advances and Prepayments	4,304	66,579	1,904	116,440
(6) Other Federal (Intragovernmental) (Note 6)	0	0	0	954,437
b. Transactions with Non-Federal (Governmental) Entities:				
(1) Investments (Note 4)	0	297	0	0
(2) Accounts Receivable, Net (Note 5)	260,244	4,360,849	189,637	2,206,857
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0	0	0
(4) Interest Receivable, Net	273	0	0	81
(5) Advances and Prepayments	424,246	202,972	7,106,537	880,318
(6) Other Non-Federal (Governmental) (Note 6)	0	0	0	0
c. Cash and Other Monetary Assets (Note 3)	19,802	51,339	42,437	1
d. Inventory, Net (Note 8)	37,669,779	41,441,119	36,519,292	60,309,149
e. Work in Process (Note 9)	0	5,277	0	2,526,277
f. Operating Materials/Supplies, Net (Note 10)	0	27	0	1,536,660
g. Stockpile Materials, Net (Note 11)	0	0	0	0
h. Seized Property (Note 12)	0	0	0	0
i. Forfeited Property, Net (Note 13)	0	0	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0	0	0
k. Property, Plant and Equipment, Net (Note 15)	124,867,674	340,975,064	246,058,972	12,265,885
l. Other Entity Assets	5,476,723	74	0	1,414,305
m. **Total Entity Assets**	$201,020,999	$453,840,706	$341,961,205	$91,777,644
2. Non-Entity Assets:				
a. Transactions With Federal (Intragovernmental) Entities:				
(1) Fund Balance with Treasury (Note 2)	($134,337)	($572,625)	$47,661	$21,937
(2) Accounts Receivable, Net (Note 5)	0	117,075	0	0
(3) Interest Receivable, Net	0	0	0	0
(4) Other (Note 6)	0	0	0	375,620

The accompanying notes are an integral part of these statements.

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Military Retirement Trust Fund	National Defense Stockpile Transaction Fund	Other Defense Agencies	U.S. Army Corps of Engineers	Eliminating Entries	Total
$57,869	$290,712	$31,075,626	$1,610,934	$0	$184,244,796
131,065,203	0	1,422,345	278,995	0	132,776,006
0	35	1,060,159	355,616	(3,233,650)	7,607,765
4,200,579	0	0	1,537	0	4,202,116
0	(749)	167,542	0	(1,060,772)	(704,752)
0	0	0	(12,555)	0	941,882
0	0	0	0	0	297
12,253	285,021	139,565	20,901	0	7,475,327
0	0	0	0	0	0
0	0	27,942	0	0	28,296
0	0	37,714	2,821	0	8,654,608
0	0	81,433	(43,873)	0	37,560
0	0	394	0	0	113,973
0	0	1,619,626	0	0	177,558,965
0	0	0	0	0	2,531,554
0	0	823	9,185	0	1,546,695
0	3,696,491	0	0	0	3,696,491
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	10,059,531	38,657,678	0	772,884,804
0	0	3,024	219,559	0	7,113,685
$135,335,904	$4,271,510	$45,695,724	$41,100,798	($4,294,422)	$1,310,710,068
$0	$0	$0	$54,311	$0	($583,053)
0	0	0	1,842	0	118,917
0	0	0	0	0	0
0	0	0	0	0	375,620

Consolidating Statements

Department of Defense
Statement of Financial Position
As of September 30, 1996
(Thousands)

ASSETS, Continued	Army	Navy	Air Force	Defense Business Operations Fund
2. **Non-Entity Assets:**				
b. Transactions With Non-Federal (Governmental) Entities:				
(1) Accounts Receivable, Net (Note 5)	$6,478	($26,673)	$9,410	$0
(2) Interest Receivable, Net	6,058	0	46,616	0
(3) Other (Note 6)	0	0	7,851	0
c. Cash and Other Monetary Assets (Note 3)	143,252	65,316	68,726	0
d. Other Non-Entity Assets	0	0	0	38,362
e. **Total Non-Entity Assets**	$21,451	($416,907)	$180,264	$435,919
3. **Total Assets**	$201,042,450	$453,423,799	$342,141,469	$92,213,563
LIABILITIES				
4. **Liabilities Covered by Budgetary Resources:**				
a. Transactions with Federal (Intragovernmental) Entities:				
(1) Accounts Payable	$2,069,074	$2,547,156	$101,602	$2,658,519
(2) Interest Payable	0	0	0	0
(3) Debt (Note 16)	0	0	0	1,382,763
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	725,319	302,605	722,395	5,546,273
b. Transactions with Non-Federal (Governmental) Entities:				
(1) Accounts Payable	1,789,207	6,461,703	2,342,764	3,544,885
(2) Accrued Payroll and Benefits				
(a) Salaries and Wages	1,957,061	250,455	1,057,347	768,690
(b) Annual Accrued Leave	0	0	0	810,068
(c) Severance Pay and Separation Allowance	327,984	405,939	17,275	0
(3) Interest Payable	0	0	0	251
(4) Liabilities for Loan Guarantees (Note 7)	0	0	0	0
(5) Lease Liabilities (Note 18)	0	0	0	3,622
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0	0	33
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	218,865	40,253	17,113	3,504,040
c. **Total Liabilities Covered by Budgetary Resources:**	$7,087,510	$10,008,111	$4,258,496	$18,219,144

The accompanying notes are an integral part of these statements.

Military Retirement Trust Fund	National Defense Stockpile Transaction Fund	Other Defense Agencies	U.S. Army Corps of Engineers	Eliminating Entries	Total
$0	$0	$0	$550,331	$0	$539,546
0	0	0	0	0	52,674
0	0	0	0	0	7,851
0	0	11	0	0	277,305
0	0	0	0	0	38,362
$0	$0	$11	$606,484	$0	$827,222
$135,335,904	$4,271,510	$45,695,735	$41,707,282	($4,294,422)	$1,311,537,290
$0	$59,515	$1,468,393	$167,978	($3,233,650)	$5,838,587
0	0	0	0	0	0
0	0	0	0	0	1,382,763
0	0	38,313	26,458	(1,060,772)	6,300,591
2,548,044	7,979	(1,985,459)	423,838	0	15,132,961
0	0	477,627	80,889	0	4,592,069
0	0	0	168,866	0	978,934
0	0	0	0	0	751,198
0	0	0	0	0	251
0	0	0	0	0	0
0	0	0	0	0	3,622
132,787,860	0	0	0	0	132,787,893
0	1,558	56,645	131,669	0	3,970,143
$135,335,904	$69,052	$55,519	$999,698	($4,294,422)	$171,739,012

Consolidating Statements

Department of Defense
Statement of Financial Position
As of September 30, 1996
(Thousands)

LIABILITIES, Continued	Army	Navy	Air Force	Defense Business Operations Fund
5. Liabilities Not Covered by Budgetary Resources:				
a. Transactions with Federal (Intragovernmental) Entities:				
(1) Accounts Payable	$0	$0	$0	$0
(2) Debt (Note 16)	0	0	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	769,119	0	0	0
b. Transactions with Non-Federal (Governmental) Entities:				
(1) Accounts Payable	0	0	0	0
(2) Debt (Note 16)	0	0	0	0
(3) Lease Liabilities (Note 18)	0	0	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	1,313,935	2,161,377	993,134	48,886
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	16,138,876	1,148,870	6,142,964	86,985
c. **Total Liabilities Not Covered By Budgetary Resources**	$18,221,930	$3,310,247	$7,136,098	$135,871
6. Total Liabilities	$25,309,440	$13,318,358	$11,394,594	$18,355,015
NET POSITION (Note 20)				
7. Balances:				
a. Unexpended Appropriations	$27,461,855	$60,976,097	$48,303,502	$1,324,293
b. Invested Capital	168,160,756	382,395,684	289,574,853	113,173,469
c. Cumulative Results of Operations	(1,667,671)	(12,421)	2,830	(33,826,228)
d. Other	0	56,328	1,788	(6,677,115)
e. Future Funding Requirements	(18,221,930)	(3,310,247)	(7,136,098)	(135,871)
f. **Total Net Position**	$175,733,010	$440,105,441	$330,746,875	$73,858,548
8. Total Liabilities and Net Position	$201,042,450	$453,423,799	$342,141,469	$92,213,563

The accompanying notes are an integral part of these statements.

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Military Retirement Trust Fund	National Defense Stockpile Transaction Fund	Other Defense Agencies	U.S. Army Corps of Engineers	Eliminating Entries	Total
$0	$0	($48,917)	$0	$0	($48,917)
0	0	0	0	0	0
0	0	0	1,641	0	770,760
0	0	5,254	0	0	5,254
0	0	0	0	0	0
0	0	0	0	0	0
414,912,140	0	2,501,462	0	0	421,930,934
110	0	182,803	549,434	0	24,250,042
$414,912,250	$0	$2,640,602	$551,075	$0	$446,908,073
$550,248,154	$69,052	$2,696,121	$1,550,773	($4,294,422)	$618,647,085
$0	$0	$31,157,739	$2,242,060	$0	$171,465,546
0	3,536,106	10,755,319	38,402,480	0	1,005,978,667
0	666,352	3,747,158	63,044	0	(31,026,936)
0	0	0	0	0	(6,618,999)
(414,912,250)	0	(2,640,602)	(551,075)	0	(446,908,073)
($414,912,250)	$4,202,458	$42,999,614	$40,156,509	$0	$692,890,205
$135,335,904	$4,271,510	$45,695,735	$41,707,282	($4,294,422)	$1,311,537,290

Consolidating Statements

Department of Defense
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1996
(Thousands)

REVENUES AND FINANCING SOURCES	Army	Navy	Air Force	Defense Business Operations Fund
1. Appropriated Capital Used	$55,643,717	$56,535,616	$56,262,701	$852,654
2. Revenues from Sales of Goods and Services				
a. To the Public	627,185	54,478	227,172	6,622,847
b. Intragovernmental	5,552,692	6,645,888	2,992,020	65,735,629
3. Interest and Penalties, Non-Federal	0	616	8,934	0
4. Interest, Federal	0	580	47	0
5. Taxes (Note 21)	0	0	0	0
6. Other Revenues and Financing Sources (Note 22)	929,604	4,426	372	497,984
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	(432,977)	0	(8,934)	0
8. Total Revenues and Financing Sources	$62,320,221	$63,241,604	$59,482,312	$73,709,114
EXPENSES				
9. Program or Operating Expenses (Note 23)	$57,789,003	$56,466,260	$55,848,245	$11,810,594
10. Cost of Goods Sold (Note 24)				
a. To the Public	627,185	48,515	227,172	5,941,338
b. Intragovernmental	5,552,692	6,672,509	2,992,020	54,860,679
11. Depreciation and Amortization	0	176	0	852,336
12. Bad Debts and Writeoffs	23,252	78,600	6,548	11,984
13. Interest				
a. Federal Financing Bank/Treasury Borrowing	0	0	0	0
b. Federal Securities	0	0	0	0
c. Other	1,576	237	3,172	653
14. Other Expenses (Note 25)	735,136	0	479,589	2,911,104
15. Total Expenses	$64,728,844	$63,266,297	$59,556,746	$76,388,688
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($2,408,623)	($24,693)	($74,434)	($2,679,574)
17. Plus (Minus) Extraordinary Items (Note 26)	0	0	0	428,259
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($2,408,623)	($24,693)	($74,434)	($2,251,315)

The accompanying notes are an integral part of these statements.

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Military Retirement Trust Fund	National Defense Stockpile Transaction Fund	Other Defense Agencies	U.S. Army Corps of Engineers	Eliminating Entries	Total
$0	$0	$39,939,047	$3,708,850	$0	$212,942,585
0	365,982	658,380	0	0	8,556,044
0	54,267	4,971,838	3,301,497	(44,256,731)	44,997,100
0	0	0	14	0	9,564
11,280,558	0	88,381	15,519	0	11,385,085
0	0	0	0	0	0
21,873,163	1,442	1,088,351	262,072	0	24,657,414
0	0	(17,936)	(191,786)	0	(651,633)
$33,153,721	$421,691	$46,728,061	$7,096,166	($44,256,731)	$301,896,159
$28,991,489	$59,360	$40,507,677	$5,945,585	$0	$257,418,213
0	141,543	744,349	0	0	7,730,102
0	14,222	4,618,048	812,971	(44,256,731)	31,266,410
0	0	355,910	349,603	0	1,558,025
0	120	1,911	70	0	122,485
0	0	0	0	0	0
0	0	0	0	0	0
0	0	871	0	0	6,509
18,600,000	0	298,348	0	0	23,024,177
$47,591,489	$215,245	$46,527,114	$7,108,229	($44,256,731)	$321,125,921
($14,437,768)	$206,446	$200,947	($12,063)	$0	($19,229,762)
(7)	0	0	0	0	428,252
($14,437,775)	$206,446	$200,947	($12,063)	$0	($18,801,510)

Consolidating Statements

Department of Defense
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1996
(Thousands)

EXPENSES, Continued	Army	Navy	Air Force	Defense Business Operations Fund
19. **Net Position, Beginning Balance, as Previously Stated**	$211,231,585	$443,232,471	$315,528,856	$76,930,111
20. Adjustments (Note 27)	(13,685,466)	(1)	3,788,199	(5,625,878)
21. Net Position, Beginning Balance, as Restated	$197,546,119	$443,232,470	$319,317,055	$71,304,233
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(2,408,623)	(24,693)	(74,434)	(2,251,315)
23. Plus (Minus) Non Operating Changes (Note 28)	(19,404,486)	(3,102,336)	11,504,254	4,805,630
24. **Net Position, Ending Balance**	$175,733,010	$440,105,441	$330,746,875	$73,858,548

The accompanying notes are an integral part of these statements.

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Military Retirement Trust Fund	National Defense Stockpile Transaction Fund	Other Defense Agencies	U.S. Army Corps of Engineers	Eliminating Entries	Total
($407,169,291)	$4,270,691	$41,966,036	$40,230,122	$0	$726,220,581
6,694,816	(123,784)	(48,901)	0	0	(9,001,015)
($400,474,475)	$4,146,907	$41,917,135	$40,230,122	$0	$717,219,566
(14,437,775)	206,446	200,947	(12,063)	0	(18,801,510)
0	(150,895)	881,532	(61,550)	0	(5,527,851)
($414,912,250)	$4,202,458	$42,999,614	$40,156,509	$0	$692,890,205

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Consolidating Statements

The accompanying notes are an integral part of these statements.

DEPARTMENT OF DEFENSE

AGENCY-WIDE
FINANCIAL STATEMENTS

SUPPLEMENTAL FINANCIAL AND
MANAGEMENT INFORMATION

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

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SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

Department of Defense - Appropriations, Funds and Accounts

Department of the Army

	Entity Funds
21 0702	Family Housing, Army (fiscal year)
21 7020	Family Housing, Army Construction
21X1705	National Board for the Promotion of Rifle Practice, Army
21 1705	National Board for the Promotion of Rifle Practice, Army (fiscal year)
21X1805	Salaries and Expenses, Cemeterial Expenses, Army
21 2010	Military Personnel, Army (fiscal year)
21X2020	Operation and Maintenance, Army
21 2020	Operation and Maintenance, Army (fiscal year)
21 2031	Aircraft Procurement, Army (fiscal year)
21 2032	Missile Procurement, Army (fiscal year)
21 2033	Procurement of Weapons and Tracked Combat Vehicles, Army (fiscal year)
21 2034	Procurement of Ammunition, Army (fiscal year)
21 2035	Other Procurement, Army (fiscal year)
21 2040	Research, Development, Test, and Evaluation, Army (fiscal year)
21 2050	Military Construction, Army (fiscal year)
21 2060	National Guard Personnel, Army (fiscal year)
21 2065	Operation and Maintenance, Army National Guard (fiscal year)
21 2070	Reserve Personnel, Army (fiscal year)
21 2080	Operation and Maintenance, Army Reserve (fiscal year)
21 2085	Military Construction, Army National Guard (fiscal year)
21 2086	Military Construction, Army Reserve (fiscal year)
21X4528	Working Capital Fund, Army Conventional Ammunition
21X5095	Wildlife Conservation, etc., Military Reservations, Army
21X5098	Restoration, Rocky Mountain Arsenal, Army
21X5194	Department of Defense, 50th Anniversary of World War II Commemoration Account, Army
21X5285	Forest and Wildlife Conservation, Military Reservations
21X5286	National Science Center, Army
21X8063	Bequest of Major General Fred C. Ainsworth Library, Walter Reed Army Medical Center
21X8927	Department of the Army General Gift Fund
	Non-entity Funds
21X6001	Proceeds of Sales of Lost, Abandoned,or Unclaimed Personal Property, Army
21X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Army
21X6010	Army Members Savings Deposit - Desert Shield/Desert Storm Savings Program
21X6015	Funds of Civilian Internees and Prisoners of War, Army
21X6031	Effects of Mentally Incompetent Soldiers, United States Army
21X6050	Employees' Payroll allotment Account, United States Savings Bonds
21 6060	Estates of Deceased Soldiers, Regular Army (fiscal year)

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SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

21X6075	Withheld Allotment of Compensation for Payment of Employee Organization Dues, Army
21X6083	Withheld Allotment of Compensation for Charitable Contributions, Army
21X6105	Withheld Employee Contributions, State or Territorial Retirement, Army
21X6108	Employer Contributions, State or Territorial Retirement, Army
21X6112	Withheld Employee Contributions, State or Territorial Disability Benefits, Army
21X6113	Withheld Employee Contributions, State or Territorial Death Benefits, Army
21X6129	Foreign Taxes Withheld, Army
21X6131	Employee and Employer Contributions, Private Insurance Plans, Army
21X6134	Amounts Withheld for Civilian Pay Allotments, Army
21X6208	Amounts Withheld for Group Life Insurance, National Guard Members, Army
21X6275	Withheld Income Taxes
21X6325	Coupons, Petroleum, Oil and Lubricants, Army
21X6434	Servicemen's Group Life Insurance Fund, Suspense, Army
21 6763	Gains and Deficiencies on Exchange Transactions, Army (fiscal year)
21X6875	Budget Clearing Account
21X6999	Accounts Payable, Check Issue Underdrafts, Army

Department of the Navy

Entity Funds

17X0380	Coastal Defense Augmentation, Navy
17 0380	Coastal Defense Augmentation, Navy (fiscal year)
17 0703	Family Housing, Navy and Marine Corps (fiscal year)
17 1105	Military Personnel, Marine Corps (fiscal year)
17 1106	Operation and Maintenance, Marine Corps (fiscal year)
17 1107	Operation and Maintenance, Marine Corps Reserve (fiscal year)
17 1108	Reserve Personnel, Marine Corps (fiscal year)
17 1109	Procurement, Marine Corps (fiscal year)
17 1205	Military Coustruction, Navy (fiscal year)
17 1235	Military Construction, Naval Reserve (fiscal year)
17X1236	Payments to Kaho'Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17X1319	Research, Development, Test and Evaluation, Navy
17 1319	Research, Development, Test, and Evaluation, Navy (fiscal year)
17 1405	Reserve Personnel, Navy (fiscal year)
17 1453	Military Personnel, Navy (fiscal year)
17 1506	Aircraft Procurement, Navy (fiscal year)
17 1507	Weapons Procurement, Navy (fiscal year)
17 1508	Procurement of Ammunition, Navy and Marince Corps (fiscal year)
17X1611	Shipbuilding and Conversion, Navy
17 1611	Shipbuilding and Conversion, Navy (fiscal year)
17 1804	Operation and Maintenance, Navy (fiscal year)
17 1806	Operation and Maintenance, Navy Reserve (fiscal year)
17 1810	Other Procurement, Navy (fiscal year)
17X3980	Navy Management Fund

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

17X4557	National Defense Sealift Fund, Navy
17 4557	National Defense Sealift Fund, Navy (fiscal year)
17X5095	Wildlife Conservation, etc., Military Reservations, Navy
17X5185	Kaho'Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17X8008	Office of Naval Records and History Fund
17X8423	Midshipmen's Store, United States Naval Academy
17X8716	Department of the Navy General Gift Fund
17X8723	Ships' Stores Profits, Navy
17X8730	United States Naval Academy Museum Fund
17X8733	United States Naval Academy General Gift Fund
	Non-entity Funds
17X6001	Proceeds of Sales of Lost, Abandoned, orUnclaimed Personal Property, Navy
17X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy
17X6025	Pay of the Navy, Deposit Fund
17X6026	Pay of the Marine Corps, Deposit Fund
17X6050	Employee Payroll Allotment Account (U.S. Bonds)
17X6075	Withheld Allotment of Compensation for Payment of Employee Organization Dues, Navy
17X6083	Withheld Allotment of Compensation for Charitable Contributions, Navy
17X6134	Amounts Withheld for Civilian Pay Allotments, Navy
17X6275	Withheld State and Local Income Taxes
17X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
17X6705	Civilian Employees Allotment Account, Navy
17X6706	Commercial Communication Service, Navy
17 6763	Gains and Deficiencies on Exchange Transactions Navy (fiscal year)
17X6850	Housing Rentals, Navy
17X6875	Suspense, Navy
17X6999	Accounts Payable, Check Issue Underdrafts, Navy

Department of the Air Force

	Entity Funds
57 0704	Family Housing, Air Force (fiscal year)
57X1999	Unclassified Receipts and Expenditures, Air Force
57 3010	Aircraft Procurement, Air Force (fiscal year)
57 3011	Procurement of Ammunition, Air Force (fiscal year)
57 3020	Missile Procurement, Air Force (fiscal year)
57 3080	Other Procurement, Air Force (fiscal year)
57X3300	Military Construction, Air Force
57 3300	Military Construction, Air Force (fiscal year)
57 3400	Operation and Maintenance, Air Force (fiscal year)
57 3500	Military Personnel, Air Force (fiscal year)
57 3600	Research, Development, Test, and Evaluation, Air Force (fiscal year)
57 3700	Reserve Personnel, Air Force (fiscal year)

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

57 3730	Military Construction, Air Force Reserve (fiscal year)
57 3740	Operation and Maintenance, Air Force Reserve (fiscal year)
57 3830	Military Construction, Air National Guard (fiscal year)
57 3840	Operation and Maintenance, Air National Guard (fiscal year)
57 3850	National Guard Personnel, Air Force (fiscal year)
57X3960	Air Force Management Fund
57X5095	Wildlife Conservation, etc., Military Reservations, Air Force
57X8418	Air Force Cadet Fund
57X8928	Department of the Air Force General Gift Fund
	Non-entity Funds
57X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Air Force
57X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Air Force
57X6010	Pay of the Air Force, Deposit Fund
57X6031	Effects of Mentally Incompetent Soldiers, United States Air Force
57 6050	Employees' Payroll Allotment Account, United States Savings Bonds
57 6060	Estates of Deceased Airmen, Regular Air Force (fiscal year)
57X6075	Withheld Allotment of Compensation for Payment of Employee Organization Dues, Air Force
57X6083	Withheld Allotment of Compensation for Department of the Air Force
57X6105	Withheld Employee Contributions, State or Territorial Retirement, Air Force
57X6108	Employer Contributions, State or Territorial Retirement, Air Force
57X6112	Withheld Employee Contributions, State or Territorial Disability Benefits, Air Force
57X6113	Withheld Employee Contributions, State or Territorial Death Benefits, Air Force
57X6129	Foreign Taxes Withheld, Air Force
57 6275	Withheld State and Local Taxes, Air Force
57X6875	Suspense, Air Force

Defense Business Operations Fund

97X4930	Defense Business Operations Fund (DBOF)
	Reporting Sub-entities:
	Army - DBOF
	Navy - DBOF
	Air Force - DBOF
	Defense Logistics Agency - DBOF
	Defense Information Systems Agency - DBOF
	Defense Finance and Accounting Service - DBOF
	Defense Commissary Agency - DBOF
	Joint Logistics Systems Center - DBOF
	U.S. Transportation Command - DBOF
97X8097	Department of Defense Military Retirement Fund
97X4555	National Defense Stockpile Transaction Fund

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

Other Defense Organizations

	Entity Funds
97 0040	Payments to Military Retirement Fund, Defense (fiscal year)
97X0100	Operation and Maintenance, Defense-Wide
97 0100	Operation and Maintenance, Defense-Wide (fiscal year)
97 0101	Contingencies, Defense
97 0102	Claims, Defense
97 0103	Base Realignment and Closure Account, Part I, Defense (fiscal year)
97 0104	Court of Military Appeals, Defense (fiscal year)
97 0105	Drug Interdiction and Counter-Drug Activities, Defense (fiscal year)
97 0106	Goodwill Games, Defense (fiscal year)
97 0107	Office of the Inspector General (fiscal year)
97 0108	Emergency Expenses, Defense Account
97X0110	Persian Gulf Regional Defense Fund, Defense
97 0115	Corporate Information Management (Business Process Reengineering)
97 0116	Summer Olympics, Defense (fiscal year)
97 0130	Defense Health Program, Defense (fiscal year)
97 0131	Real Property Maintenance, Defense (fiscal year)
97X0132	Claims, Mount Pinatubo, Defense
97 0132	Claims, Mount Pinatubo, Defense (fiscal year)
97 0133	Payment to Coast Guard, Defense (fiscal year)
97X0134	Former Soviet Union Threat Reduction, Defense
97 0300	Procurement, Defense-Wide (fiscal year)
97 0350	National Guard and Reserve Equipment, Defense (fiscal year)
97X0360	Defense Production Act Purchases, Defense
97 0360	Defense Production Act Purchases, Defense (fiscal year)
97 0370	NATO Cooperative Defense Fund
97X0390	Chemical Agents and Munitions Destruction, Defense
97 0390	Chemical Agents and Munitions Destruction, Defense (fiscal year)
97X0400	Research, Development, Test, and Evaluation, Defense-Wide
97 0400	Research, Development, Test, and Evaluation, Defense-Wide (fiscal year)
97 0450	Developmental Test and Evaluation, Defense (fiscal year)
97 0460	Operational Test and Evaluation, Defense (fiscal year)
97 0500	Military Construction, Defense-Wide (fiscal year)
97X0510	Base Realignment and Closure Account, Part II, Defense
97 0706	Family Housing, Defense-Wide (fiscal year)
97 0800	Special Foreign Currency Program, Defense
97X0801	Foreign Currency Fluctuations, Defense
97X0803	Foreign Currency Fluctuation, Construction, Defense
97X0804	North Atlantic Treaty Organization Infrastructure, Defense
97 0805	Milcon Reserve Components
97 0809	Acquisition, Construction, and Improvements, Coast Guard, Defense (fiscal year)
97X0810	Environmental Restoration, Defense
97X0819	Humanitarian Assistance, Defense
97 0819	Humanitarian Assistance, Defense (fiscal year)

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SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

97 0826	Mildred & Claude Pepper Foundation
97 0827	World University Games, Defense (fiscal year)
97 0828	Defense Reinvestment for Economic Growth, Defense (fiscal year)
97 0829	World Cup USA, Defense (fiscal year)
97 0832	Special Olympics - World Games
97X3910	ADP Equipment Management Fund, Defense
97X4090	Homeowners Assistance Fund, Defense
97 4090	Homeowners Assistance Fund, Defense (fiscal year)
97X4093	William Langer Jewel Bearing Plant Revolving Fund, Defense
97X4931	Buildings Maintenance Fund
97X4950	Pentagon Reservation Maintenance Revolving Fund
97X4965	Emergency Response Fund, Defense
97 5186	Defense Cooperation Account
97X5187	Defense Cooperation Account, Defense
97X5188	Disposal of Department of Defense Real Property
97X5189	Lease of Department of Defense Real Property
97X5193	Department of Defense Overseas Military Facility Investment Recovery Account
97X5195	Use of Proceeds from the Transfer or Disposition of Commissary Facilities, Defense
97X5196	Theater Missile Defense Cooperation Account, Defense
97X5441	Burdensharing Contribution, Defense
97X8096	Department of Defense Dependents' Education Gift Fund
97X8098	Department of Defense, Education Benefits Fund
97 8164	Surcharge Collections, Sales of Commissary Stores
97X8165	Foreign National Employees Separation Pay Account, Defense
97X8168	National Security Education Trust Fund
97X8311	Uniformed Services University of the Health Sciences Gift Fund
97X8335	Voluntary Separation Incentive Trust Fund
	Non-entity Funds
97X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Office of Secretary of Defense
97X6050	Employees Payroll Allotment Account, U.S. Savings Bonds
97X6130	Employee and Employer Contributions, Foreign Government Social Security and Related Programs, Office of Secretary of Defense
97X6131	Employee and Employer Contributions, Insurance Plans, Office of Secretary of Defense
97X6147	NATO Airborne Early Warning Program, Office of Secretary of Defense
97X6149	Cooperative Research & Development Project Fund, Defense Intelligence Agency
97X6275	Withheld State and Local Taxes
97X6875	Deposit Fund Suspense

U.S. Army Corps of Engineers

	Entity Funds
96X3112	Flood Control, Mississippi River and Tributaries, Corps of Engineers, Civil
96X3121	General Investigations, Corps of Engineers, Civil

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

96X3122	Construction, General, Corps of Engineers, Civil
96X3123	Operation and Maintenance, General, Corps of Engineers, Civil
96 3123	Operation and Maintenance, General, Corps of Engineers, Civil (fiscal year)
96X3124	General Expenses, Corps of Engineers, Civil
96 3124	General Expenses, Corps of Engineers, Civil
96X3125	Flood Control and Coastal Emergencies, Corps of Engineers, Civil
96 3125	Flood Control and Coastal Emergencies, Corps of Engineers, Civil (fiscal year)
96X3126	General Regulator Functions, Corps of Engineers, Civil
96X3930	Consolidated Working Fund, Army, Engineers, Civil
96X4902	Revolving Fund, Corps of Engineers, Civil
96X5007	Special Recreation Use Fees, Corps of Engineers, Civil
96X5066	Hydraulic Mining in California, Debris Fund
96X5090	Payments to States, Flood Control Act of 1954
96X5125	Maintenance and Operation of Dams and Other Improvements of Navigable Waters
96X8333	Coastal Wetlands Restoration Trust Fund
96X8862	Rivers and Harbors Contributed and Advance Funds, Corps of Engineers, Civil
96X8868	Oil Spill Research, Corps of Engineers, Civil
96X6999	Account Payable, Check Issue Overdrafts, Corps of Engineers, Civil
	Non-entity Funds
96X6075	Withheld Allotment of Compensation for Payment of Employee Organization Dues, Corps of Engineers, Civil
96X6083	Withheld Allotment of Compensation for Charitable Contributions, Corps of Engineers, Civil
96X6094	Advances from the District of Columbia, Corps of Engineers, Civil
96X6134	Amounts Withheld for Civilian Pay Allotments, Corps of Engineers
96X6145	Technical Assistance, United States Dollars Advanced from Foreign Government, Corps of Engineers, Civil
96X6302	Moneys Withheld from Contractors, Corps of Engineers, Civil

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

AUDIT OPINION

DEPARTMENT OF DEFENSE

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

May 14, 1997

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

SUBJECT: Disclaimer of Opinion on the Department of Defense Consolidated Financial Statements for FY 1996 (Project No. 5FH-2026.01)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for financial statements, internal controls, and compliance with laws and regulations. As the Chief Financial Officer of DoD, the Under Secretary of Defense (Comptroller), is responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to DoD. Our responsibility is to render an opinion on the financial statements based on our audit, to determine whether internal controls were adequate, and to determine whether DoD complied with laws and regulations.

Disclaimer of Opinion. We were unable to render an opinion on the DoD Consolidated Financial Statements for FY 1996. Although progress has been made, 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 statements provided to management for DoD operations cannot be relied on for making decisions or assessing performance. The accounting data were not reliable, and we were unable to apply other auditing procedures to satisfy ourselves that the data in the financial statements were accurate and complete. Therefore, the scope of our work was not sufficient to allow us to render an opinion on these financial statements.

Internal Controls. We reviewed the internal control structure for the eight reporting entities included in the DoD consolidated financial statements. The internal control structure consists of the overall control environment, accounting systems, and control procedures established to provide reasonable assurance that management uses to regulate and guide its operations.

The DoD internal control structure was not adequate to ensure that resources were properly managed and accounted for and that financial statements were free of material misstatements. Also, DoD accounting systems were not integrated, and DoD did not provide adequate documentation, audit trails, and general ledger controls. Control procedures over assets were inadequate and caused inaccurate reporting of real property, capital leases, construction in progress, inventory, and preparation of footnotes. The FY 1996 Annual Statements of Assurance for DoD and the Defense Finance and Accounting Service identified as material weaknesses the most significant conditions we found.

Managers improved the financial reporting at many DoD entities by taking corrective actions. However, these actions did not improve the overall reporting of financial information at the consolidated statement level. DoD has also initiated a Program Management Office to manage the consolidation and modernization of all migratory, interim migratory, and legacy accounting systems in order to achieve statutory and regulatory compliance and improve financial management reporting within DoD. We believe this centralized approach will improve accountability and reporting capabilities.

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AUDIT OPINION

Compliance With Laws and Regulations. We assessed compliance with laws and regulations related to the DoD consolidated financial statements. Noncompliance with laws and regulations is a reportable condition if the noncompliance could result in material misstatements in the financial statements.

Noncompliance with laws and regulations continued to exist within DoD. Accounting systems and internal controls did not completely or accurately disclose the financial condition of DoD as required by title 31, United States Code. Numerous financial systems did not meet the requirements of Office of Management and Budget (OMB) Circular No. A-127, "Financial Management Systems," July 23, 1993, which requires integrated financial management systems and fully documented transactions. Additionally, DoD did not always comply with OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, in areas such as Accounts Receivable, Operating Materials and Supplies, Accounts Payable, Contingent Liabilities, Prior Period Adjustments, and the Overview.

Additional Reports. This is the second in a series of reports related to the DoD Consolidated Financial Statements for FY 1996. Inspector General, DoD, Report No. 97-117, "Eliminating Entries," March 31, 1997, discusses the reporting of eliminating entries. This report briefly summarizes the major deficiencies affecting DoD. We plan to issue reports with further details on internal controls and compliance with laws and regulations.

Robert J. Lieberman
Assistant Inspector General
for Auditing

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Appendix C. Summary of Prior Coverage

General Accounting Office

Report No.	Title	Date
AIMD/NSIAD 97-61	Financial Management: An Overview of Finance and Accounting Activities in DoD (OSD Case No. 1270)	February 19, 1997
AIMD-97-45	Financial Management: Improved Management Needed for DoD Disbursement Process Reforms (OSD Case No. 1300)	March 31, 1997
AIMD-97-29	Financial Management: DoD Inventory of Financial Management Systems Is Incomplete (OSD Case No. 1273)	January 31, 1997
AIMD-96-99	DoD Accounting Systems: Efforts to Improve System for Navy Need Overall Structure (OSD Case No. 1210)	September 30, 1996
AIMD-96-94	Navy Financial Management: Improved Management of Operating Materials and Supplies Could Yield Significant Savings (OSD Case No. 1168)	August 16, 1996
AIMD-96-65	CFO Act Financial Audits: Navy Plant Property Accounting and Reporting Is Unreliable (OSD Case No. 1050-D)	July 8, 1996
AIMD-96-54	Defense Business Operations Fund (DBOF): DoD Is Experiencing Difficulty in Managing the Fund's Cash (OSD Case No. 1109)	April 10, 1996
NSIAD-95-127	DoD Infrastructure: DoD's Planned Finance and Accounting Structure Is Not Well Justified (OSD Case No. 9921)	September 18, 1995
AIMD-95-79	DBOF: Management Issues Challenge Fund Implementation (OSD Case No. 9859)	March 1, 1995

Report No.	Title	Date
AIMD-95-73	Financial Management: Control Weaknesses Increase Risk of Improper Navy Civilian Payroll Payments (OSD Case No. 9763-A)	May 8, 1995
AIMD-94-132	DBOF: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices (OSD Case No. 9339-F)	June 22, 1994
AIMD-94-80	Financial Management, Status of the DBOF (OSD Case No. 9339-D)	March 9, 1994
AIMD-94-12	Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (OSD Case No. 9276-D)	December 22, 1993
AIMD-94-9	Financial Management: Army Real Property Accounting and Reporting Weaknesses Impede Management Decision-Making (OSD Case No. 9276-B)	November 2, 1993

Inspector General, Department of Defense

97-178	Audit on Internal Controls and Compliance With Laws and Regulations for the Defense Business Operations Fund Financial Statements for FY 1996	June 26, 1997
97-177	Audit on Internal Controls and Compliance With Laws and Regulations for the DoD Military Retirement Trust Fund Financial Statements for FY 1996	June 25, 1997
97-176	Internal Controls and Compliance With Laws and Regulations for the National Defense Stockpile Transaction Fund Financial Statements for FY 1996	June 25, 1997
97-155	Internal Controls and Compliance With Laws and Regulations for the Other Defense Organizations Receiving 97 Appropriations	June 11, 1997
97-117	Eliminating Entries	March 31, 1997
97-112	Air Mobility Command Financial Reporting of Property, Plant and Equipment	March 19, 1997

Report No.	Title	Date
97-110	Material Accounting and Management Control Weaknesses in the Defense Agencies' FYs 1995 and 1996 Financial Information	March 17, 1997
97-107	Defense Contract Management Command Capitalization of Fixed Assets	March 10, 1997
97-100	Asset Presentation on Military Department General Fund Financial Statements	February 25, 1997
97-073	Reliability of the FY 1995 Financial Statements for the Defense Logistics Agency General Fund	January 15, 1997
97-051	Corps of Engineers Financial Management System	December 18, 1996
97-047	Consolidated Financial Report on the National Guard and Reserve Equipment Appropriation for the Army National Guard	December 13, 1996
97-044	Army National Guard Military Equipment	December 11, 1996
97-026	Major Deficiencies Preventing Auditors From Rendering Audit Opinions on FY 1995 DoD General Fund Financial Statements	November 19, 1996
97-025	Consolidated Financial Report on the National Guard and Reserve Equipment Appropriation for the Army Reserve	November 19, 1996
97-020	Capitalization of Defense Technology Security Administration Equipment	November 4, 1996
97-017	Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations	October 31, 1996
97-008	Summary Report on the FY 1994 Financial Statement Audits of Defense Agencies	October 25, 1996
97-006	Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995	October 15, 1996
96-231	Accounting for Unliquidated Obligations for the Defense Fuel Supply Center	September 25, 1996

Report No.	Title	Date
96-216	Evaluation of FY 1995 Defense Reutilization and Marketing Service Financial Data	September 4, 1996
96-215	Financial Management at the Defense Advanced Research Projects Agency	August 28, 1996
96-213	Financial Accounting at the National Security Agency	August 20, 1996
96-212	Capitalization of DoD General Property, Plant, and Equipment	August 19, 1996
96-198	Defense Logistics Agency Revenue Eliminations	July 22, 1996
96-180	The General Fund Interim Migratory Accounting Strategy	June 26, 1996
96-169	Internal Controls and Compliance with Laws and Regulations for the DoD Military Retirement Trust Fund Financial Statements for FY 1995	June 19, 1996
96-161	Compilation of FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service Indianapolis Center	June 13, 1996
96-160	Defense Business Operations Fund Equity Transfer -- Defense Commissary Agency	June 13, 1996
96-159	Quick-Reaction Report on Potential Antideficiency Act Violations at the Department of Defense Education Activity	June 13, 1996
96-155	The Defense Information Systems Agency General Ledger Military Equipment Account	June 10, 1996
96-098	Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 1995 Air Force Consolidated Financial Statements	April 18, 1996
96-094	Inspector General, DoD, Oversight of the Army Audit Agency Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994	April 10, 1996

Report No.	Title	Date
96-083	Accounting Support for Preparation of Joint Chiefs of Staff Financial Statements	March 12, 1996
96-068	Accounting Support for Preparation of Ballistic Missile Defense Organization Financial Statements	February 9, 1996
96-048	Defense Accounting Office, Washington Headquarters Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency	December 19, 1995
96-039	Financial Accounting for the Defense Nuclear Agency	December 11, 1995
96-021	Defense Finance and Accounting Service Work on the FY 1994 Air Force Defense Business Operations Fund Financial Statements	November 6, 1995
96-003	Defense Information Systems Agency FY 1994 General-Purpose Financial Statements	October 5, 1995
95-301	Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements	August 29, 1995
95-294	Major Accounting Deficiencies in the DBOF in FY 1994	August 18, 1995
95-267	DBOF Consolidated Statement of Financial Position for FY 1994	June 30, 1995
95-264	Defense Finance and Accounting Service Work on the Air Force FY 1994 Financial Statements	June 29, 1995
95-259	Internal Controls for the Military Sealift Command Portion of the Transportation Business Area of the FY 1994 DBOF Financial Statements	June 28, 1995
95-228	Statement of Financial Position for the Commissary Resale Stock Fund, as of September 30, 1994	June 8, 1995

Report No.	Title	Date
95-220	Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the DBOF for FY 1994	June 5, 1995
95-219	DBOF-Communications Information Services Activity Financial Statements for FY 1994	June 5, 1995
95-218	Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994	June 5, 1995
95-217	Financial Statements for the Commissary Operations Fund, as of September 30, 1994	June 2, 1995
95-209	DBOF-Defense Information Service Organization Financial Statements for FY 1994	May 31, 1995
95-197	Statement of Financial Position for the Defense Logistics Agency Distribution Depot Business Area of the DBOF, as of September 30, 1994	May 19, 1995
95-195	Statement of Financial Position for the Defense Logistics Agency Supply Management Business Area of the DBOF, as of September 30, 1994	May 17, 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
95-023	Application Controls Over Selected Portions of the Standard Army Intermediate Level Supply System	November 4, 1994

Army Audit Agency

Report No.	Title	Date
AA 97-136	FY 96 Financial Statements: U.S. Army Corps of Engineers, Civil Works	February 28, 1997
AA 97-133	Army's Principal Financial Statements for FYs 1996 and 1995	February 21, 1997
AA 96-155	Financial Reporting of Wholesale Munitions	April 19, 1996
AA 96-154	Examinations of the Army's Financial Statements for Fiscal Years 1995 and 1994: Report on Internal Controls and Compliance With Laws and Regulations	July 11, 1996
AA 96-152	Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994: Auditor's Report	March 15, 1996
AA 96-73	DBOF, FY 95 Financial Statements--Supply Management, Revenues and Expenses: U.S. Army Missile Command	February 15, 1996
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

Naval Audit Service

Report No.	Title	Date
029-97	Department of Navy FY 1996 Annual Financial Report: Report on Internal Controls and Compliance With Laws and Regulations	April 15, 1997
022-97	Department of the Navy Fiscal Year 1996 Annual Financial Report: Report on Auditor's Opinion	March 1, 1997
044-95	FY 1994 Consolidating Financial Statements of the Department of the Navy DBOF	May 30, 1995
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

97053011	Eliminating Entries and Nonoperating Changes, FY 1996 Air Force Consolidated Financial Statements	April 15, 1997
97053012	Contingent Liabilities, FY 1996 Air Force Consolidated Financial Statements	April 10, 1997
96053019	Real Property and Nonmilitary Equipment, FY 1996 Air Force Consolidated Financial Statements	February 11, 1997
96053015	Military Pay, FY 1996 Air Force Consolidated Financial Statements	April 15, 1997
96053005	Operating Materials and Supplies, FY 1996 Air Force Consolidated Financial Statements	January 30, 1997
96053004	Civilian Pay, FY 1996 Air Force Consolidated Financial Statements	April 17, 1997
96053003	Fund Control Process, FY 1996 Air Force Consolidated Financial Statements	February 7, 1997

Appendix C. Summary of Prior Coverage

Report No.	Title	Date
96053002	Federal Mission Property, Plant and Equipment FY 1996 Air Force Consolidated Financial Statements	February 3, 1997
96053001	Opinion on FY 1996 Air Force Consolidated Financial Statements	March 1, 1997
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

Appendix D. Laws and Regulations Reviewed

Subtitle II, "The Budget Process," Title 31, United States Code (U.S.C.)

Subtitle III, "Financial Management," 31 U.S.C.

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

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

Public Law 103-356, "Federal Financial Management Act of 1994," October 13, 1994

Public Law 103-356, "Government Management Reform Act of 1994," October 13, 1994

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

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

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

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

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

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

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

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

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

Public Law 94-580, "Resource Conservation and Recovery Act of 1976," October 21, 1976

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

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

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

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

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

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

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

OMB Bulletin No. 93-18, "Audited Financial Statements," June 25, 1993

OMB Circular A-34 (Revised), "Instructions on Budget Execution," August 8, 1985

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

OMB Circular A-125 (Revised), "Prompt Payment," December 12, 1989

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

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

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

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

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

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

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

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

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

DoD 7000.14-R, "Financial Management Regulation," volumes 1 through 15, issued August 1992 through March 1997

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

"DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996

DFAS Financial Management Departmental Reporting Manual, Book 2, "Accounting Classification and Data Elements," April 1, 1995

Appendix E. Summary of Work Performed

Reporting Entity	FY 1996 Reported Assets (thousands)	FY 1996 Reported Expenses (thousands)	Scope of Audit Work Performed	Organizations Performing Audit Work	Opinion	Audit Report Number
Army	$ 201,042,450	$ 64,728,844	Limited[1]	Army Audit Agency	Disclaimer	AA 97-133
Navy	453,423,799	63,266,297	Limited[2]	Naval Audit Service	Disclaimer	022-97
Air Force	342,141,469	59,556,746	Limited[1]	Air Force Audit Agency	Disclaimer	96053001
Defense Business Operations Fund	92,213,563	76,388,688	Limited[1]	IG, DoD Army Audit Agency Naval Audit Service Air Force Audit Agency	Disclaimer	97-178
Military Retirement Trust Fund	135,335,904	47,591,489	Full	IG, DoD	Unqualified	97-177
National Defense Stockpile Transaction Fund	4,271,510	215,245	Full	IG, DoD	Qualified	97-176
U.S. Corps of Engineers, Civil Works	41,707,282	7,108,229	Limited[3]	Army Audit Agency	Disclaimer	AA 97-136
Other Defense Organizations	45,695,735	46,527,114	Limited[4]	IG, DoD	No opinion	97-155
Total[5]	**$1,315,831,712**	**$365,382,652**				

[1]The Military Department audit organizations and the IG, DoD, audited selected accounts in the Statements of Financial Position and the Statements of Operations and Changes in Net Position.

[2]The Naval Audit Service audited the Statement of Financial Position.

[3]The Army Audit Agency audited the Statement of Operations and Changes in Net Position.

[4]The IG, DoD, reviewed the internal controls and compliance with laws and regulations.

[5]These amounts represent the totals before eliminating entries are subtracted.

Appendix F. Management Representation Letter

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

COMPTROLLER

Apr - 9

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Management Representation Letter for the FY 1996 DoD-wide Consolidated Financial Statements

Reference is made to the FY 1996 Principal Financial Statements for the DoD-wide Consolidated Financial Statements (Project No. 5FH-2026). 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 consolidated DoD-wide financial statements in accordance with OMB Bulletin 94-01.

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

- I understand that we have prepared the carrying value or classification of assets and liabilities in a manner that conforms to our published policies and I have no plans or intentions to change it.

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

- I know of no other employees being involved in irregularities that could materially affect the financial statements that are not a matter of public record.

- I know of no 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.

- We do not consider related third-party transactions and related amounts receivable or payable of interested participants, including assessments, loans, and guarantees as applicable and make no assurance in that regard.

- I know of no 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.

- I know of no 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 know of no 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 DoD-wide Consolidated Financial Statements that will be furnished shortly to you by the General Counsel of the Department of Defense.

- 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.

- The offices responsible for the stewardship of equipment and stockage inventories have made plans to reduce excess or obsolete inventories. The department has attempted to estimate this inventory value consistent with established guidelines for net realizable value.

- To my knowledge and based on the management representation letters of subordinate offices, 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 know of no plans to avoid compliance with any aspect of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

- I know of no 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 e-mail: covello@ousdc.osd.mil or (703) 697-6149.

John J. Hamre

Attachment

DEFENSE-WIDE CONSOLIDATED FINANCIAL STATEMENTS
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 1996. 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-wide consolidated financial statements.

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. Integrated agency accounting and financial management systems are expected to provide for complete, reliable, consistent, and timely information that is prepared on a uniform basis and responsive to the financial information needs of agency management. However, the Department must rely on existing accounting systems--systems that often are not integrated and that provide DoD Component unique information. The summarized information must be collected from several DoD Component-unique sources, which results in a further lack of comparability.

In general, 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 (USGSGL) accounts have not been fully incorporated into Defense Finance and Accounting Service (DFAS) accounting systems. Consequently, for the FY 1996 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 for use in producing the FY 1996 financial statements. Instead, reports from departmental budget and reporting systems sometimes were relied on to prepare financial reports. Similarly, some activities were not supported by a fully integrated double-entry accounting system. In those instances, information was gathered from automated and manual systems to create a consolidated general ledger. Procedures used to create the general ledgers were not always fully documented, and procedures were not always 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 accounting activities or reporting entities have controls in place to ensure that all valid transactions are properly recorded, processed, and summarized in order to always provide totally 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

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DEFENSE-WIDE CONSOLIDATED FINANCIAL STATEMENTS
IDENTIFIED PROCEDURAL AND SYSTEMIC DEFICIENCIES

timely manner. The absence of systems with fully integrated general ledger accounts, to capture all required financial information relative to DoD assets, limits the Department's capability to ascertain whether all assets are included in financial statement amounts. Consequently, there is no standard financial control over the amounts reported.

C. Standard General Ledger. The USGSGL has not been fully implemented throughout the Department of Defense. During FY 1996, many different general ledger structures were in use by activities across the Department. 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 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 financial statements in strict accordance with OMB guidance.

In addition, the absence of standard general ledger accounting systems makes it difficult to ascertain whether like items are reported in the same general ledger accounts and balances. The Department has developed an interim migration strategy to consolidate DoD accounting systems. Once the interim migratory systems become functional, the Department expects to improve its accounting and reporting capabilities, and save resources, by using fewer systems and consolidating accounting functions. Interim migratory systems have been designated in the DoD Chief Financial Officer's Financial Management Status Report and 5-Year Plan for 1996-2000. 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 DFAS 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 Defense-wide financial statements for FY 1996, some functional systems that feed data to the accounting systems were not reviewed adequately for conformance with applicable accounting requirements. Internal controls may have been inadequate in these feeder systems to ensure that items were inventoried or accounted for properly.

F. Inadequate Coding Structure. The coding structure within the accounting and financial management systems employed by DoD Component activities has not been developed to adequately capture and report all of the data necessary for preparing financial statements.

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Attachment

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Part 2. Internal Controls

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

B. Internal Controls. The internal controls governing the processes for preparing financial statements still are not adequate for significant portions of the adjustment and financial statement preparation processes.

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

D. Negative Unliquidated Obligations. Auditors have concluded that accounting offices, and the installations that they support, do not always effectively monitor or accurately report negative unliquidated obligation balances.

E. In-Transit Disbursements. The auditors have reported that, contrary to policy, procedures do not ensure, necessarily, that disbursements always are posted to the correct obligation on a timely basis.

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

G. Adjustments to General Ledger Accounts. Adjusting entries sometimes may be 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 there are problems adhering to procedures that are in place.

H. Reconciliation of Property Records. Additional improvements were needed in accounting for equipment, and reconciling equipment values with subsidiary records.

I. Reconciliation of Subsidiary Records. Some required monthly reconciliations of disbursement and collection transactions in the disbursing system were not performed or only partially performed.

J. 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

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recorded; also, some funding documents were not received, which prevented the activities from billing customers.

K. Classification of Assets. Some equipment, inventories held for sale and inventories not held for sale may have been classified incorrectly.

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

M. Intrafund Eliminations. Auditors have stated that the consolidated financial statements 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.

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

O. In-Transit Accounts. The Department has, in the past, reported negative balances in an in-transit account. The auditors have concluded that the existence of a negative balance in an inventory account is inaccurate, and that one may not be able to rely on the systems that produced such figures.

P. Valuation of Inventory. The auditors have reported that inventory was incorrectly valued. They also have stated 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. Accrual Accounting Procedures. General ledger and subsidiary accounts may not always be established as required and, in some cases, miscellaneous revenues either may 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.

S. Audit Trails. Some reporting entities may not have 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. Interfacing of Accounting Systems. OMB Circular A-127, "Financial Management Systems," requires that accounting systems interface with logistical systems and meet other

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requirements such as system documentation, audit trails, and general ledger control. The majority of the Department's 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. The DoD Financial Management Regulation, Volume 1, "General Financial Management Information, Systems and Requirements," requires that activities use the U.S. Government standard general ledger chart of accounts. The Under Secretary of Defense (Comptroller) (USD(C)) acknowledges that the standard general ledger has not been fully implemented throughout the Department. 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. The DoD Financial Management Regulation requires that activities separately depreciate each building. However, existing accounting systems generally preclude determination of depreciation expense. For example, many activities do not have an accounting system that allows them to compute depreciation on separate buildings.

D. Inventory Valuation. 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. Maintenance activities sometimes value inventory at standard price, regardless of condition. This results in overvalued excess and unserviceable inventory.

Appendix G. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

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

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Administration and Management
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
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
National Security and International Affairs Division, Technical Information Center, General Accounting Office

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

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

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