

**A**udit



**R**eport

INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND  
REGULATIONS FOR THE DEFENSE SECURITY ASSISTANCE  
AGENCY FINANCIAL STATEMENTS FOR FY 1997

Report Number 98-164

June 25, 1998

Office of the Inspector General  
Department of Defense

### **Additional Information and Copies**

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, homepage at: [WWW.DODIG.OSD.MIL](http://WWW.DODIG.OSD.MIL).

### **Suggestions for Future Audits**

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8908 (DSN 664-8908) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)  
Inspector General, Department of Defense  
400 Army Navy Drive (Room 801)  
Arlington, VA 22202-2884

### **Defense Hotline**

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to [Hotline@DODIG.OSD.MIL](mailto:Hotline@DODIG.OSD.MIL); or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

### **Acronyms**

CERPS	Centralized Expenditure/Reimbursement Processing System
CLSSA	Cooperative Logistics Supply Support Arrangements
DFAS	Defense Finance and Accounting Service
DIFS	Defense Integrated Financial System
DSAA	Defense Security Assistance Agency
FASAB	Federal Accounting Standards Advisory Board
FFMIA	Federal Financial Management Improvement Act
FMS	Foreign Military Sales
GAO	General Accounting Office
IG	Inspector General
JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget
OPLOC	Operating Location
USD(C)	Under Secretary of Defense (Comptroller)
USGSGGL	U.S. Government Standard General Ledger



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

June 25, 1998

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

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and  
Regulations for the Defense Security Assistance Agency Financial  
Statements for FY 1997 (Report No. 98-164)

We are providing this audit report for review and comment. Financial statement audits are required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We were unable to render an opinion on the Defense Security Assistance Agency Financial Statements for FY 1997 because of deficiencies in internal controls and accounting systems and noncompliance with Federal accounting and reporting standards. Our opinion and the financial statements are included in Appendix C. Part I of this report discusses material weaknesses in internal controls and noncompliance with laws and regulations. Part II of this report contains appendixes for management's use.

We considered management comments on a draft of this report when preparing the final report. DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Deputy Chief Financial Officer provide additional comments on Recommendations B.2., B.3., E.1.a., E.1.b., E.2., and D., by August 25, 1998.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird at (703) 604-9175 (DSN 664-9175, e-mail [rbird@dodig.osd.mil](mailto:rbird@dodig.osd.mil)) or Mr. Byron B. Harbert at (303) 676-7405 (DSN 926-7405, e-mail [bharbert@dodig.osd.mil](mailto:bharbert@dodig.osd.mil)). See Appendix F for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink that reads "Robert J. Lieberman".

Robert J. Lieberman  
Assistant Inspector General  
for Auditing



## Office of the Inspector General, DoD

Report No. 98-164  
(Project No. 7FD-2011.01)

June 25, 1998

### Internal Controls and Compliance With Laws and Regulations for the Defense Security Assistance Agency Financial Statements for FY 1997

#### Executive Summary

**Introduction.** Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires an annual audit of the financial statements of Government operations, trust funds, revolving funds, and commercial activities. The Defense Security Assistance Agency (DSAA) administers the DoD security assistance program under Public Law 87-195, the "Foreign Assistance Act of 1961," September 4, 1961, as amended; Public Law 90-269, the "Arms Export Control Act," October 22, 1968, as amended; and other statutes, Executive Orders, and directives. The DSAA Financial Statements for FY 1997 reported \$27.9 billion of assets. Of that amount, \$15.5 billion was for the Foreign Military Sales Trust Fund, \$6.9 billion was for the Foreign Military Loan Liquidating account, \$3.2 billion was for the Foreign Military Financing Direct Loan Account, \$2.1 billion was for the Foreign Military Financing Grant Account, \$210 million was for the Special Defense Acquisition Fund, and \$56 million was for five other programs. DSAA, as the fund manager, is responsible for establishing and maintaining an internal control structure and complying with laws and regulations. The Defense Finance and Accounting Service is responsible for accounting for DSAA operations, which includes establishing and maintaining the accounting systems for the funds managed by DSAA.

**Audit Objectives.** The primary audit objective was to determine whether the DSAA Financial Statements for FY 1997 were presented fairly in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, as modified by Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996. We also determined whether internal controls were adequate to ensure that the financial statements were free of material error. We assessed compliance with laws and regulations for transactions and events that could have a direct and material effect on the financial statements. We also followed up on conditions reported in previous audits of the DSAA Financial Statements.

**Disclaimer of Opinion.** We were unable to render an opinion on the DSAA Financial Statements for FY 1997. Significant deficiencies, as identified in our audits of the DSAA Financial Statements for FYs 1992, 1995, and 1996, still exist. Because of

deficiencies in accounting systems and control procedures, there was a lack of reasonable assurance that the financial statements were reliable. Specifically, the Defense Finance and Accounting Service did not account for revenues and expenses in the DSAA financial statements from about \$14.5 billion of goods and services sold to foreign customers; adequate audit trails did not exist for Air Force and Navy disbursements; accounts receivable were overstated; and inventories were not recorded. DSAA provided management and legal representation letters, but the management representation letter did not attest to the accuracy or completeness of the financial statements. See Appendix D for copies of both letters.

**Internal Controls.** Internal controls were not effective in accounting for and managing resources, ensuring compliance with laws and regulations, and ensuring that the financial statements were free of material misstatements. Adequate audit trails for disbursements need to be developed and documented, and internal controls over disbursements were inadequate. As a result of inadequate internal controls, \$494 million was disbursed without authorization. Part I.A. is our report on internal controls.

**Compliance with Laws and Regulations.** Instances of noncompliance with laws and regulations continue to exist, materially affecting the reliability of the DSAA Financial Statements for FY 1997. Revenues and expenses for about \$14.5 billion of foreign military sales were not reported; accounts receivable were overstated by \$1.87 billion; and up to \$459 million of foreign military sales inventory was not reported. Part I.B. is our report on compliance with laws and regulations. Appendix E lists the laws and regulations we reviewed.

**Summary of Recommendations.** We recommend that audit trails for disbursements be developed, tested, and documented; that a review be conducted to determine whether a report on administrative control of funds should be submitted; that foreign military sales disbursements be restricted to certain disbursing stations; that authorized disbursing stations be designated and procedures established to ensure that disbursing stations always obtain expenditure authority before making foreign military sales disbursements; that requests for advance payments not be recorded as accounts receivable; and that inventory purchased with foreign military sales funds be accounted for and reported. No recommendations regarding DSAA financial statements were made because the Office of Management and Budget and the DoD agreed in May 1998 that separate DSAA financial statements will no longer be prepared. Instead, DSAA financial activity will be addressed in the DoD Consolidated financial statements.

**Management Comments.** The Deputy Chief Financial Officer concurred with the recommendations on audit disbursement trails and reviewing foreign military sales disbursements; partially concurred with the recommendation to designate foreign military sales disbursing offices; and nonconcurred with the recommendations to limit the number of foreign military sales disbursing offices, to not record requests for advance payments as accounts receivable, and to account for inventory purchased with foreign military sales funds. He stated that monthly disbursements had been reviewed for the period March 1997 to February 1998 and showed no instances where

disbursements exceeded a country's available cash deposits. The Deputy Chief Financial Officer disagreed with the views expressed in Part I.B., Review of Compliance With Laws and Regulations. See Part I for a discussion of the management comments and Part III for the text of the comments.

**Audit Response.** The management comments on Recommendations A.1., A.2., and B.1. were responsive. The comments on Recommendations B.2., B.3., E.1.a., E.1.b, and E.2. were partially responsive and suggested an alternative action. However, the management comments did not explain the specific action that was planned to implement the revised recommendation. The management comments on Recommendation D indicated a misunderstanding. Recommendation D. in the draft report was to revise DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," to state that accounts receivable arise when an entity provides goods or services to a customer, although the entity has not received advance payment. We clarified the recommendation to state that the DoD Financial Management Regulation should be revised to delete the requirement to record requests for advance payment as accounts receivable. We request that the Deputy Chief Financial Officer provide additional comments on Recommendations B.2., B.3., E.1.a., E.1.b., E.2., and D. by August 25, 1998.



# Table of Contents

---

<b>Executive Summary</b>	i
<b>Part I. - Audit Results</b>	
Audit Background	2
Audit Objectives	3
<b>Part I.A. - Review of Internal Controls</b>	
Introduction	6
Finding A. Audit Trails for Disbursements	8
Finding B. Expenditure Authority	15
<b>Part I.B. - Review of Compliance with Laws and Regulations</b>	
Introduction	22
Material Noncompliances	22
Finding C. Revenues and Expenses	25
Finding D. Accounts Receivable	29
Finding E. Reporting of Inventory	31
<b>Part II. - Additional Information</b>	
Appendix A. Audit Process	
Scope	37
Methodology	40
Appendix B. Prior Audit Reports	43
Appendix C. Financial Statements and Audit Opinion	47
Appendix D. Management and Legal Representation Letters	49
Appendix E. Laws and Regulations Reviewed	51
Appendix F. Report Distribution	53
<b>Part III. - Management Comments</b>	
Under Secretary of Defense (Comptroller) Comments	56



## **Part I. - Audit Results**

---

## **Audit Background**

**Introduction.** Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires an annual audit of the financial statements of Government operations, trust funds, revolving funds, and commercial activities. The consolidated financial statements of the Defense Security Assistance Agency (DSAA) consist of 10 accounts, with total assets reported at \$27.9 billion. Each of the 10 accounts has its own set of financial statements. We reviewed the Foreign Military Sales (FMS) Trust Fund, one of the accounts, which had total assets reported at \$15.5 billion. The FMS Trust Fund’s reported assets were 55 percent of the total assets of the DSAA Financial Statements for FY 1997. Our responsibility is to render an opinion on those statements based on our audit.

**Accounting Functions and Responsibilities.** The Defense Finance and Accounting Service (DFAS) performs accounting functions and prepares financial statements for DSAA. DSAA operates under the control and direction of the Assistant Secretary of Defense (International Security Affairs). DFAS and DSAA jointly prepare the DSAA financial statements. DFAS is responsible for entering information from DoD entities into the financial systems, operating and maintaining the financial systems, and ensuring the continued integrity of the information entered. The DoD entities are responsible for providing accurate financial information to DFAS.

**Accounting Policy.** The DSAA financial statements for FYs 1997 and 1996 were to be prepared in accordance with Office of Management and Budget (OMB) Bulletin No. 94-01, “Form and Content of Agency Financial Statements,” November 16, 1993, as modified by OMB Bulletin No. 97-01, “Form and Content of Agency Financial Statements,” October 16, 1996. Footnote No. 1 of the DSAA financial statements discusses the significant accounting policies used to prepare the financial statements.

**Disclaimer of Opinion.** We were unable to render an opinion on the DSAA Financial Statements for FY 1997. Our disclaimer of opinion was included in the financial statements transmitted by the Under Secretary of Defense (Comptroller) (USD[C]) to OMB. The financial statements and audit opinion are in Appendix C.

---

## **Audit Objectives**

Our overall objective was to determine whether the DSAA Financial Statements for FY 1997 were presented fairly in accordance with OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01. We also evaluated internal controls and compliance with laws and regulations. Part I.A. is our report on internal controls. Part I.B. is our report on compliance with laws and regulations. Appendix A discusses the scope and methodology, auditing standards, and accounting principles. Appendix B provides a summary of prior coverage.



## **Part I. A. - Review of Internal Controls**

### Introduction

**Audit Responsibilities.** Our audit objective was to determine whether controls over transactions supporting the accounts in the DSAA Statement of Financial Position and Statement of Operations for FY 1997 were adequate to ensure that the financial statements were free of material error. In planning and performing our audit of the DSAA Financial Statements for FY 1997, we evaluated the internal controls. We performed this evaluation to:

- determine the auditing procedures necessary to render an opinion on the financial statements; and
- determine whether internal controls had been established.

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

**Management Responsibilities.** As the Chief Financial Officer, the USD(C) oversees all financial management activities for DoD programs and operations, including the accounting functions of DFAS. The Military Departments, Defense agencies, and DoD field activities are responsible for managing their operations. Establishing and maintaining internal controls appropriate to the entity is an important management responsibility. The objectives of internal controls are to provide management with reasonable, but not absolute, assurance that:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation; and
- 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 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.

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

## Reportable Conditions

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

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

**Reportable Conditions of the DSAA Financial Statements.** Deficiencies identified in previous audits of the FMS Trust Fund continued to exist. Readily accessible audit trails did not exist for Air Force and Navy disbursements. In addition, DFAS disbursed \$494 million without ensuring the availability of funds. See Findings A and B for details of these deficiencies and recommendations for corrective action.

---

## **Finding A. Audit Trails for Disbursements**

DFAS did not have clearly established audit trails for FMS Trust Fund disbursements. Specifically, DFAS did not have ready access to data that would allow disbursements to be traced directly from the Funds Disbursed account in the FMS Trust Fund general ledger to source documents at disbursing offices that served Air Force and Navy organizations. The DFAS Denver Center, Denver, Colorado, had not documented the audit trail for disbursements. As a result, neither managers nor auditors could satisfy themselves that the \$5.9 billion balance of the Fund Balance With Treasury account was fairly presented.

### **Regulatory Requirements**

**Internal Control Standards and DoD Guidance.** OMB Circular No. A-127, "Financial Management Systems," July 23, 1993, requires transaction details supporting U.S. Government Standard General Ledger (USGSGL) accounts to be available in the financial management systems and directly traceable to specific account codes in the USGSGL. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993, provides the key accounting requirements for DoD financial management systems. Key Accounting Requirement No. 8 states that in any compliant system, the financial transactions for which the system accounts must be adequately supported with pertinent documents and source records. The DoD Financial Management Regulation, volume 6, "Reporting Policies and Procedures," February 1996, also requires DFAS to maintain a complete and documented audit trail to support the reports it prepares. Volume 6 was revised in January 1998, but the USD(C) made no changes to the requirements for audit trails.

### **Accounting Systems**

The Defense Integrated Financial System (DIFS) is the centralized accounting system that generates data for the FMS Trust Fund financial statements. DIFS is supported by various feeder systems, including Military Department-level systems and installation-level systems. Disbursing stations enter data on FMS Trust Fund disbursements into installation-level systems. Disbursement data from the installation-level systems are consolidated in the DIFS feeder systems, and are further consolidated in DIFS.

## **Results of Prior Audits**

In prior audits, we attempted to test disbursement transactions by taking a sample of FMS Trust Fund disbursement records from DIFS and tracing those records through the various feeder systems and installation-level systems and ultimately to the supporting documents maintained by the disbursing offices. As reported previously, the audit trail was not adequate to confirm the accuracy of reported disbursements because DIFS did not allow accounting transactions to be traced to the source documents. Specifically, DIFS did not contain the voucher number or date of disbursement, and some disbursements recorded in DIFS were summaries of several individual disbursements.

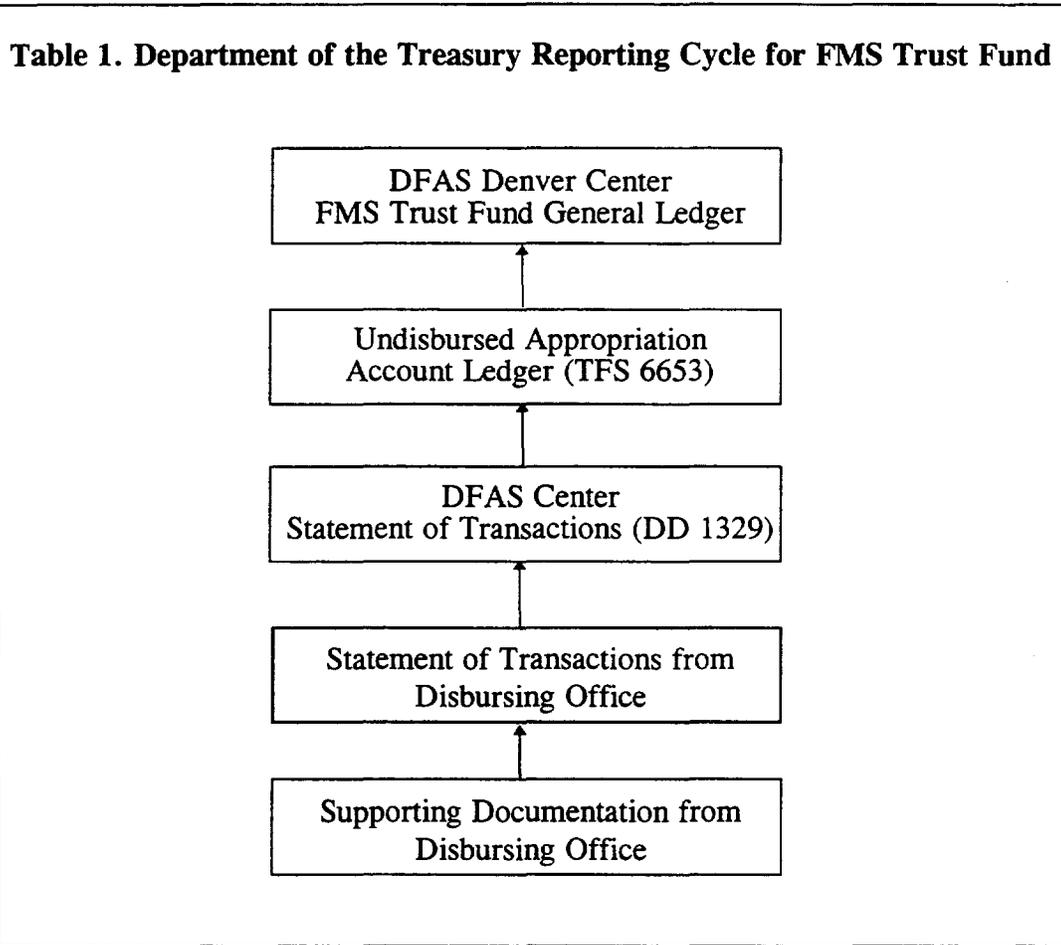
## **Flow of Data on FMS Disbursements**

For our audit of the DSAA Financial Statements for FY 1997, the DFAS Denver Center recommended that we trace disbursements through the Department of the Treasury reporting cycle, rather than through DIFS. The Funds Disbursed account in the FMS Trust Fund general ledger is a subaccount of the Fund Balance With Treasury account and reflects all disbursements made from the FMS Trust Fund (Department of the Treasury Account No. 97-11X8242). The DFAS Denver Center uses the amount of disbursements reported on the Undisbursed Appropriation Account Ledger (TFS 6653), reported by the Department of the Treasury to DoD, to determine the balance of the Funds Disbursed account. Each DFAS Center reports monthly disbursements to the Department of the Treasury, by appropriation, using the consolidated Statement of Transactions (DD 1329). The Department of the Treasury then consolidates this information and reports the monthly collections and disbursements to the fund holders using the Undisbursed Appropriation Account Ledger.

The DFAS Denver Center recommended that we reconcile the Statements of Transactions from each DFAS Center with the Undisbursed Appropriation Account Ledger for Department of the Treasury Account No. 97-11X8242. When we were satisfied that the Statements of Transactions represented all disbursements reported on the Undisbursed Appropriation Account Ledger, we planned to reconcile the individual Statements of Transactions from each disbursing office with the Statement of Transactions reported by the DFAS Center to the Department of the Treasury. This reconciliation would determine whether the Statements of Transactions prepared by the DFAS Center included all transactions reported by the disbursing offices. Finally, we would reconcile the detailed transaction history from the installation-level system with the Statement of Transactions from the disbursing office. Table 1. shows the flow of data on FMS Trust Fund disbursements through the Department of the Treasury reporting cycle.

## Finding A. Audit Trails for Disbursements

---



### Review of FMS Disbursements

We visited one DFAS Operating Location (OPLOC) for each Military Department. At each OPLOC, we attempted to identify a universe of transactions and trace a sample to the source documents.

**Audit Trail for Army Disbursements.** For the Army, we selected FMS disbursement transactions processed by the St. Louis, Missouri, OPLOC for May 1997. We reconciled Army disbursements reported on the Undisbursed Appropriation Account Ledger through various levels of reporting to the detailed transaction history from the Headquarters Army System. We then

## **Finding A. Audit Trails for Disbursements**

traced a judgmental sample of transactions from the Headquarters Army System to the source documents at the St. Louis OPLOC. Table 2 shows the reconciliation of data on Army FMS disbursements for the St. Louis OPLOC.

<b>Department of the Treasury</b>	
Undisbursed Appropriation Account Ledger (TFS 6653)	\$226,080,812.80
<b>DFAS Indianapolis Center</b>	
Statement of Transactions	\$226,366,674.50
Statement of Transactions (Supplemental)	( 285,861.70)
Total reported by DFAS Indianapolis Center	\$226,080,812.80
St. Louis OPLOC portion of total reported by DFAS Indianapolis Center	\$ 3,488,098.02
<b>St. Louis OPLOC</b>	
Statement of Transactions	\$ 3,488,098.02
Detailed transactions from Headquarters Army System	\$ 3,488,098.02

**Audit Trails for Air Force Disbursements.** For the Air Force, we selected FMS Trust Fund disbursements processed by the Dayton, Ohio, OPLOC for July 1997. The DFAS Denver Center recommended that we use data from the Case Management Control System to trace Air Force FMS Trust Fund disbursements to source documents. However, we could not use this method because the Case Management Control System combined multiple disbursements into single records. For the transactions to be traced to source documents, each transaction must be individually identified. We notified the DFAS Denver Center that the Case Management Control System did not identify individual transactions, and they recommended that we use data from the Air Force General Accounting and Finance System.

To obtain data on FMS Trust Fund disbursements from the General Accounting and Finance System, the Dayton OPLOC had to develop new retrieval programs. Initially, the retrievals did not provide accurate data. However,

## **Finding A. Audit Trails for Disbursements**

---

after 2 months, the Dayton OPLOC provided us with an accurate list of Air Force FMS Trust Fund disbursements. We then traced a judgmental sample of transactions to source documents at the Dayton OPLOC. Table 3 shows the reconciliation of data on Air Force FMS disbursements for the Dayton OPLOC.

**Table 3. Audit Trails for Air Force FMS Disbursements**

<b>Department of the Treasury</b>	
Undisbursed Appropriation Account Ledger (TFS 6653)	\$682,364,781.62
<b>DFAS Denver Center</b>	
Statement of Transactions (DD 1329)	\$682,364,781.62
Dayton OPLOC portion of total reported by DFAS Denver Center	\$ 36,473,296.00
<b>DFAS Dayton OPLOC</b>	
Statement of Transactions	\$ 36,473,296.00
Detailed transactions from General Accounting and Finance System	\$ 36,473,296.00

**Audit Trails for Navy Disbursements.** For the Navy, we selected FMS Trust Fund disbursements processed by the San Diego, California, OPLOC for May 1997. The DFAS Denver Center recommended that we use data from the Centralized Expenditure/Reimbursement Processing System (CERPS) to trace Navy FMS Trust Fund disbursements to source documents. After a 2-month delay caused by the DFAS Denver Center's problems in providing a complete population of disbursement transactions for May 1997, we used this method to trace a judgmental sample of transactions.

We could not reconcile transactions from CERPS to the Undisbursed Appropriation Account Ledger. We reconciled the San Diego OPLOC portion of FMS Trust Fund transactions to the total amount of Navy FMS transactions in CERPS, but we could not reconcile the total amount of Navy FMS transactions in CERPS to the Statement of Transactions that the DFAS Cleveland Center, Cleveland, Ohio, submitted to the Department of the Treasury. The amounts differed by \$431,326.33. The DFAS Denver Center could not explain this difference. As a result, we could not use the Department

## Finding A. Audit Trails for Disbursements

of the Treasury reporting cycle to trace the Navy FMS Trust Fund transactions, as recommended by the DFAS Denver Center. Table 4 shows the reconciliation of data on Navy FMS disbursements for the San Diego OPLOC.

**Table 4. Audit Trail for Navy FMS Disbursements**

<b>Department of the Treasury</b> Undisbursed Appropriation Account Ledger (TFS 6653)	\$310,958,484.81
<b>DFAS Cleveland Center</b> Statement of Transactions (DD 1329)	\$310,958,484.81
Total Navy FMS transactions in CERPS	\$311,389,811.14
DFAS San Diego OPLOC portion of total reported by DFAS Cleveland Center	\$ 9,223,236.12
<b>DFAS San Diego OPLOC</b> Detailed transactions from CERPS	\$ 9,223,236.12

### Summary

DFAS has not established, tested, and documented adequate audit trails for FMS Trust Fund disbursements. Although DFAS Denver Center officials suggested audit trails for us to follow, they had not tested and documented those audit trails and could not predict the problems we would experience. We traced disbursements satisfactorily at the St. Louis OPLOC, one of several OPLOCs that serves the Army.

Although we eventually traced a sample of Air Force disbursements for July 1997, officials at the Dayton OPLOC spent 2 months determining how to obtain data from which we could sample. To satisfy ourselves regarding the fair presentation of the Fund Balance With Treasury account, we would need to sample from numerous disbursing stations for each Military Department, and our universe would need to include transactions from all 12 months of the applicable fiscal year. Based on our review of the FY 1997 disbursements at the Dayton OPLOC, we could not perform sufficient tests (using a reasonable

## **Finding A. Audit Trails for Disbursements**

---

number of audit personnel to perform the review in a reasonable period of time) of disbursements at the DFAS OPLOCs that serve the Air Force. Consequently, the audit trail for Air Force disbursements was not adequate.

For the Navy, we could not reconcile disbursements in CERPS to amounts reported to the Department of the Treasury by the DFAS Cleveland Center, Cleveland, Ohio. Therefore, we conclude that an adequate audit trail does not exist for Navy disbursements.

## **Recommendations and Management Comments**

**A. We recommend that the Director, Defense Finance and Accounting Service Denver Center:**

**1. Establish and document an audit trail for Foreign Military Sales Trust Fund disbursements. The audit trail should allow managers and auditors to have ready access to all data on disbursement transactions.**

**2. Test the audit trail to ensure that it provides an accurate method for tracing disbursements from the general ledger to source documents and from source documents to the general ledger.**

**Management Comments.** The Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller), concurred with the recommendations, stating that an audit trail for disbursements will be established, documented, and tested by September 30, 1998.

---

## **Finding B. Expenditure Authority**

During FY 1997, disbursing officers disbursed at least \$494 million from the FMS trust fund in excess of the expenditure authority they had obtained. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 15, chapter 4, requires each disbursing officer to obtain expenditure authority before making FMS disbursements and to establish internal controls to achieve this objective. However, disbursing officers did not establish the internal controls needed, although they received instructions from the Director, DFAS, that no FMS disbursements were to be made without obtaining expenditure authority. At one disbursing station, personnel were unaware that they needed to obtain expenditure authority before disbursing funds for FMS. Existing controls were inadequate to ensure that disbursing officers complied with the requirement to obtain expenditure authority. As a result, funds may be disbursed in excess of cash deposits on hand at the country level, and a violation of the regulatory requirements for administrative control of funds may have occurred.

### **Requirements for FMS Disbursements**

Public Law 90-269, the "Arms Export Control Act," October 22, 1968, is the statutory basis for the sale of DoD articles and services to foreign governments. The Act authorizes sales from DoD stocks, cash sales, credit sales, and sales involving guaranties. As an exception to the statutory prohibition against incurring obligations before funds or appropriations are available, section 22(a) of the Arms Export Control Act (cash sales) specifically authorizes the United States to contract for a foreign country if the country provides a "dependable undertaking" that it will pay the amount of the contract, which insures the United States against any loss, and that it will make funds available for payments. For such sales, foreign governments will provide an initial cash deposit to cover certain anticipated disbursements. Thereafter, the foreign government will be billed and appropriate adjustments will be made to ensure that adequate cash deposits are on hand to meet anticipated disbursements. Except as specifically authorized by statute, funds appropriated by Congress cannot be used to meet disbursement requirements. To preclude the use of appropriated funds under such circumstances and to ensure that adequate cash deposits are on hand to meet anticipated disbursements, disbursing officers are required to obtain expenditure authority before making disbursements to contractors. Controls are outlined in the DoD Financial Management Regulation.

## **Finding B. Expenditure Authority**

---

**Adverse Financial Conditions.** The DoD Financial Management Regulation, volume 15, chapter 2, paragraph 021201, states:

When FMS case obligations exceed the amounts approved in the DD Form 2060, "FMS Obligational Authority," or disbursements exceed "Country-level" expenditure authority issued by SAAC,<sup>1</sup> a violation-of-administrative-control-of-funds type report will be submitted by the DoD Component incurring the overobligation or overexpenditure unless exempted in paragraph 021202.

The conditions described in paragraph 021202 do not include disbursing funds in excess of expenditure authority. Paragraph 021203 states that the report required in paragraph 021201 will be identified as an overobligation report or an overexpenditure report (or both) of FMS obligational authority. Paragraph 021203 also states that the report will be prepared in the format prescribed in DoD Directive 7200.1, "Administrative Control of Appropriations," May 4, 1995, and submitted to Headquarters, DFAS.

### **Disbursements Exceeded FMS Expenditure Authority**

During FY 1997, disbursing officers disbursed \$494 million from the FMS Trust Fund in excess of expenditure authority they had obtained. For the period October 1, 1996, through September 30, 1997, we analyzed disbursements for over 170 disbursing stations that report to the DFAS Centers in Denver, Colorado; Indianapolis, Indiana; Cleveland, Ohio; and Columbus, Ohio. The disbursing stations reported their activity through the assigned DFAS Center. By comparing the net monthly disbursements of each disbursing station to the net expenditure authority issued by the DFAS Denver Center, we determined that all 170 disbursing stations had disbursed FMS Trust Funds in excess of expenditure authority obtained during the year. Although all stations made some disbursements without expenditure authority, some disbursing stations did not obtain expenditure authority for most of their FMS disbursements.

We analyzed the FMS activity of the San Diego OPLOC for the period February through June 1997. The San Diego OPLOC disbursed \$42 million from the FMS Trust Fund, but had obtained only \$22 million in expenditure authority. As a result, during the 5-month period, the San Diego OPLOC made an average of 48 percent of its disbursements from the FMS Trust Fund without the necessary expenditure authority. In March 1997, the San Diego OPLOC made 86 percent of its FMS disbursements without obtaining expenditure authority.

---

<sup>1</sup> The Security Assistance Accounting Center (SAAC) existed before DFAS was established in January 1991. The name of this organization was changed to the Deputate for Security Assistance, DFAS Denver Center.

## Obtaining Required Expenditure Authority

Personnel at disbursing stations did not obtain expenditure authority before disbursing funds from the FMS Trust Fund because the needed internal controls were not established. Obtaining expenditure authority before making disbursements is unique to FMS and is an extra step in the payment process. At the San Diego OPLOC, personnel from three of four divisions that we interviewed from three or four divisions were unfamiliar with the need to obtain expenditure authority for FMS disbursements.

**Concerns Over Controls of FMS Disbursements.** In a memorandum issued on August 8, 1996, the Director, DFAS, expressed serious concern over controls related to FMS Trust Fund disbursements. He requested that aggressive action be taken to remedy the problem and reemphasized the need to comply with all control requirements. The Director, DFAS, stated,

... expenditure authority must be requested for FMS Trust Fund disbursements prior to issuing checks or making electronic funds transfer payments ... Effective immediately, we expect all disbursing officers to achieve a zero tolerance in obtaining FMS expenditure authority and in reporting valid disbursements by FMS country and case . . . .

Even after this memorandum was issued, at least \$494 million was disbursed in FY 1997 without expenditure authority. Managers and personnel at disbursing stations told us that they were under pressure to make disbursements promptly and felt that the additional effort required for FMS disbursements was not justified. They did not suffer adverse consequences when they failed to obtain expenditure authority; consequently, they had inadequate motivation to comply with the policy. Obtaining expenditure authority currently may complicate and delay the disbursement process because DoD requirements and FMS disbursements are combined in many contractor invoices.

## Summary

Unless expenditure authority is obtained prior to disbursing, there is no assurance that cash necessary to pay for FMS purchases will be available when needed. Although regulatory requirements existed and the Director, DFAS, emphasized the need to correct the problem, disbursing stations continued to disburse FMS funds without obtaining expenditure authority.

The DoD Financial Management Regulation, volume 15, chapter 2, paragraph 021201, states that a report on a violation of administrative control of funds is required when:

## **Finding B. Expenditure Authority**

---

- obligations exceed the amounts approved in the DD Form 2060, and
- disbursements at country level exceed the amount of expenditure authority obtained.

Our audit identified \$494 million in unauthorized expenditures. These circumstances suggest that a review is needed to determine whether disbursements from the FMS Trust Fund exceeded, at country level, the expenditure authority obtained. If this occurred, DFAS must submit a report on a violation of administrative control of funds and determine whether the failure to obtain expenditure authority resulted in cash disbursements that exceeded the cash available for any country. This determination should consider the cash available in the FMS Trust Fund, as well as cash in the country's authorized interest-bearing account at the Federal Reserve Bank of New York or a commercial bank. If disbursements exceeded the total available cash for a country or countries, DFAS should obtain reimbursement and interest on any amounts due. DFAS should also identify the funding source of disbursements made in excess of available funds. If appropriated funds were used, DFAS should conduct a review in accordance with the DoD Financial Management Regulation, volume 14, "Administrative Control of Funds and Antideficiency Act Violations," chapter 3, August 1995, to determine whether an Antideficiency Act or other violation of administrative control of funds may have occurred.

If DFAS restricted the number of disbursing stations authorized to make FMS disbursements, this action would help ensure that expenditure authority is always obtained.

## **Management Comments on the Finding and Audit Response**

**Management Comments.** The Deputy Chief Financial Officer disagreed with the statement that obtaining expenditure authority complicates or delays the disbursement process.

**Audit Response.** Our audit documented some of the difficulties encountered by disbursing officers in obtaining expenditure authority before making disbursements. At many disbursing offices, obtaining expenditure authority is a manual process that requires the disbursing officer to identify and make a list of FMS disbursements, submit the list to the DFAS Denver Center, and wait for a response from the DFAS Denver Center before disbursing. The process involves additional workload for the disbursing office, and the normal delay is up to several days. With fewer disbursing offices, it may be possible to streamline this process. DFAS Denver Center and the remaining disbursing offices should work collaboratively toward that goal.

## **Recommendations, Management Comments, and Audit Response**

**B. We recommend that the Director, Defense Finance and Accounting Service:**

**1. Review disbursements from the FMS Trust Fund against disbursement authorization levels and total cash available to determine whether disbursements exceeded available cash at the country level. If disbursements exceeded country-level cash deposits, the Defense Finance and Accounting Service should submit a report on administrative control of funds, as required by the DoD Financial Management Regulation, obtain reimbursement, and charge appropriate interest for the amounts due.**

**2. Restrict the number of disbursing stations that are authorized to make disbursements from the Foreign Military Sales Trust Fund.**

**3. Designate the authorized disbursing stations and establish procedures to ensure that those disbursing stations always obtain expenditure authority before making Foreign Military Sales disbursements.**

**Management Comments.** The Deputy Chief Financial Officer concurred with the recommendation to review disbursements and stated that the DFAS Denver Center had reviewed monthly disbursements for the period March 1997 to February 1998. The review showed no instance in which disbursements exceeded a country's available cash deposits. The Deputy Chief Financial Officer nonconcurred with the recommendation to restrict the number of authorized FMS disbursing offices, stating that the number will be reduced during DoD consolidation. The Deputy Chief Financial Officer concurred in part with the recommendation to designate authorized FMS disbursing offices, stating that no new designations will be established for disbursing FMS funds. The Deputy Chief Financial Officer also stated that procedures for expenditure authority will be modified to improve compliance, but did not give details of the modifications.

**Audit Response.** The Deputy Chief Financial Officer's comments were responsive to Recommendation B.1. and partially responsive to Recommendations B.2. and B.3. The Deputy Chief Financial Officer did not agree to limit the number of disbursing offices making FMS disbursements, but indicated that the number would be reduced through consolidation. The Deputy Chief Financial Officer also stated that controls over expenditure authority would be modified to improve compliance, but did not state precisely what actions would be taken. We request that the Deputy Chief Financial Officer provide additional comments, indicating the specific plans for reducing FMS disbursing offices through the DoD consolidation and the action to be taken to modify controls over expenditure authority.



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

### Introduction

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

The Chief Financial Officer, DoD; the Director, DSAA; the Secretaries of the Military Departments; the Directors of the DoD agencies; and the Director, DFAS, are responsible for ensuring compliance with laws and regulations applicable to the FMS Trust Fund. To obtain reasonable assurance as to whether the financial statements were free of material misstatements, we tested compliance with applicable laws and regulations that may directly affect the financial statements, and with other laws and regulations designated by OMB and DoD.

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

**Title 31, U.S.C., section 501, “Chief Financial Officers Act of 1990.”** The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD to prepare agency-wide audited financial statements and submit them to OMB no later than March 1, 1998.

**Title 31, U.S.C., section 3512, “Federal Financial Management Improvement Act of 1996.”** On September 9, 1997, OMB issued a memorandum, “Implementation Guidance for the Federal Financial Management Improvement Act (FFMIA) of 1996.” The FFMIA requires Federal agencies to implement and maintain financial management systems that comply substantially with Federal requirements for financial management systems, applicable Federal accounting standards, and the USGSL at the transaction level. The FFMIA also requires

## Review of Compliance With Laws and Regulations

---

that we report on agency compliance with Federal requirements and accounting standards and the USGSGL. These requirements are well-established in the following Federal policy documents:

- OMB Circular No. A-127, “Financial Management Systems,” July 23, 1993, establishes Government policy for developing, evaluating, and reporting on financial management systems. It requires financial management systems to provide complete, reliable, consistent, timely, and useful information. To achieve this goal, DoD and other Federal agencies must establish and maintain a single, integrated financial management system using the USGSGL.
- OMB Circular No. A-134, “Financial Accounting Principles and Standards,” May 20, 1993, establishes policies and procedures for approving and publishing financial accounting principles and standards. It also establishes the policies that Executive agencies and OMB are to follow in seeking and providing interpretations and other advice related to the standards.
- The Joint Financial Management Improvement Program (JFMIP) is a cooperative undertaking of the OMB, the Department of the Treasury, and the Office of Personnel Management, working with each other and with operating agencies to improve financial management practices throughout the Government. The JFMIP has published a series of “Federal Financial Management System Requirements.”
- The “Core Financial System Requirements,” September 1995, which are part of the JFMIP “Federal Financial Management System Requirements,” establish standard requirements for the foundation modules of an agency’s integrated financial management system. These requirements state that a financial management system must support the partnership between program and financial managers and assure the integrity of information for decisionmaking and measuring performance.

As part of our audit to obtain reasonable assurance about whether the DSAA Financial Statements for FY 1997 were free of material misstatement, we performed tests of their compliance with certain provisions of laws and regulations when noncompliance with these laws and regulations could have a direct and material effect on the determination of amounts in the financial statements. We also tested compliance with other laws and regulations specified in OMB Bulletin No. 93-06, “Audit Requirements for Federal Financial Statements,” January 8, 1993, as modified by OMB Bulletin No. 98-04, “Addendum to OMB Bulletin No. 93-06,” January 16, 1998. In planning and performing our tests of compliance, we considered the implementation guidance issued by OMB on September 9, 1997, relating to the FFMIA.

## **Review of Compliance With Laws and Regulations**

---

For FY 1997, the financial management systems that support the DSAA financial statements were not in substantial compliance with the requirements of the FFMIA. DoD financial management systems comprise multiple finance, accounting, and feeder systems that are the responsibility of DFAS, the Military Departments, and the Defense agencies. DoD financial management systems were unable to produce auditable and timely financial statements for FY 1997 primarily because the accounting and related systems were not designed for financial reporting. The financial condition of DSAA and its operating results for FY 1997 were not verifiable.

**DSAA Material Noncompliances.** Approximately \$14.5 billion of revenues and expenses were not reported in the DSAA and FMS Trust Fund Financial Statements for FY 1997. We previously noted this condition in our audit reports on the DSAA Financial Statements for FYs 1992, 1995, and 1996. In addition, accounts receivable were overstated by \$1.87 billion, and up to \$459 million of inventory was not reported. See Findings C, D, and E for details and recommendations for corrective action.

### **Management Comments on Part I.B. and Audit Response**

**Management Comments.** The Deputy Chief Financial Officer stated that the USD(C) does not share the views expressed in the audit report concerning the accounting treatment of revenues, expenses, accounts receivable, and inventory reporting.

**Audit Response.** The views expressed in this section are based on the Chief Financial Officers Act of 1990, the Federal Financial Management Act of 1994, and OMB accounting standards.

---

## **Finding C. Revenues and Expenses**

The DSAA Financial Statements for FY 1997 did not include approximately \$14.5 billion of FMS revenues and expenses. The DSAA Financial Statements for FY 1997 reported \$560 million of FMS revenues and \$559 million of FMS expenses that were FMS surcharges. The Army, Navy, and Air Force financial statements reported \$2.3 billion of reimbursable revenues and expenses for FMS. No DoD entity reported any portion of the approximately \$12.2 billion of FMS revenues and expenses for goods and services that were obtained from contractors and then sold. The DoD Financial Management Regulation prohibits the reporting of FMS revenues and expenses, except for surcharges, in the financial statements of the FMS Trust Fund. As a result, the DSAA and FMS Trust Fund Financial Statements for FY 1997 understated revenues and expenses by approximately \$14.5 billion. We previously noted this condition in our audit reports on the DSAA Financial Statements for FYs 1992, 1995, and 1996.

### **Federal Reporting Requirements**

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires Federal agencies to prepare financial statements for their operations, revolving funds, trust funds, and commercial activities. OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01, prescribes the format and content for financial statements prepared under the requirements of the Chief Financial Officers Act of 1990. OMB Bulletin No. 94-01 requires that revenues and expenses be reported in the Statement of Operations.

### **Noncompliant DoD Policy**

The DoD Financial Management Regulation, volume 15, prohibits the reporting of revenues and expenses in the financial statements of the FMS Trust Fund. Volume 15, paragraph 030207, states:

The Arms Export Control Act requires that the FMS program be operated at no cost to the U.S. Government. The provisions of the Letter of Offer provide that the USG will execute the Offer and Acceptance on a non-profit basis. Therefore, recognition of an equity balance in the FMS Trust Fund is prohibited. The Foreign Military Sales Trust Fund Financial Statements will not include equity, revenue or expense accounts.

## **Finding C. Revenues and Expenses**

---

The purpose of the prohibition is to ensure that no equity is reported in the financial statements. Without proper accounting and reporting, however, it is impossible to determine whether DoD is complying with the Arms Export Control Act.

### **Financing of Foreign Military Sales**

Foreign military sales are financed by two methods: reimbursable and direct-cite. In reimbursable sales, a DoD Component sells existing DoD stocks or the services of DoD personnel. The DoD appropriation or working capital fund that paid for the goods or services is reimbursed from the country's funds within the FMS Trust Fund. In direct-cite sales, a DoD Component contracts with a private firm to supply the goods or services directly to the foreign customer. DoD disbursing offices pay the contractor's bills by directly citing the FMS Trust Fund.

### **DoD Reporting of Revenues and Expenses**

Revenues and expenses for FMS were reported inconsistently, as follows:

- Revenues and expenses for FMS surcharges were reported in the financial statements of DSAA and the FMS Trust Fund. DoD applied surcharges to the prices of FMS goods and services to cover the costs of administration, contract administration, and transportation. DSAA reported \$560 million of revenues and \$559 million of expenses in the FY 1997 financial statements.
- Revenues and expenses for reimbursable FMS were included, but not separately identified, in the financial statements of the Army, the Navy, and the Air Force. The Military Departments reported a total of \$2.3 billion in reimbursable sales, as follows:

Army	\$ 255 million
Navy	909 million
Air Force	<u>1,170 million</u>
<b>Total</b>	<b>\$2,334 million</b>

- Revenues and expenses were not reported for direct-cite FMS. If reported, direct-cite FMS would have totaled \$12.2 billion in FY 1997.

## **Deputy Chief Financial Officer's Position**

Regarding the DoD policy of prohibiting the accounting and reporting of revenues and expenses, the Deputy Chief Financial Officer stated that direct-cite FMS were not sales, but brokering arrangements in which DoD facilitated sales between a country and a contractor. Therefore, revenues and expenses did not exist because no sales were made. The Deputy Chief Financial Officer also maintained that FMS revenues and expenses for reimbursable transactions should be reported by the DoD Components that made the sales, not in the FMS Trust Fund's financial statements.

## **Sales or Brokering Arrangements**

The position that direct-cite FMS represent brokering arrangements instead of sales is incorrect. In all direct-cite FMS, a DoD Component has a contract to sell goods or services to a foreign country. That DoD Component also has a contract with the producer or supplier to buy the goods or services. The foreign customer is not a party to the contract between the DoD Component and the contractor. The Arms Export Control Act requires foreign customers that make FMS purchases to pay for goods and services in advance of delivery. When the goods or services are delivered, DoD pays the contractor's bill, using funds that the customer previously paid to DoD. Those funds reside in the FMS Trust Fund. These circumstances clearly outline the terms of a sale. If direct-cite FMS were a brokering arrangement, DoD would not be a party to contracts between the country (buyer) and the contractor (seller). Such contracts do not exist for FMS.

## **Reporting by DoD Components**

The Deputy Chief Financial Officer stated that the DoD Components that engage in an activity should report that activity in their financial statements. Therefore, applicable DoD Components reported revenues and expenses related to reimbursable FMS in their financial statements. However, these sales were not reported in the financial statements of the FMS Trust Fund.

## **Recommendation in Prior Audit Report**

In IG, DoD, Audit Report No. 96-187, "Internal Controls and Compliance with Laws and Regulations for the FY 1995 Financial Statements of the Defense Security Assistance Agency," June 28, 1996, we recommended that the USD(C) require that the revenues and expenses of the FMS Trust Fund be recognized in

## **Finding C. Revenues and Expenses**

---

compliance with OMB Bulletin No. 94-01, or obtain a waiver from OMB. The USD(C) partially concurred, stating that a waiver would be requested from OMB; however, the waiver has not been requested.

### **Joint Agreement**

Beginning on January 28, 1998, managers in the Office of the USD(C), the IG, DoD, OMB, and the General Accounting Office met periodically to discuss issues related to the DoD financial statements. Among the topics discussed was the issue of reporting FMS revenues and expenses. The discussions resulted in an agreement on May 14, 1998, by all participants. According to the agreement, DoD will omit revenues and expenses for direct-cite FMS from future financial statements. The omission will be disclosed in a footnote to the DoD consolidated financial statements. The footnote will give an estimate of the amount of FMS revenues and expenses excluded. The agreement also provides that financial statements for DSAA will not be prepared in the future; instead, DSAA financial activity will be included in the DoD Consolidated financial statements. The agreement resolved the issue of reporting FMS revenues and expenses.

### **Summary**

OMB requires revenues and expenses to be reported in the Statement of Operations for all reporting entities that prepare financial statements. The USD(C) had not complied with this requirement in the financial statements of DSAA and the FMS Trust Fund since the statements were first produced in FY 1992. As a result, \$14.5 billion of business activity was not reported in the DSAA and FMS Trust Fund Financial Statements for FY 1997, and \$12.2 billion of this activity was not reported in any DoD Component's FY 1997 financial statements. However, the joint agreement of May 14, 1998, eliminates the requirement for reporting revenues and expenses for direct-cite FMS in future financial statements. Therefore, we are making no recommendations.

### **Management Comments**

The Deputy Chief Financial Officer suggested that the recent agreement, described above, be included in the audit report, and that the matter is closed. We agree.

---

## **Finding D. Accounts Receivable**

Accounts receivable were misclassified in the DSAA Financial Statements for FY 1997 because requests to FMS customers for advance payments were recorded as accounts receivable. The DoD Financial Management Regulation requires that advance billings to FMS customers for payment in advance be recorded as accounts receivable; this practice is not in accordance with Statement of Federal Financial Accounting Standards No. 1 or generally accepted accounting principles. As a result, accounts receivable and total assets were overstated by nearly \$1.9 billion in the DSAA Financial Statements for FY 1997.

### **Accounting Principles for Accounts Receivable**

Under generally accepted accounting principles and Statement of Federal Financial Accounting Standards No. 1, accounts receivable result when a reporting entity provides goods or services to a customer. However, the DoD Financial Management Regulation, volume 15, chapter 5, paragraph 050301, states,

... amounts payable to SAAC for sales of defense articles and services under these terms which require payment in advance of delivery/performance, or within 60 days thereof, will be classified as accounts receivable . . . .

**Arms Export Control Act.** The Arms Export Control Act requires FMS customers to pay in advance of delivery of goods and services. The purpose of this requirement is to insure the U.S. Government against any potential loss from foreign military sales.

### **Classification of Accounts Receivable**

Under the terms of the Arms Export Control Act, accounts receivable do not normally exist for FMS. When goods or services have been provided without advance payment, an arrearage exists. In DoD, arrearages are equivalent to accounts receivable. As of September 30, 1997, the FMS Trust Fund had \$596,000 in accounts receivable. However, the DSAA Financial Statements for FY 1997 reported \$1.87 billion of accounts receivable for the FMS Trust Fund.

We discussed the misclassification of accounts receivable with officials at DFAS, DSAA, and the Office of the USD(C). All parties agreed that requests for advance payments should not be recorded as accounts receivable or

## **Finding D. Accounts Receivable**

---

elsewhere in the general ledger chart of accounts. A USD(C) official proposed that the amount of requests for advance payments be recorded in a footnote to the DSAA financial statements. We agree with that proposal.

### **Recommendation, Management Comments and Audit Response**

**Revised Recommendation.** After discussions with management, we revised the text of Recommendation D. to clarify a misunderstanding. Recommendation D. of the draft report recommended that the DoD Financial Management Regulation be revised to state that accounts receivable arise when an entity provides goods or services to a customer, although the entity has not received advance payment. Although that wording is accurate, we revised the recommendation to state the specific change that should be made to the DoD Financial Management Regulation.

**D. We recommend that the Under Secretary of Defense (Comptroller) revise applicable sections of the DoD Financial Management Regulation to delete the requirement to record requests for advance payment as accounts receivable.**

**Management Comments.** The Deputy Chief Financial Officer nonconcurred with the draft report recommendation, stating that the Statement of Federal Financial Accounting Standards No. 1 provided for the recognition of accounts receivable based on legal provisions, and that an FMS case was a binding agreement that required advance payments.

**Audit Response.** The Deputy Chief Financial Officer's comments to the draft report recommendation were nonresponsive. Statement of Federal Financial Accounting Standards No. 1 gives an example of taxes due. This example implies that the Government has provided services, earning the right to collect the taxes owed. Statement of Federal Financial Accounting Standards No. 1 does not suggest that accounts receivable could arise without the billing party having earned the payment. We agree that advance payments are required by FMS case agreements; however, that requirement does not affect the accounting treatment of accounts receivable. We request that the Deputy Chief Financial Officer provide additional comments on the revised recommendation.

---

## **Finding E. Reporting of Inventory**

The DSAA Financial Statements for FY 1997 did not report up to \$459 million of inventory that was purchased with funds from the FMS Trust Fund. The DoD Financial Management Regulation did not require the Military Departments to report to DFAS the amount of inventory that was purchased with FMS funds under Cooperative Logistics Supply Support Arrangements (CLSSA). As a result, the DSAA Financial Statements for FY 1997 understated inventory and total assets by the amount of inventory purchased with FMS Trust Funds for sale to FMS customers.

### **Regulatory Requirements**

OMB Bulletin No. 94-01, as modified by OMB Bulletin No. 97-01, requires departments and agencies that prepare financial statements under the Chief Financial Officers Act of 1990 to report the value of inventory in the Statement of Financial Position.

### **Cooperative Logistics Supply Support Arrangements**

Normally, FMS customers cannot buy spare parts off-the-shelf from U.S. inventories, unless the items ordered are excess to DoD requirements. This policy prevents DoD stocks from being depleted, which could adversely affect U.S. readiness. Therefore, the FMS customer must wait while the order is contracted for and produced. DoD allows FMS customers to invest in U.S. inventories of spare parts so those customers can make off-the-shelf purchases from U.S. stocks. These FMS cases are called CLSSA.

In a CLSSA case, the FMS customer makes a payment that will be used to stock designated spare parts in advance of the customer's need. After allowing for procurement lead time (usually 17 months), the customer may order items and receive immediate shipment from DoD stocks. The customer pays for the items supplied, and those funds are used to replenish the DoD inventory. As of September 30, 1997, DSAA had transferred \$459 million of CLSSA case funds to the Army, the Navy, and the Air Force to buy inventory for CLSSA customers. At any time, the amount of CLSSA inventory is not the exact amount that has been provided to the Military Departments, because a portion of that amount is not on hand but is due from procurement.

## **Finding E. Reporting of Inventory**

---

### **Accounting and Reporting Practices**

Footnote No. 1.K. to the DSAA Financial Statements for FY 1997 states that the FMS Trust Fund has no inventory. We disagree with this statement; inventories were purchased with funds from the FMS Trust Fund for subsequent sale to FMS customers.

The DoD Financial Management Regulation does not require the Military Departments to identify the items and quantities of inventories purchased for CLSSA customers or to report those inventories to the DFAS Denver Center for inclusion in the DSAA financial statements.

We could not determine the exact amount of CLSSA inventory because, at any time, some of the \$459 million exists as inventory and the remainder is due from procurement.

### **Summary**

DoD maintains inventory for FMS customers under the CLSSA program. This inventory was purchased with funds provided to the Military Departments by the FMS Trust Fund. The Military Departments should account for CLSSA inventory and should report the year-end balances to the DFAS Denver Center for the DSAA financial statements. Otherwise, inventory and total assets will continue to be materially understated in the DSAA financial statements.

### **Recommendations, Management Comments, and Audit Response**

**E.1. We recommend that the Under Secretary of Defense (Comptroller) revise the DoD Financial Management Regulation to require the Military Departments, beginning in FY 1998, to:**

**a. Account for inventory purchased with funds from Cooperative Logistics Supply Support Arrangements.**

**b. Report annually (as of September 30) to the Defense Finance and Accounting Service Denver Center the value of on-hand inventory from Cooperative Logistics Supply Support Arrangements.**

## **Finding E. Reporting of Inventory**

---

**E.2. We recommend that the Director, Defense Finance and Accounting Service Denver Center, designate and direct staff officials to work with the Military Departments to establish reporting procedures for all inventory from Cooperative Logistics Supply Support Arrangements.**

**Management Comments.** The Deputy Chief Financial Officer nonconcurred with the recommendations, stating that FMS customers do not own any inventory, but have the right to order items. The Deputy Chief Financial Officer stated that the Military Departments should recognize the inflow of cash as a deferred credit.

**Audit Response.** The Deputy Chief Financial Officer's comments were partially responsive. Although the Deputy Chief Financial Officer nonconcurred with Recommendations E.1.a., E.1.b., and E.2., the suggestion that the Military Departments recognize the inflow of cash as a deferred credit is an acceptable alternative. However, the Deputy Chief Financial Officer did not outline a plan for implementing the suggested action. We request that the Deputy Chief Financial Officer provide additional details on how the Military Departments will recognize the inflow of cash from CLSSA customers as a deferred credit in the liabilities section of the Statement of Financial Position.



## **Part II. - Additional Information**



---

## Appendix A. Audit Process

### Scope

**Statements Reviewed.** We examined the financial statements of the FMS Trust Fund as of September 30, 1997. We did not examine the statements of the Loan Liquidating Account, the Loan Financing Account, the Special Defense Acquisition Fund, the Assistance for Relocation of Facilities in Israel Account, the Foreign Military Financing Grant Program, the International Military Education and Training Program, the Military-to-Military Contact Program Account, and the Unanticipated Needs for Defense of Israel Against Terrorism Account because available audit resources could not accommodate audits of those accounts. The DSAA Statement of Financial Position for FY 1997 reported assets of \$27.9 billion, of which \$15.5 billion was for the FMS Trust Fund. DSAA administers security assistance for the Secretary of Defense and is primarily responsible for policy and oversight. The Military Departments implement and execute the FMS program. The DFAS Denver Center provides centralized accounting services for DSAA. We examined the Statement of Financial Position and the Statement of Operations and Changes in Net Position that were submitted to us on March 13, 1998. Our audit efforts provide a reasonable basis for our results.

**Scope Limitations.** The following circumstances limited our review of the general ledger accounts.

- Revenues and expenses for FMS were not accounted for and reported.
- We were unable to validate the reasonableness of \$15.1 billion of disbursements made from October 1996 to July 1997 because adequate audit trails had not been established and documented for Air Force and Navy disbursements.
- Inventory purchased with funds from the FMS Trust Fund was not accounted for and reported.

**DoD Functional Area Reform Goals.** In response to Public Law 103-62, the "Government Performance and Results Act of 1993," August 3, 1993, most major DoD functional areas have established performance improvement reform objectives and goals. This report pertains to the achievement of the following objectives and goals for DoD functional areas.

**Financial Management Functional Area. Objective:** Reengineer DoD business practices. **Goal:** Standardize, reduce, clarify, and reissue financial management policies. (FM-4.1)

## Appendix A. Audit Process

---

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

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

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

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

## Appendix A. Audit Process

---

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

**Review of Internal Controls.** An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements, including the accompanying notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statements. We evaluated the internal controls of DSAA and the DFAS Denver Center related to the FMS Trust Fund. We reviewed the Statement of Financial Position, the Statement of Operations and Changes in Net Position, and related general ledger account balances for the FMS Trust Fund as of September 30, 1997. We verified or attempted to verify balances to subsidiary records and supporting source documentation generated by the accounting system. The DFAS Denver Center maintained the Defense Integrated Financial System (DIFS), which produced the general ledger accounts for the FMS Trust Fund.

**Review of Compliance With Laws and Regulations.** Compliance with laws and regulations is the responsibility of DoD managers. To obtain reasonable assurance that the DSAA financial statements were free of material misstatements, we performed tests of compliance with applicable laws and regulations. See Appendix E for a list of the laws and regulations we reviewed.

## Methodology

**Auditing Standards.** We conducted this financial statement audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, and OMB Bulletin No. 93-06. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. We relied on the guidelines suggested by the GAO and our professional judgment in assessing the materiality of matters affecting the fair presentation of the financial statements and related internal control weaknesses.

**Computer-Processed Data.** Based on management's representation and our audit work, we concluded that the computer-processed data were not completely reliable.

**Audit Period and Locations.** The audit was conducted from April 1997 through March 1998 at various DFAS offices that process and report financial data on the FMS Trust Fund.

**Representation Letters.** We received legal and management representation letters from DSAA. The management representation letter did not attest to the accuracy or completeness of the financial data. See Appendix D for the legal and management representation letters.

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



---

## Appendix B. Prior Audit Reports

During the last 5 years, the IG, DoD, has issued six audit reports on the DSAA financial statements. The reported conditions, recommendations, and management comments are summarized below.

**IG, DoD, Report No. 97-171, “Internal Controls and Compliance With Laws and Regulations for the FY 1996 Financial Statements of the Defense Security Assistance Agency,” June 19, 1997.** We disclaimed an opinion on the FY 1996 Financial Statements of DSAA because significant deficiencies still existed, as identified in our audit of the FY 1995 Financial Statements of DSAA. As a result of deficiencies in the accounting systems and control procedures, DSAA management did not have reasonable assurance that the financial statements were reliable. Specifically, the FMS Trust Fund Statement of Operations and Changes in Financial Position, as of September 30, 1996, showed zero balances for all revenue and expense accounts. Also, audit trails were not easily accessible to allow the review of disbursements and accounts payable. The report made no recommendations because the issues remained unresolved.

**IG, DoD, Report No. 96-187, “Internal Controls and Compliance With Laws and Regulations for the FY 1995 Financial Statements of the Defense Security Assistance Agency,” June 28, 1996.** We disclaimed an opinion on the FY 1995 Financial Statements of DSAA because DSAA did not ensure that the DFAS Denver Center had established adequate audit trails from account balances to the underlying transactions used to support the FY 1995 Statement of Financial Position for the FMS Trust Fund. Additionally, DoD policy did not allow the DFAS Denver Center to account for revenues and expenses in the financial statements of the FMS Trust Fund. As a result, those financial statements were not in compliance with OMB Bulletin No. 94-01. Within DSAA and the DFAS Denver Center, internal controls for the FMS Trust Fund needed improvement because they did not provide reasonable assurance that material misstatements would be prevented or detected in a timely manner. The report made recommendations on revenues and expenses, attrition surcharges, audit trails, undistributed disbursements, accounts payable, unearned revenue, and accounts receivable.

- **Revenue and Expenses.** We recommended that the USD(C) and the Chief Financial Officer revise the DoD Financial Management Regulation, volume 15, “Security Assistance Policy and Procedures,” March 1993, to require the recognition of the FMS Trust Fund revenues and expenses. The USD(C) agreed to obtain a waiver from compliance with OMB Bulletin No. 94-01; however, the USD(C) did not request the waiver until March 31, 1998.

## Appendix B. Prior Audit Reports

---

- **Attrition Surcharge.** We recommended that the USD(C) revise regulations to require the recognition and reporting of the U.S. Government equity in the attrition surcharge fund. DSAA has begun to recognize U.S. Government equity in the attrition surcharge fund in its financial statements, but the regulations have not been revised. We recommended that DSAA analyze and adjust the surcharge rate and also redistribute the account balances annually. DSAA has begun analyzing and monitoring the surcharge account balances and annually reviews the rates to recommend rate adjustments or redistribution of the account balance.
- **Audit Trails.** We recommended that the DFAS Denver Center establish accessible audit trails from the account balances to underlying transactions used to support the FY 1995 Statement of Financial Position for the FMS Trust Fund. Specifically, we recommended that the DFAS Denver Center modify DIFS to include the disbursement number and date. The DFAS Denver Center submitted a system change request to include the disbursement number and date.
- **Undistributed Disbursements.** We recommended that the DFAS Denver Center establish management controls to identify the agencies that are causing undistributed disbursements and to ensure that disbursing stations identify a valid FMS country, case, or surcharge account before processing disbursements from the FMS Trust Fund. We also recommended that DSAA implement a plan to resolve the issue of undistributed disbursements. Headquarters, DFAS, issued guidance to disbursing stations, requiring monthly reconciliations, requests for expenditure authority, and identification of the FMS country and case when making FMS Trust Fund disbursements. However, the new guidance has not solved the problem of undistributed disbursements. DSAA is continuing to review its procedures in an effort to minimize undistributed disbursements, but has not yet implemented a plan to resolve the issue of undistributed disbursements.
- **Accounts Payable.** We recommended that the Navy report its FMS accounts payable to the DFAS Denver Center for inclusion in the DSAA financial statements. The Navy reported FMS accounts payable in the FY 1997 financial statements. We also recommended that DFAS maintain a subsidiary ledger for accounts payable to allow the identification and testing of audit trails and the reconciliation of accounts payable balances before preparing the DSAA trial balance. DFAS has begun recording accounts payable in a subsidiary ledger and performing reconciliations before preparing the trial balance. The adequacy of the new procedures will be addressed in subsequent financial statement audits. We also recommended the aging of

accounts payable. The DoD Financial Management Regulation is being revised to require implementing agencies to maintain a list of aged accounts payable. We recommended that at the end of each month, the DFAS Denver Center accrue the anticipated expenses attributable to accounts payable. In September 1996, the DFAS Denver Center began accruing the anticipated expenses attributed to accounts payable. A draft revision to the DoD Financial Management Regulation has been prepared and should be published in July 1998.

- **Unearned Revenue.** We recommended that subsidiary ledgers be maintained and reconciled monthly for unearned revenue - advances. The DFAS Denver Center has begun maintaining and reconciling subsidiary ledgers monthly.
- **Accounts Receivable.** We recommended that the DFAS Denver Center review accounts receivable transactions to ensure that overcollections from customers are reported as a liability for the FMS Trust Fund on the general ledger. The DFAS Denver Center has begun reporting overcollections as a liability. We recommended the aging of accounts receivable. The DoD Financial Management Regulation is being revised to clarify the criteria for aging.

**IG, DoD, Report No. 93-123, "Consolidating Financial Statements of the Foreign Military Sales Trust Fund - FY 1992," June 24, 1993.** We rendered an adverse opinion on the financial statements because the statements did not account for the revenues, expenses, or net position of the FMS Trust Fund. Those account balances were reported at zero, although DoD disbursed \$12.4 billion on behalf of foreign customers for goods and services sold in FY 1992. In addition, Army and Navy accounts payable of the FMS Trust Fund were not reported; only the amounts reported by the Air Force were included. Material internal control weaknesses, as defined by OMB Bulletin No. 93-06, existed. No official or organization exercised overall management of the FMS Trust Fund's day-to-day operations. Although DSAA was responsible for overall program policy and direction and was designated as the fund manager, it did not have the authority to exercise its responsibilities.



## **Appendix C. Financial Statements and Audit Opinion**



***DEFENSE SECURITY  
ASSISTANCE AGENCY***

***PART II***

***PRINCIPAL STATEMENTS***

***AND***

***RELATED NOTES***

## Overview

---

***DEFENSE SECURITY  
ASSISTANCE AGENCY***

***PART II***

***A.***

***PRINCIPAL STATEMENTS***

## Overview

---

# Principal Statements

**Department of Defense**  
**Defense Security Assistance Agency - (Combined)**  
**Statement of Financial Position**  
**As of September 30, 1997**  
**(Thousands)**

ASSETS	<u>1997</u>	<u>1996</u>
<b>1. Entity Assets:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$2,714,792	\$2,432,725
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	21,465	34,001
(4) Interest Receivable	0	0
(5) Advances and Prepayments	0	0
(6) Other Federal (Intragovernmental) (Note 6)	1,561,769	1,628,851
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	0
(2) Accounts Receivable, Net (Note 5)	5	667,268
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	7,426,464	7,982,943
(4) Interest Receivable, Net	747,684	0
(5) Advances and Prepayments	0	135
(6) Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	10,179	50,384
e. Work in Process (Note 9)	0	0
f. Operating Materials/Supplies, Net (Note 10)	0	0
g. Stockpile Materials, Net (Note 11)	0	0
h. Seized Property (Note 12)	0	0
i. Forfeited Property, Net (Note 13)	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0
k. Property, Plant and Equipment, Net (Note 15)	0	0
l. War Reserves	0	0
m. Other Entity Assets	0	0
<b>n. Total Entity Assets</b>	<b>\$12,482,358</b>	<b>\$12,796,307</b>
<b>2. Non-Entity Assets:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$5,869,310	\$5,886,631
(2) Accounts Receivable, Net (Note 5)	0	0
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	0	0

---

The accompanying notes are an integral part of these statements.

# Principal Statements

**Department of Defense**  
**Defense Security Assistance Agency - (Combined)**  
**Statement of Financial Position**  
**As of September 30, 1997**  
**(Thousands)**

<b>ASSETS, Continued</b>	<u><b>1997</b></u>	<u><b>1996</b></u>
<b>2. Non-Entity Assets:</b>		
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	\$1,870,041	\$4,482,308
(2) Interest Receivable, Net	0	0
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	7,694,679	8,605,325
d. Other Non-Entity Assets	0	0
e. <b>Total Non-Entity Assets</b>	<u>\$15,434,030</u>	<u>\$18,974,264</u>
<b>3. Total Assets</b>	<u><u>\$27,916,388</u></u>	<u><u>\$31,770,571</u></u>
<b>LIABILITIES</b>		
<b>4. Liabilities Covered by Budgetary Resources:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	\$146,412	\$40,669
(2) Interest Payable	48,171	0
(3) Debt (Note 16)	4,459,020	4,380,977
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	1,764,262	1,864,117
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	1,508,190	1,050,156
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	0	0
(b) Annual Accrued Leave	0	0
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	0	0
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	17,067,205	21,787,703
c. <b>Total Liabilities Covered by Budgetary Resources:</b>	<u>\$24,993,260</u>	<u>\$29,123,622</u>

---

The accompanying notes are an integral part of these statements.

# Principal Statements

**Department of Defense  
 Defense Security Assistance Agency - (Combined)  
 Statement of Financial Position  
 As of September 30, 1997  
 (Thousands)**

**LIABILITIES, Continued**

	<u>1997</u>	<u>1996</u>
<b>5. Liabilities Not Covered by Budgetary Resources:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	\$0	\$0
(2) Debt (Note 16)	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. <b>Total Liabilities Not Covered by Budgetary Resources</b>	<b>\$0</b>	<b>\$0</b>
<b>6. Total Liabilities</b>	<b>\$24,993,260</b>	<b>\$29,123,622</b>
<b>NET POSITION (Note 20)</b>		
<b>7. Balances:</b>		
a. Unexpended Appropriations	\$2,142,640	\$1,807,872
b. Invested Capital	110,764	811,052
c. Cumulative Results of Operations	669,724	28,025
d. Other	0	0
e. Future Funding Requirements	0	0
f. <b>Total Net Position</b>	<b>\$2,923,128</b>	<b>\$2,646,949</b>
<b>8. Total Liabilities and Net Position</b>	<b>\$27,916,388</b>	<b>\$31,770,571</b>

---

The accompanying notes are an integral part of these statements.

# Principal Statements

**Department of Defense  
Defense Security Assistance Agency - (Combined)  
Statement of Operations and Changes in Net Position  
For the Period Ended September 30, 1997  
(Thousands)**

	<u>1997</u>	<u>1996</u>
<b>REVENUES AND FINANCING SOURCES</b>		
1. Appropriated Capital Used	\$3,115,628	\$3,076,657
2. Revenues from Sales of Goods and Services		
a. To the Public	1,129,574	352,072
b. Intragovernmental	0	0
3. Interest and Penalties, Non-Federal	617,428	653,410
4. Interest, Federal	25,140	28,545
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	607,926	594,032
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	(864,641)	(905,164)
8. <b>Total Revenues and Financing Sources</b>	<u>\$4,631,055</u>	<u>\$3,799,552</u>
<b>EXPENSES</b>		
9. Program or Operating Expenses (Note 23)	\$3,670,502	\$3,087,760
10. Cost of Goods Sold (Note 24)		
a. To the Public	518,998	297,530
b. Intragovernmental	0	0
11. Depreciation and Amortization	0	0
12. Bad Debts and Writeoffs	3,806	26,922
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	373,364	370,418
b. Federal Securities	0	0
c. Other	0	0
14. Other Expenses (Note 25)	12,360	0
15. <b>Total Expenses</b>	<u>\$4,579,030</u>	<u>\$3,782,630</u>
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	\$52,025	\$16,922
17. Plus (Minus) Extraordinary Items (Note 26)	<u>0</u>	<u>0</u>
18. <b>Excess (Shortage) of Revenues and     Financing Sources Over Total Expenses</b>	<u>\$52,025</u>	<u>\$16,922</u>

The accompanying notes are an integral part of these statements.

# Principal Statements

---

**Department of Defense  
Defense Security Assistance Agency - (Combined)  
Statement of Operations and Changes in Net Position  
For the Period Ended September 30, 1997  
(Thousands)**

	<u>1997</u>	<u>1996</u>
<b>EXPENSES, Continued</b>		
19. Net Position, Beginning Balance, as Previously Stated	\$2,646,949	\$2,599,591
20. Adjustments (Note 27)	48,460	(12,928)
21. Net Position, Beginning Balance, as Restated	<u>\$2,695,409</u>	<u>\$2,586,663</u>
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	52,025	16,922
23. Plus (Minus) Non Operating Changes (Note 28)	<u>175,694</u>	<u>43,364</u>
24. Net Position, Ending Balance	<u><u>\$2,923,128</u></u>	<u><u>\$2,646,949</u></u>

---

The accompanying notes are an integral part of these statements.

# Principal Statements

---

**Department of Defense**

**Defense Security Assistance Agency - (11X4116, 11X4121, 11X4122, 11X4174 - Combined)**

**Statement of Cash Flows - (Indirect)**

**For the Period Ended September 30, 1997**

**(Thousands)**

	<u>1997</u>	<u>1996</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>\$50,431</u>	<u>\$16,517</u>
Adjustments Affecting Cash Flow:		
2. Appropriated Capital Used	(119,896)	(115,677)
3. Decrease (Increase) in Accounts Receivable	(396,837)	(550,542)
4. Decrease (Increase) in Other Assets	868,957	748,544
5. Increase (Decrease) in Accounts Payable	17,395	(18,062)
6. Increase (Decrease) in Other Liabilities	(561,215)	(273,867)
7. Depreciation and Amortization	0	0
8. Other Unfunded Expenses	0	0
9. Other Adjustments	14	(12,927)
10. Total Adjustments	<u>(\$191,582)</u>	<u>(\$222,531)</u>
11. Net Cash Provided (Used) by Operating Activities	<u>(\$141,151)</u>	<u>(\$206,014)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
12. Sale of Property, Plant and Equipment	\$0	\$0
13. Purchase of Property, Plant and Equipment	0	0
14. Sale of Securities	0	0
15. Purchase of Securities	0	0
16. Collection of Loans Receivable	(31,734)	0
17. Creation of Loans Receivable	48,234	0
18. Other Investing Cash Provided (Used)	<u>0</u>	<u>0</u>
19. Net Cash Provided (Used) by Investing Activities	<u>\$16,500</u>	<u>\$0</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
20. Appropriations (Current Warrants)	\$100,848	\$87,977
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	0	0
22. Deduct:		
a. Withdrawals	175,215	329,177
b. Transfers of Cash to Others	<u>1,783</u>	<u>5,000</u>
23. Net Appropriations	<u>(\$76,150)</u>	<u>(\$246,200)</u>

---

**The accompanying notes are an integral part of these statements.**

## Principal Statements

**Department of Defense**

**Defense Security Assistance Agency - (11X4116, 11X4121, 11X4122, 11X4174 - Combined)**

**Statement of Cash Flows - (Indirect)**

**For the Period Ended September 30, 1997**

**(Thousands)**

	<u>1997</u>	<u>1996</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES, Continued</b>		
24. Borrowing from the Public	\$0	\$0
25. Repayments on Loans to the Public	0	0
26. Borrowing from the Treasury and the Federal Financing Bank	328,255	350,879
27. Repayments on Loans from the Treasury and the Federal Financing Bank	(250,213)	(251,257)
28. Other Borrowings and Repayments	20,831	0
29. Net Cash Provided (Used) by Financing Activities	\$22,723	(\$146,578)
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	(\$101,928)	(\$352,592)
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	612,685	965,277
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	\$510,757	\$612,685
 <b>Supplemental Disclosure of Cash Flow Information:</b>		
	<u>1997</u>	<u>1996</u>
33. Total Interest Paid	\$373,364	\$370,418
 <b>Supplemental Schedule of Financing and Investing Activity:</b>		
	<u>1997</u>	<u>1996</u>
34. Property and Equipment Acquired Under Capital Lease Obligations	\$0	\$0
35. Property Acquired Under Long-Term Financing Arrangements	\$0	\$0
36. Other Exchanges of Non-cash Assets or Liabilities	\$0	\$0

---

**The accompanying notes are an integral part of these statements.**

# Principal Statements

---

---

**The accompanying notes are an integral part of these statements.**

# Principal Statements

**Department of Defense**  
**Defense Security Assistance Agency - (11X1081, 11X1082, 11X1084, 11X1088, 11X1089 - Combined)**  
**Statement of Financial Position**  
**As of September 30, 1997**  
**(Thousands)**

ASSETS	<u>1997</u>	<u>1996</u>
<b>1. Entity Assets:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$2,154,123	\$1,820,040
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	0	0
(4) Interest Receivable	0	0
(5) Advances and Prepayments	0	0
(6) Other Federal (Intragovernmental) (Note 6)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	0
(2) Accounts Receivable, Net (Note 5)	5	20
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0	0
(4) Interest Receivable, Net	0	0
(5) Advances and Prepayments	0	135
(6) Other Non-Federal (Governmental) (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	0	0
e. Work in Process (Note 9)	0	0
f. Operating Materials/Supplies, Net (Note 10)	0	0
g. Stockpile Materials, Net (Note 11)	0	0
h. Seized Property (Note 12)	0	0
i. Forfeited Property, Net (Note 13)	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0
k. Property, Plant and Equipment, Net (Note 15)	0	0
l. War Reserves	0	0
m. Other Entity Assets	0	0
<b>n. Total Entity Assets</b>	<u>\$2,154,128</u>	<u>\$1,820,195</u>
<b>2. Non-Entity Assets:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	\$463	\$55
(2) Accounts Receivable, Net (Note 5)	0	0
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	0	0

---

The accompanying notes are an integral part of these statements.

# Principal Statements

---

## Department of Defense

Defense Security Assistance Agency - (11X1081, 11X1082, 11X1084, 11X1088, 11X1089 - Combined)

### Statement of Financial Position

As of September 30, 1997

(Thousands)

#### ASSETS, Continued

	<u>1997</u>	<u>1996</u>
<b>2. Non-Entity Assets:</b>		
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	\$0	\$0
(2) Interest Receivable, Net	0	0
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Other Non-Entity Assets	0	0
e. Total Non-Entity Assets	<u>\$463</u>	<u>\$55</u>
<b>3. Total Assets</b>	<u><u>\$2,154,591</u></u>	<u><u>\$1,820,250</u></u>

#### LIABILITIES

#### 4. Liabilities Covered by Budgetary Resources:

a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	\$0	\$0
(2) Interest Payable	0	0
(3) Debt (Note 16)	0	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	11,841	12,037
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	0	0
(b) Annual Accrued Leave	0	0
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	0	0
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. Total Liabilities Covered by Budgetary Resources:	<u>\$11,841</u>	<u>\$12,037</u>

---

The accompanying notes are an integral part of these statements.

# Principal Statements

**Department of Defense**

**Defense Security Assistance Agency - (11X1081, 11X1082, 11X1084, 11X1088, 11X1089 - Combined)**

**Statement of Financial Position**

**As of September 30, 1997**

**(Thousands)**

**LIABILITIES, Continued**

	<u>1997</u>	<u>1996</u>
<b>5. Liabilities Not Covered by Budgetary Resources:</b>		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	\$0	\$0
(2) Debt (Note 16)	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. Total Liabilities Not Covered by Budgetary Resources	\$0	\$0
<b>6. Total Liabilities</b>	<b>\$11,841</b>	<b>\$12,037</b>
<b>NET POSITION (Note 20)</b>		
<b>7. Balances:</b>		
a. Unexpended Appropriations	\$2,142,622	\$1,807,808
b. Invested Capital	0	0
c. Cumulative Results of Operations	128	405
d. Other	0	0
e. Future Funding Requirements	0	0
f. Total Net Position	\$2,142,750	\$1,808,213
<b>8. Total Liabilities and Net Position</b>	<b>\$2,154,591</b>	<b>\$1,820,250</b>

---

The accompanying notes are an integral part of these statements.

# Principal Statements

## Department of Defense

Defense Security Assistance Agency - (11X1081, 11X1082, 11X1084, 11X1088, 11X1089 - Combined)

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

	<u>1997</u>	<u>1996</u>
<b>REVENUES AND FINANCING SOURCES</b>		
1. Appropriated Capital Used	\$2,995,732	\$3,028,378
2. Revenues from Sales of Goods and Services		
a. To the Public	0	0
b. Intragovernmental	0	0
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	128	405
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0	0
<b>8. Total Revenues and Financing Sources</b>	<u>\$2,995,860</u>	<u>\$3,028,783</u>
<b>EXPENSES</b>		
9. Program or Operating Expenses (Note 23)	\$2,995,732	\$3,028,378
10. Cost of Goods Sold (Note 24)		
a. To the Public	0	0
b. Intragovernmental	0	0
11. Depreciation and Amortization	0	0
12. Bad Debts and Writeoffs	0	0
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	0	0
14. Other Expenses (Note 25)	0	0
<b>15. Total Expenses</b>	<u>\$2,995,732</u>	<u>\$3,028,378</u>
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	\$128	\$405
17. Plus (Minus) Extraordinary Items (Note 26)	<u>0</u>	<u>0</u>
<b>18. Excess (Shortage) of Revenues and     Financing Sources Over Total Expenses</b>	<u>\$128</u>	<u>\$405</u>

The accompanying notes are an integral part of these statements.

## Principal Statements

---

### Department of Defense

Defense Security Assistance Agency - (11X1081, 11X1082, 11X1084, 11X1088, 11X1089 - Combined)

Statement of Operations and Changes in Net Position

For the Period Ended September 30, 1997

(Thousands)

	<u>1997</u>	<u>1996</u>
<b>EXPENSES, Continued</b>		
19. Net Position, Beginning Balance, as Previously Stated	\$1,808,213	\$1,458,862
20. Adjustments (Note 27)	<u>0</u>	<u>0</u>
21. Net Position, Beginning Balance, as Restated	\$1,808,213	\$1,458,862
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	128	405
23. Plus (Minus) Non Operating Changes (Note 28)	<u>334,409</u>	<u>348,946</u>
24. Net Position, Ending Balance	<u>\$2,142,750</u>	<u>\$1,808,213</u>

---

The accompanying notes are an integral part of these statements.



# Principal Statements

**Department of Defense**  
**Defense Assistance Security Agency - Eliminations**  
**Statement of Financial Position**  
**As of September 30, 1997**  
**(Thousands)**

**ASSETS**

1997

**1. Entity Assets:**

a. Transactions with Federal (Intragovernmental) Entities:	
(1) Fund Balance with Treasury (Note 2)	\$0
(2) Investments, Net (Note 4)	0
(3) Accounts Receivable, Net (Note 5)	0
(4) Interest Receivable	0
(5) Advances and Prepayments	0
(6) Other Federal (Intragovernmental) (Note 6)	0
b. Transactions with Non-Federal (Governmental) Entities:	
(1) Investments (Note 4)	0
(2) Accounts Receivable, Net (Note 5)	0
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)	0
(4) Interest Receivable, Net	0
(5) Advances and Prepayments	0
(6) Other Non-Federal (Governmental) (Note 6)	0
c. Cash and Other Monetary Assets (Note 3)	0
d. Inventory, Net (Note 8)	0
e. Work in Process (Note 9)	0
f. Operating Materials/Supplies, Net (Note 10)	0
g. Stockpile Materials, Net (Note 11)	0
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)	0
l. War Reserves	0
m. Other Entity Assets	0
n. Total Entity Assets	<u>\$0</u>

**2. Non-Entity Assets:**

a. Transactions with Federal (Intragovernmental) Entities:	
(1) Fund Balance with Treasury (Note 2)	\$0
(2) Accounts Receivable, Net (Note 5)	0
(3) Interest Receivable, Net	0
(4) Other (Note 6)	0

---

The accompanying notes are an integral part of these statements.

# Principal Statements

---

**Department of Defense**  
**Defense Assistance Security Agency - Eliminations**  
**Statement of Financial Position**  
**As of September 30, 1997**  
**(Thousands)**

**ASSETS, Continued**

1997

**2. Non-Entity Assets:**

**b. Transactions with Non-Federal (Governmental) Entities:**

(1) Accounts Receivable, Net (Note 5)	\$0
(2) Interest Receivable, Net	0
(3) Other (Note 6)	0

**c. Cash and Other Monetary Assets (Note 3)**

0

**d. Other Non-Entity Assets**

0

**e. Total Non-Entity Assets**

0

**3. Total Assets**

0

**LIABILITIES**

**4. Liabilities Covered by Budgetary Resources:**

**a. Transactions with Federal (Intragovernmental) Entities:**

(1) Accounts Payable	\$0
(2) Interest Payable	0
(3) Debt (Note 16)	0
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	0

**b. Transactions with Non-Federal (Governmental) Entities:**

(1) Accounts Payable	0
(2) Accrued Payroll and Benefits	
(a) Salaries and Wages	0
(b) Annual Accrued Leave	0
(c) Severance Pay and Separation Allowance	0
(3) Interest Payable	0
(4) Liabilities for Loan Guarantees (Note 7)	0
(5) Lease Liabilities (Note 18)	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	0

**c. Total Liabilities Covered by Budgetary Resources:**

0

---

The accompanying notes are an integral part of these statements.

Department of Defense  
 Defense Assistance Security Agency - Eliminations  
 Statement of Financial Position  
 As of September 30, 1997  
 (Thousands)

## LIABILITIES, Continued

1997**5. Liabilities Not Covered by Budgetary Resources:**

a. Transactions with Federal (Intragovernmental) Entities:	
(1) Accounts Payable	\$0
(2) Debt (Note 16)	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	0
b. Transactions with Non-Federal (Governmental) Entities:	
(1) Accounts Payable	0
(2) Debt (Note 16)	0
(3) Lease Liabilities (Note 18)	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0
c. Total Liabilities Not Covered by Budgetary Resources	<u>\$0</u>

<b>6. Total Liabilities</b>	<u>\$0</u>
-----------------------------	------------

## NET POSITION (Note 20)

**7. Balances:**

a. Unexpended Appropriations	\$0
b. Invested Capital	0
c. Cumulative Results of Operations	0
d. Other	0
e. Future Funding Requirements	0
f. Total Net Position	<u>\$0</u>

<b>8. Total Liabilities and Net Position</b>	<u>\$0</u>
--	------------

---

The accompanying notes are an integral part of these statements.

# Principal Statements

---

**Department of Defense  
Defense Assistance Security Agency - Eliminations  
Statement of Operations and Changes in Net Position  
For the Period Ended September 30, 1997  
(Thousands)**

1997

**REVENUES AND FINANCING SOURCES**

1. Appropriated Capital Used	\$0
2. Revenues from Sales of Goods and Services	
a. To the Public	0
b. Intragovernmental	0
3. Interest and Penalties, Non-Federal	0
4. Interest, Federal	0
5. Taxes (Note 21)	0
6. Other Revenues and Financing Sources (Note 22)	0
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0
8. Total Revenues and Financing Sources	<u>\$0</u>

**EXPENSES**

9. Program or Operating Expenses (Note 23)	\$0
10. Cost of Goods Sold (Note 24)	
a. To the Public	0
b. Intragovernmental	0
11. Depreciation and Amortization	0
12. Bad Debts and Writeoffs	0
13. Interest	
a. Federal Financing Bank/Treasury Borrowing	0
b. Federal Securities	0
c. Other	0
14. Other Expenses (Note 25)	0
15. Total Expenses	<u>\$0</u>
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	\$0
17. Plus (Minus) Extraordinary Items (Note 26)	0
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>\$0</u>

---

The accompanying notes are an integral part of these statements.

---

Department of Defense  
Defense Assistance Security Agency - Eliminations  
Statement of Operations and Changes in Net Position  
For the Period Ended September 30, 1997  
(Thousands)

	<u>1997</u>
<b>EXPENSES, Continued</b>	
19. Net Position, Beginning Balance, as Previously Stated	\$0
20. Adjustments (Note 27)	0
21. Net Position, Beginning Balance, as Restated	<u>\$0</u>
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	0
23. Plus (Minus) Non Operating Changes (Note 28)	<u>0</u>
24. Net Position, Ending Balance	<u><u>\$0</u></u>

---

The accompanying notes are an integral part of these statements.

# Principal Statements

---

**Department of Defense**  
**Defense Assistance Security Agency - Eliminations**  
**Statement of Cash Flows**  
**For the Period Ended September 30, 1997**  
**(Thousands)**

1997

**CASH FLOWS FROM OPERATING ACTIVITIES**

1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	<u>\$0</u>
Adjustments Affecting Cash Flow:	
2. Appropriated Capital Used	0
3. Decrease (Increase) in Accounts Receivable	0
4. Decrease (Increase) in Other Assets	0
5. Increase (Decrease) in Accounts Payable	0
6. Increase (Decrease) in Other Liabilities	0
7. Depreciation and Amortization	0
8. Other Unfunded Expenses	0
9. Other Adjustments	0
10. Total Adjustments	<u>\$0</u>
11. Net Cash Provided (Used) by Operating Activities	<u>\$0</u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

12. Sale of Property, Plant and Equipment	\$0
13. Purchase of Property, Plant and Equipment	0
14. Sale of Securities	0
15. Purchase of Securities	0
16. Collection of Loans Receivable	0
17. Creation of Loans Receivable	0
18. Other Investing Cash Provided (Used)	<u>0</u>
19. Net Cash Provided (Used) by Investing Activities	<u>\$0</u>

**CASH FLOWS FROM FINANCING ACTIVITIES**

20. Appropriations (Current Warrants)	\$0
21. Add:	
a. Restorations	0
b. Transfers of Cash from Others	0
22. Deduct:	
a. Withdrawals	0
b. Transfers of Cash to Others	<u>0</u>
23. Net Appropriations	<u>\$0</u>

---

The accompanying notes are an integral part of these statements.

**Department of Defense**  
**Defense Assistance Security Agency - Eliminations**  
**Statement of Cash Flows**  
**For the Period Ended September 30, 1997**  
**(Thousands)**

	<u>1997</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES, Continued</b>	
24. Borrowing from the Public	\$0
25. Repayments on Loans to the Public	0
26. Borrowing from the Treasury and the Federal Financing Bank	0
27. Repayments on Loans from the Treasury and the Federal Financing Bank	0
28. Other Borrowings and Repayments	<u>0</u>
29. Net Cash Provided (Used) by Financing Activities	<u>\$0</u>
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	\$0
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	<u>0</u>
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	<u><u>\$0</u></u>

**Supplemental Disclosure of Cash Flow Information:**

1997

33. Total Interest Paid	\$0
-------------------------	-----

**Supplemental Schedule of Financing and Investing Activity:**

1997

34. Property and Equipment Acquired Under Capital Lease Obligations	\$0
35. Property Acquired Under Long-Term Financing Arrangements	\$0
36. Other Exchanges of Non-cash Assets or Liabilities	\$0

---

The accompanying notes are an integral part of these statements.

# Principal Statements

---

---

The accompanying notes are an integral part of these statements.

***DEFENSE SECURITY  
ASSISTANCE AGENCY***

***PART II***

***B.***

***RELATED FOOTNOTES  
TO THE PRINCIPAL  
STATEMENTS***

## Footnotes

---

(BLANK PAGE)

**Defense Security Assistance Agency  
Footnotes to the Principal Statements**

**Note 1. Significant Accounting Policies:**

**A. Basis of Presentation:** These financial statements have been prepared to report the financial position and results of operations of the Defense Security Assistance Agency, as required by the Chief Financial Officers (CFOs) Act, and other appropriate legislation. They have been prepared from the books and records of the Agency in accordance with Department of Defense (DoD) Financial Management Regulation Volume 6, Chapter 6, as adopted from Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," and the applicable portions of OMB Bulletin 97-01.

**B. Reporting Entity:**

**Defense Security Assistance Agency (DSAA):** The DSAA was established as a separate agency of the Department of Defense (DoD) to administer the nation's security assistance programs. In fulfilling this mission, DSAA has administrative responsibility for the Foreign Military Sales (FMS) Trust Fund, the Special Defense Acquisition Fund (SDAF), the Foreign Military Loan Liquidating Account (FMLLA), and the Foreign Military Financing Direct Loan Financing Account (FMFDLFA). Also, there are other financial accounts that comprise the remainder of the military aspects of the Security Assistance program.

Fiscal year 1997 represents the 6th year that the Defense Security Assistance Agency has prepared, and had audited, financial statements for the FMS Trust Fund (8242), SDAF (4116), Foreign Military Financing Loan Liquidating Account (4121) and Foreign Military Financing Account (4122). Fiscal 1997 is the 2nd year that DSAA has prepared, and had audited financial statements for the 1080 series of accounts. Fiscal year 1997 is the first year that DSAA has prepared, and had audited financial statements for the Military Debt Reduction Financing Account (4174). These are required by the CFO Act and the Government Management Reform Act (GMRA).

The accompanying audited financial statements account for all funds which the DSAA is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The audited financial statements are presented on the accrual basis of accounting as required by DoD accounting policies.

## Footnotes

---

### **C. Budgets and Budgetary Accounting:**

#### **International Military Education and Training (IMET), Treasury Symbol Code 1081:**

The International Military Education and Training is an appropriated fund account that provides training in the United States, and in some cases, in overseas U.S. military facilities, to selected foreign military and related civilian personnel on a grant basis. Although historically a relatively modest program in terms of cost, the Executive Branch attaches great significance to IMET because the program provides U.S. access to and influences foreign governments.

**Foreign Military Financing Grant Account (FMF), Treasury Symbol Code 1082:** The Foreign Military Financing Grant Account is an appropriated aid program that makes financing available to certain U.S. friends and allies to procure U.S. defense articles and services. This FMF account is made available on a grant and a concessional interest rate loan basis.

**Military-to-Military Contact Program (MMCP), Treasury Symbol Code 1084:** The MMCP is a one year appropriation for Fiscal Year 1995 only, authorized by the Foreign Operations, Export Financing, and Related Programs Appropriations Act (P.L. 103-306). The purpose of this program is to allow the Secretary of Defense to conduct military-to-military contacts and comparable activities that are designed to encourage a democratic orientation of defense establishments and military forces of other countries. In FY 1996 and FY 1997, funding for this type of program went back in the Armed Services Appropriation Bill (Department 97) and is not part of the security assistance program.

**Assistance for Relocation of Facilities in Israel, Treasury Symbol Code 1088:** The Foreign Assistance Act of 1961, as amended, Chapter 7, gave the President authorization to construct air bases in Israel for the Government of Israel in the amount not to exceed \$800 million. Funding was made available for the construction by yearly appropriation acts. The Supplemental Appropriations Act, 1979, provided for necessary expenses for the construction authorized in Chapter 7. The Defense Security Assistance Agency transferred funds (57-11X1088) during past fiscal years to the Air Force to carry out this program. All appropriated funds in this account have been fully liquidated. The remaining funds were added to the account by Israel from grant funds given to them and are accounted for as non-entity assets. The additional funds are to close out remaining contracts.

**Unanticipated Needs for Defense of Israel Against Terrorism, Treasury Symbol Code 1089:** Fiscal Year 1996 was the initial and only year of this program which appropriated grant funds in the amount of \$50 million for emergency expenses necessary to meet unanticipated needs for the acquisition and provision of goods and services by Israel for the eradication of terrorism in and around Israel. This program was fully funded and disbursed in FY 1996.

**Special Defense Acquisition Fund (SDAF), Treasury Symbol Code 4116:** The SDAF was authorized by the International Security and Development Cooperation Act of 1981. The SDAF is used as a revolving fund under the control of the DoD to finance the acquisition of defense articles and services in anticipation of their transfer (pursuant to the AECA, the Foreign Assistance Act (FAA), or other legislation) to eligible friends, allies, and international organizations. The SDAF account is reimbursed through sales and transfers of items carried in the account. In FY 1993, Congress provided the last obligational authority for new procurement which had to be obligated by 30 September 1995. Public Law 103-306 provided \$20,000,000 for purposes of closing SDAF, to remain available for obligation until 30 September 1998: Provided, that this authority (\$20,000,000) is not used to initiate new procurements.

**Foreign Military Loan Liquidating Account (FMLLA), Treasury Symbol Code 4121:** The Credit Reform Act consolidated into this symbol, all assets, liabilities, and equities for loan balances recorded prior to FY 1992 in accounts 11\*1082, 11M1083, 11M1084, and 11X4121. This account disburses funds previously made available and accounted for the above referenced accounts.

**Foreign Military Financing Direct Loan Financing Account (FMFDLFA), Treasury Symbol Code 4122:** The Credit Reform Act resulted in the establishment of this account to provide the vehicle for making disbursements of Foreign Military Financing Loan funds for approved procurements and for subsequent collection of debt service due for the loans after September 30, 1991. The account uses permanent borrowing authority from the Treasury combined with transfers of appropriated funds from account 11\*1085 to make the required disbursements for loan recipient countries for their FMS or commercial procurements. Receipts of debt service payments from borrowers are used to repay the borrowings from Treasury.

**Foreign Military Financing Program Account (FMFPA), Treasury Symbol Code 1085:** This appropriated fund account (Federal Credit Reform Act of 1990) was established to provide the funds necessary to finance the subsidy element of the loan program. Expenditures from this account finance the subsidy element of direct loan disbursements and are transferred into the Foreign Military Financing Direct Loan Financing Account (4122) to make required loan disbursements for approved FMS or commercial sales. For the purpose of this report, FMFPA accounting transactions, to the extent they are relevant to the 4122 account, are included in the data reported for the 4122 account.

**Military Debt Reduction Financing Account (MDRFA), Treasury Symbol Code 4174:** This account was established for the debt relief of certain countries as established by Public Law 103-87. The Military Debt Reduction Account buys the portfolio of loans from the Foreign Military Loan Liquidating Account (11X4121), thus transferring the loans from 11X4121 to 11X4174. OMB has apportioned the funds for the relief of Niger, Senegal and Haiti.

## Footnotes

---

The Paris Club provides debt reduction initially on payments coming due over a specific period which correspond to the length of an IMF-supported economic reform program. Reduction then is staged, with each successive stage contingent upon debtor country compliance with its IMF-support program. Under Naples Terms, stock of debt reduction is provided after three years of good performance with respect to IMF reform programs and payments to Paris Club creditors. The United States incurs the budget cost of the eventual stock of debt reduction when it agrees to the initial "maturities" reduction of payments coming due, since bilateral agreements commit us to stock reduction once the Paris Club agrees to provide it.

In FY 1994-95, the United States signed bilateral agreements committing to 50 percent debt reduction for Niger, and to 67 percent debt reduction for Senegal and Haiti. The total funding for the three countries in the account equals \$3,837 thousand, which represents the net present value of expected payments (post-forgiveness) as calculated by OMB and Treasury.

**FMS Trust Fund, Treasury Symbol Code 8242:** The FMS Trust Fund was established as a means of facilitating the purchases of U.S. defense articles and services by friends and allies, as authorized in the Arms Export Control Act (AECA). The Trust Fund provides a vehicle through which the United States Government processes foreign country funds required for FMS case payments to U.S. contractors for new procurement, and to DoD components for sales from stocks. The FMS program operates using contract authority. Contract authority is statutory authority to incur obligations prior to an appropriation (or realization of revenues) for the future payment of such obligations. For the FMS program, 82 Stat 1323 (22 U.S.C. 2762) establishes its permanent indefinite authority. The total value of implemented cases is the only limiting factor in the total amount of obligations that can be incurred.

### **D. Basis of Accounting:**

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. The FMS Trust Fund (8242) has cost clearing accounts in which revenues and expenses are recognized upon payment of the expenses. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

SDAF uses the completed contract method of accounting. Under this method, gain or loss is recognized at the time of FMS case closure when costs associated with the contract can be determined.

All source level data; vouchers, obligation documents, etc., are at the installation level. The DoD audit trail is, and has been for many years, in the form of report submissions by accounting month. Report audit trails from departmental to installation level systems have been identified. Transaction samples could be taken from installation level systems where voucher numbers and other data is accessible.

---

### **E. Revenues and Other Financing Sources:**

While the Congress appropriates some funds to finance portions of the security assistance program via the Foreign Military Financing appropriation, the majority of sales are paid from customers' deposits in the FMS Trust Fund.

In accordance with the DoD Acting Chief Financial Officer's memorandum of August 31, 1992, the FMS Trust Fund does not recognize nor report revenue, with the exception of cost clearing accounts. The cost clearing accounts are: Administrative Surcharge, Transportation Cost, Contract Administrative Surcharge, and Attrition Cost. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. Since various DoD components actually perform the services and sell the articles, recognition of revenue and expense occurs in the financial statements of the applicable DoD components. The financing source for the FMLLA, FMFDLFA and MDRFA are Congressional appropriations.

Other than the balance in the attrition account, the assets and liabilities of the FMS Program are not assets and liabilities of the Department of Defense, but rather, they are assets and liabilities of the Department's FMS customers and the Office of Management and Budget (OMB). As such, the financial reporting of those assets and liabilities are not included in the overall Department of Defense reporting.

### **F. Accounting for Intra-Governmental Activities:**

The security assistance program, as an activity of DoD, interacts with, and is dependent upon, other financial activities of the government as a whole. The Department, through its Components, sells articles and services to friends and allies under the provisions of the Arms Export Control Act, as amended and the Foreign Assistance Act, as amended. Customers are required to make deposits, in advance, to the FMS Trust Fund. The Trust Fund then reimburses, directly or indirectly, the DoD Components for the cost of administering and executing the program. The indirect reimbursement is in the form of allowing the DoD Components to cite the Trust Fund on appropriate budgetary and expenditure documents. During fiscal year 1997, the Trust Fund reimbursed the DoD Components in the amount of \$15,096 million for articles and services sold under the FMS Program.

## Footnotes

---

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

There are several banking relationships involved in administering, and fiduciary responsibilities associated with, the accounting for security assistance funds. Some funds are held in treasury accounts, others are with the Federal Reserve Bank, and still others are with commercial banks. As of September 30, 1997, the security assistance program has a balance of \$8.58 billion in the U.S. Treasury, and \$7.69 billion on deposit with the Federal Reserve Bank and other commercial banks.

### H. Foreign Currency:

All payments and collections involved in the security assistance program are accounted for in U.S. Dollars.

### I. Accounts Receivable:

As presented in the consolidated statement of financial position, accounts receivable includes accounts, claims, and refunds receivable. The security assistance program has, as of September 30, 1997, a net accounts receivable as follows:

(Dollars in thousands)

	<u>Amount</u>	<u>Allowance</u>	<u>Total Net</u>
Account Receivable	\$1,870,046	\$0	\$1,870,046
Government			
Intragovernmental	\$21,465	\$0	\$21,465
Refunds	\$0	\$0	\$0
Claims	\$0	\$0	\$0
Total	\$1,891,511	\$0	\$1,891,511

The FMS Trust Fund's \$1.87 billion portion of the public receivables is based upon its requirement to bill in advance of providing articles and services as established in the Arms Export Control Act of 1976. The amount billed to customers on DD Forms 645, adjusted for both special bill arrangements and individual cases that have collections in excess of financial requirements, is the basis for the trust fund's accounts receivable value.

Since the FMS program is required to operate at a no loss or gain scenario, an allowance for bad debts will only be established upon determination of the State Department.

### J. Loans Receivable:

Loans are accounted for as receivables after funds have been disbursed. The amount of loans obligated but not disbursed are disclosed in Note 7.

---

**K. Inventories:**

The FMS Trust Fund has no inventory. Items are either delivered directly to the FMS customer from the contractor or in the cases of FMS sales from U.S. stocks, they are retained as inventory in the procurement or DBOF accounts of the military departments until transferred to the ownership of the foreign customer.

Inventory in SDAF is controlled and managed by the DoD Components and the SDAF inventory value is acquisition cost as reported to the DSAA by the DoD Components. See Note 8 for specific information.

**L. Investments in U.S. Government Securities:**

The security assistance program does not invest in U.S. government securities.

**M. Property and Equipment:**

The funds and accounts making up the security assistance program have no property or equipment. For the FMS trust fund, this policy is established by the DoD Acting Chief Financial Officer memorandum of August 31, 1992.

**N. Prepaid and Deferred Charges:**

The prepayment for SDAF represents payments made to contractors where inventory has not yet been delivered. All payments are posted as a pre-paid asset. FMS trust fund progress payments to contractors are accounted for using the constructive delivery method and, accordingly, are identified as an expenditure at time of payment.

**O. Leases:**

Not applicable

**P. Contingencies:**

Not applicable

**Q. Accrued Leave:**

No fund included in these statements records any accrual of unpaid leave.

## Footnotes

---

### **R. Equity:**

As identified in his memorandum of August 31, 1992, the DoD Acting Chief Financial Officer states that the FMS Trust Fund is a trust fund requiring DoD to act in a fiduciary capacity on behalf of its customers. All revenue, expense, and operational reporting for the program is the responsibility of the Military Departments. Accordingly, the FMS Trust Fund accounts only for dollars in and dollars out on a cash basis and has no net position, with the exception of cost clearing accounts. Recognition of equity will be the balance retained in the "Attrition" cost clearing account.

For SDAF, a decapitalization in the amount of \$166,000 thousand was completed via a nonexpenditure transfer authorization, document number 97-SDAF-0001, on September 16, 1997, to account 112814. This reduced the capitalized amount of \$200,000 thousand to \$34,000 thousand. Normally any excess resulting from operation of the fund is transferred to the miscellaneous receipts account. However in 1997, the DSAA Program Manager for SDAF determined that \$49,144 thousand of excess revenue would be returned to the Treasury after the remaining capitalization of the fund was returned. Therefore, the equity in the SDAF account is \$110,764 thousand.

### **S. Aircraft/Ship Crashes:**

Not applicable

### **T. Treaties for Use of Foreign Bases:**

Not applicable

### **U. Comparative Data:**

DFAS-DE/IR prepared the FY 1997 CFO statements with comparative FY 1996 balances for all appropriations reported by DSAA. The DSAA report includes CFO reports for all the administered funds. Prior to 1996 DSAA only provided financial statements with footnotes for the revolving and trust fund types.

Reclassification of assets for appropriation "8242" and newly referenced appropriation "1088" as non-entity assets occurred in FY 1996. "8242" reported revenue and expense on cost clearing accounts in FY 1997 with the cumulative result being reported as equity.

The Statement of Cash Flows is required on revolving fund types (4000 series accounts) in FY 1997.

**V. Undelivered Orders:**

The security assistance program is obligated for goods and services, which have been ordered but not yet received (undelivered orders) as of September 30, 1997, in the amount of \$26,772,505 thousand; \$22,699,167 thousand is attributable to the FMS trust fund orders under contract authority; \$40,454 thousand is attributable to SDAF under contract authority; \$1,894,280 thousand is attributable to 4122 under borrowing authority; \$2,135,779 thousand is attributable to outstanding obligated funds appropriated for the 1080 series (note 20); and \$2,825 thousand is attributable to 1088 as contract authority.

## Footnotes

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

#### A. Fund and Account Balances:

	<u>Trust Fund</u>	<u>Entity Assets</u>		<u>Other Fund Types</u>	<u>Total</u>
		<u>Revolving Funds</u>	<u>Appropriated Funds</u>		
Unobligated Balance Available Restricted					
Reserve for Antic. Resc	49,912				49,912
Obligated (not Expensed)		178,229	2,486,651		2,664,880
Unfunded Contract Auth. Unused Borrowing Auth.					
Treasury Balance	<u>49,912</u>	<u>178,229</u>	<u>2,486,651</u>		<u>2,714,792</u>

#### Non Entity Assets

Beginning Balance	5,838,185
Funds Collected	14,569,993
Funds Disbursed	<u>14,538,868</u>
Ending Balance	<u>5,869,310</u>

#### B. Other Information:

Entity Assets: The \$178,229 thousand in A(Obligated-Revolving) is attributable to 11X4116 (SDAF). \$332,528 thousand of A(Obligated-Appropriated) is applicable to 11X4122. DSAA was instructed by Treasury to classify these funds as appropriated. The remaining \$2,154,123 thousand is applicable to the 11 1080 series accounts, with the exception of the 1088 account. The amount in A (Col Trust Fund) is for the FMS Trust Fund cost clearing accounts.

Nonentity Assets: These amounts are for the remainder of the FMS Trust Fund and \$463 thousand ending balance from the 1088 account. The amounts presented equal values from the 1997 Year End Closing Statement (SF2108).

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

	<u>Entity Assets</u>	<u>NonEntity Assets</u>
A. Cash		7,694,679
B. Foreign Currency		
C. Other Monetary Assets:		
1. Gold		
2. Special Drawing Rights		
3. U.S. Reserves in the IMF		
4. Other		
5. Total, Other Monetary Assets		
D. Total Cash, Foreign Currency and Other Monetary Assets		<u>7,694,679</u>

E. Other Information: There are several banking relationships involved in administering, and fiduciary responsibility, of security assistance funds. Some funds are held in Treasury accounts, others are with the Federal Reserve Bank, and still others are with Commercial Banks. Cash balances are in agreement with the September 30, 1997 Federal Reserve and Commercial Bank balances.

**Note 4. Investments:**

Not applicable

**Note 5. Accounts Receivable, Net (in thousands):**

	<u>Gross Amount Due</u>	<u>Allowance For Estimated Uncollectables</u>	<u>Allowance Method Used</u>	<u>Net Amount Due</u>
A. Entity Receivables				
1. Intragovernmental	21,465		N/A	21,465
2. Governmental	5		N/A	5
B. Non-Entity Receivables				
1. Intragovernmental				
2. Governmental	<u>1,870,041</u>		<u>N/A</u>	<u>1,870,041</u>
Total Receivables	<u>1,891,511</u>		<u>N/A</u>	<u>1,891,511</u>

## Footnotes

---

### C. Other Information:

The SDAF portion of this value (\$21,465 thousand) represents \$1,465 thousand due from “reverse” military inter-departmental purchase requests (MIPRs), and \$20,000 thousand balance of a \$50,000 thousand advance to DLA.

The 8242 portion of 5B(Governmental) is \$1,870,041 thousand. The FMS Trust Fund is required to work on a no loss basis, therefore, an allowance for Estimated Uncollectibles does not exist. An actual “Uncollectible” will only be established based on State Department determination.

The remaining \$5 thousand is from a receivable due the Air Force under 1084.

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

#### A. Other Entity Assets:

##### 1. Federal (Intragovernmental)

###### a. FMFDLFA

\$1,561,769

##### Total

\$1,561,769

##### 2. Non-Federal (Governmental)

##### Total

\$0

B. Other Information: \$1,561,769 of A.1(1) is attributable to 11X4122. This is a right to receive cash through borrowing authority from Treasury.

#### C. Other Non-Entity Assets:

##### 1. Federal (Intragovernmental)

##### Total

\$0

##### 2. Non-Federal (Governmental)

##### Total

\$0

#### D. Other Information: None

**Note 7. Loans and Loan Guarantees, Non Federal Borrowers:**

A. The entity operates the following loan and/or loan guarantee programs:

1. Pre-1992 Direct Loan Obligations - DSAA Direct Loans
2. Pre-1992 Direct Loan Obligations - DSAA Rescheduled Loans (Direct Portion)
3. Pre-1992 Direct Loan Obligations - DSAA Rescheduled Loans (Guaranty Portion)
4. Pre-1992 Direct Loan Obligations - FFB Loans
5. Pre-1992 Direct Loan Obligations - Subrogated Defaulted FFB Loans
6. Pre-1992 Direct Loan Obligations - Subrogated Defaulted Refinanced Loans
7. Pre-1992 Direct Loan Obligations - Refinanced Loans
8. Pre-1992 Direct Loan Obligations - Commercial Bank Loans
9. Post-1991 Direct Loan Obligation - DSAA Direct Loans
10. Post-1991 Direct Loan Obligation - DSAA Military Debt Reduction

Direct loan obligations or loan guarantee commitments made prior to FY 1992, and the resulting direct loans or loan guarantees, are reported net of an allowance for estimated uncollectible loans or estimated losses.

Direct loan obligations or loan guarantee commitments made after FY 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act. The Act provides that the present value of the subsidy costs (i.e. interest rate differentials, interest subsidies, estimated delinquencies and defaults, fee offsets and other cash flows) associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed.

An analysis of loans receivable, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy and administrative costs associated with the loans and loan guarantees is provided in the following sections.

B. Direct Loans Obligated Prior to FY 1992 (in thousands):

<u>Loan Program</u>	<u>Loans and Interest Receivable, Gross</u>	<u>Allowance for Est. Uncoll. Loans &amp; Interest</u>	<u>Loans and Interest Receivable, Net</u>	<u>Foreclosed Property</u>	<u>Value of Assets Related to Direct Loans</u>
A1	2,477,398	0	2,477,398	0	0
A2	342,594	0	342,594	0	0
A3	518,874	0	518,874	0	0
A4	3,096,464	0	3,096,464	0	0
A5	<u>448,115</u>	<u>0</u>	<u>448,115</u>	<u>0</u>	<u>0</u>
TOTAL	<u>6,883,445</u>	<u>0</u>	<u>6,883,445</u>	<u>0</u>	<u>0</u>

## Footnotes

### C. Direct Loans Obligated after FY 1991 (in thousands):

<u>Loan Program</u>	<u>Loans Receivable, Gross</u>	<u>Interest Receivable</u>	<u>Foreclosed Property</u>	<u>Allowance for Subsidy Cost (Present Value)</u>	<u>Net Present Value of Assets Related to Direct Loans</u>
A9	1,451,405	15,788	0	189,666	1,277,527
A10	13,464	2,745	0	3,032	13,177
<b>Total</b>	<u>1,464,869</u>	<u>18,533</u>		<u>192,698</u>	<u>1,290,704</u>

D. Defaults on Pre-1992 Loan Guarantees: None

NOTE: FFB loans are considered Direct Loans, however \$79,155 thousand of loan principal was defaulted to FFB by various countries thus DSAA paid FFB the defaulted principal.

E. Defaults on Post-1991 Loan Guarantees: None

F. Liability for Loan Guarantees: None

NOTE: DSAA expects to collect 100% of its defaulted guaranty loans.

### G. Subsidy Expense for Post-1991 Loans:

#### 1. Current Year's Direct Loans (in thousands)

<u>Loan Program</u>	<u>Interest Differential</u>	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total</u>
1. FMFDLFA	(31,692)	89,909	0	0	58,217
2. MDRFA	0	375	0	0	375
<b>Total</b>	<u>(31,692)</u>	<u>90,284</u>	<u>0</u>	<u>0</u>	<u>58,592</u>

#### 2. Direct Loan Modifications and Re-estimates (in thousands)

<u>Loan Programs</u>	<u>Modifications</u>	<u>Re-estimates</u>	<u>Total</u>
1. FMFDLFA	0	13,445	13,445
2. MDRFA	0	0	0
<b>Total</b>	<u>0</u>	<u>13,445</u>	<u>13,445</u>

3. Total Direct Loan Subsidy Expenses (in thousands)

Loan Program

1. FMFDLFA	71,662
2. MDRFA	<u>375</u>
Total	<u>72,037</u>

H. Subsidy Expense for Post-1991 Loan Guarantees.

1. Current Year's Loan Guarantees: None
2. Loan Guarantee Modifications and Re-estimates: None
3. Total Loan Guarantees Subsidy Expense: None

I. Administrative Expense: None

J. Other Information:

	(thousands)
Face Value of Guaranteed Refinanced Loans	5,691,355
Accrued Interest Guaranteed Refinanced Loans	219,677
DSAA Guaranteed Portion of Refinanced Loans (90% of Face Value)	5,319,929
Portion of Refinanced Loans Secured by Country Deposits in the Financing Bank (10% Face Value)	591,103
Undisbursed Balances Available for New Direct Loan Receivables	0

## Footnotes

---

### **Note 8. Inventory, Net (in thousands):**

	<u>Inventory Amount</u>	<u>Allowance For Losses</u>	<u>Inventory Net</u>	<u>Valuation Method</u>
A. Inventory Categories:				
1. Held for Current Sale	10,179		10,179	
2. Held in Reserve for Future Sale War Reserve Materiel				
3. Excess, Obsolete, Unserviceable				
4. Held for Repair				
Total	<u>10,179</u>		<u>10,179</u>	

### B. Restrictions on Inventory Use, Sale, or Disposition:

SDAF inventory must be used for transfers in security assistance programs unless approved by SECDEF, redelegated to DSAA Director, for sale to Military Departments.

### C. Other Information:

All inventory belongs to SDAF. The valuation, as reported by the military departments, is the acquisition cost of items on hand at installation level not identified to a specific sale to a foreign customer. In FY1997, \$1,437 thousand of unsalable equipment was written off.

### **Note 9. Work in Process:**

Not applicable

### **Note 10. Operating Materials and Supplies (OM&S), Net:**

Not applicable

### **Note 11. Stockpile Materials Net:**

Not applicable

### **Note 12. Seized Property:**

Not applicable

### **Note 13. Forfeited Property, Net:**

Not applicable

### **Note 14. Goods Held Under Price Support and Stabilization Programs, Net:**

---

Not applicable

**Note 15. Property, Plant and Equipment, Net:**

Not applicable

**Note 16. Debt (in thousands):**

Liabilities Covered by Budgetary Resources	Beginning <u>Balance</u>	New <u>Borrowing</u>	<u>Repayments</u>	Ending <u>Balance</u>	<u>Refinance</u>
<b>A. Intragovernment Debt:</b>					
1. Borrowing from the Treasury	1,133,783	328,255	51,311	1,410,727	0
2. Borrowing from Fed Financing Bank	3,247,194	0	198,901	3,048,293	0
3. Borrowing from Other Fed Agencies	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Intragovernmental Debt	<u>4,380,977</u>	<u>328,255</u>	<u>250,212</u>	<u>4,459,020</u>	<u>0</u>

Liabilities Not Covered By  
Budgetary Resources

**B.**

1. Public Debt: Not applicable
2. Agency Debt: Not applicable

**C. Total Liabilities for Debt:**

Not Covered by Budgetary Resc: Not applicable

<b>D. Total Debt</b>	<u>4,380,977</u>	<u>328,255</u>	<u>250,212</u>	<u>4,459,020</u>	<u>0</u>
----------------------	------------------	----------------	----------------	------------------	----------

**E. Other Information:**

The FMLLA (Treasury Symbol Code 4121) portion of the security assistance program has borrowed funds from the Treasury for disbursement under a valid loan program.

The FMFDLFA (Treasury Symbol Code 4122) program has borrowed funds from the Treasury for disbursements for valid loan programs under credit reform.

The MDRFA (Treasury Symbol Code 4174) program has borrowed funds from the Treasury for disbursements for valid loan programs under credit reform.

## Footnotes

---

### **Note 17. Other Liabilities (in thousands):**

#### A. Other Liabilities Covered by Budgetary Resources:

	<u>Non-Current Liab.</u>	<u>Current Liabilities</u>	<u>Total</u>
1. Intragovernmental			
a. FMFDLFA-Bor	0	1,561,769	1,561,769
b. FMFDLFA-Sub	<u>0</u>	<u>202,493</u>	<u>202,493</u>
Total	<u>0</u>	<u>1,764,262</u>	<u>1,764,262</u>
2. Governmental			
a. SDAF	95,150	0	95,150
b. 8242	0	13,794,765	13,794,765
c. FMLLA	<u>3,177,290</u>	<u>0</u>	<u>3,177,290</u>
Total	<u>3,272,440</u>	<u>13,794,765</u>	<u>17,067,205</u>

#### B. Other Information:

The SDAF portion of this element was computed by using Advances to Others and Advances from Others in accordance with the completed contract method of accounting.

Advances from Others (GLAC 2310)	573,923
Advances to Others (GLAC 1410)	<u>478,773</u>
Other Non-Federal Liabilities	<u>95,150</u>

Amount in A2(2), 8242 is in accordance with the Arms Export Control Act of 1976. Funds collected into the Trust Fund are in advance of the performance of services or sale of goods. Amounts are the values expected to be expended by the U.S. Government on behalf of foreign customers.

The FMFDLFA value represents future repayments of borrowings from Treasury for credit reform loans.

#### C. Other Liabilities Not Covered by Budgetary Resources: Not applicable.

#### D. Other Information: None

### **Note 18. Leases:**

Not applicable

### **Note 19. Pensions and Other Actuarial Liabilities:**

Not applicable

**Note 20. Net Position (in thousands):**

	<u>Revolving Funds</u>	<u>Trust Funds</u>	<u>Appropriated Funds</u>	<u>Total</u>
A. Unexpended Appropriations				
1. Unobligated				
a. Available			4,179	4,179
b. Unavailable			2,682	2,682
2. Undelivered Orders			2,135,779	2,135,779
B. Invested Capital	110,764		0	110,764
C. Cumulative Results of Operations	619,684	49,912	128	669,724
D. Other				
E. Future Funding Requirements				
F. Total	<u>730,448</u>	<u>49,912</u>	<u>2,142,768</u>	<u>2,923,128</u>
G. Other Information:				

1. Invested Capital (B): The \$110,764 thousand is attributable to SDAF. Normally any excess resulting from the operation of the fund is transferred to the Treasury miscellaneous receipts account. However, in 1996, the DSAA Program Manager for SDAF determined that \$27,620 thousand of excess revenue would be returned to the Treasury after the remaining capitalization of the fund is returned. In FY 1997, an additional \$49,144 thousand of excess revenue will be returned to the Treasury after the remaining capitalization of the fund is returned. Also, in FY 1997 \$166,000 thousand was returned to the Treasury miscellaneous receipts account 112814 (Repayments of Investments and Recoveries).

2. Cumulative Results of Operations (C): FMLLA is not considered a revolving fund. It is a liquidating fund. It is being classified as a revolving fund since the Treasury is classifying it as a revolving fund for the FACTS reporting. \$609,692 thousand is attributable to FMLLA, \$9,992 thousand is attributable to MDRFA. An accounting policy change to 8242 resulted in \$49,912 thousand being reported under trust funds.

3. Unexpended Appropriations (A):

Unobligated Available; \$2,077 thousand is attributable to 1081, \$749 thousand is attributable to 1082, and \$1,353 thousand is attributable to 1084.

Unobligated Unavailable; \$1,836 thousand is attributable to 1081, \$828 thousand is attributable to 1082, and \$18 thousand is attributable to 4122 (FMFDLFA).

Undelivered Orders; \$23,556 thousand is attributable to 1081, \$2,110,430 thousand is attributable to 1082, \$1,330 thousand is attributable to 1084, and \$463 thousand is attributable to 1088.

## Footnotes

---

### **Note 21. Taxes:**

Not applicable

### **Note 22. Other Revenues and Financing Sources (in thousands):**

	<u>1997</u>	<u>1996</u>
A. Other Revenue and Financing Sources:		
1. MDRFA	12,360	0
2. FMLLA	587,912	591,134
3. FMFDLFA	7,526	2,493
4. 1082	<u>128</u>	<u>405</u>
Total	<u>607,926</u>	<u>594,032</u>

### **B. Other Information:**

(FMLLA) Amount is the Contra-Revenue-Collected for Others and deposited to Treasury.  
(FMFDLFA) Had insufficient funds to make annual interest payment to treasury. Per Treasury Bulletin No. 93-05, additional borrowing was made to cover interest payments. (MDRFA) had a gain in assets from the acquisition of loans.

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

	<u>1997</u>	<u>1996</u>
A. Operating Expenses by Object Classification:		
1. Personal Services and Benefits		
2. Travel and Transportation		
3. Rental, Communication and Utilities		
4. Printing and Reproduction		
5. Contractual Services		
6. Supplies and Materials		
7. Equipment not Capitalized		
8. Grants, Subsidies and Contributions 3,067,394	3,087,760	
9. Insurance Claims and Indemnities		
10. Other	<u>603,108</u>	<u>0</u>
11. Total Expenses by Object Class	<u>3,670,502</u>	
	<u>3,087,760</u>	

B. Operating Expense by Program: Not applicable

C. Other Information:

Grants, Subsidies, and Contributions (8); FMFDLFA incurred \$71,662 thousand of loan subsidy expense. The remaining \$2,995,732 thousand is normal grant execution for the 1080 series accounts.

Other (10); FMLLA had expense of \$48,234 thousand for defaulted guaranteed loans, and a credit for Contra Bad Debts Expense - Incurred for Others of \$3,655 thousand. The remaining \$558,529 thousand was operating expense of 8242.

## Footnotes

---

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

B. Cost of Material Sold from Inventory (using Latest Acquisition Cost)	
1. Beginning Inventory L.A.C.	50,384
2. Less: Beginning Allowance for Unrealized Holding Gains/Losses	0
3. Plus: Purchases at Cost	478,793
4. Plus: Customer Returns - Credit Given	0
5. Plus: DLR Exchange Credits	0
6. Less: Inventory Losses Realized	0
7. Less: Ending Inventory - L.A.C.	10,179
8. Plus: Ending Allowance for Unrealized Holding Gains/Losses	0
9. Less: Equity Transfers of Inventory to Others	0
10. Plus: Equity Transfers of Inventory from Others	0
11. Equals: Cost of Goods Sold from Inventory	<u>518,998</u>

#### Other Information:

All Cost of Goods Sold (CGS) relate to the Special Defense Acquisition Fund (SDAF). Since SDAF uses the completed contract method of accounting, all costs associated with a contract are identified at the time of an FMS case closure (see note 1 D). Line 1a represents the CGS of those FMS cases closed during FY 1997 plus the net change in ending inventory between FY 1996 and FY 1997 (see note 8). Line 3 includes the FY 1997 contract administration costs that are directly related to the sale of SDAF items.

### **Note 25. Other Expenses (in thousands):**

	<u>1997</u>	<u>1996</u>
A. Other Expenses:		
1. Loan Program - FMLLA	<u>12,360</u>	<u>0</u>
Total	<u>12,360</u>	<u>0</u>

B. Other Information: FMLLA had a \$12,360 thousand loss on disposition of assets.

### **Note 26. Extraordinary Items:**

Not applicable

**Note 27. Prior Period Adjustments (in thousands):**

A. Prior Period Adjustments:	
1. FMLLA	14
2. 8242	<u>48,446</u>
Total	<u>48,460</u>

B. Other Information: FMLLA made a one time adjustment to correct loan CM908D, which increased equity and decreased other liabilities. This adjustment was between DSAA Rescheduled Loans (Direct portion) and Rescheduled Loans (Guaranty portion). 8242 made an adjustment to record a beginning year net position of its clearing accounts. This portion of 8242 must report revenue, expenses and corresponding equity due to a change in DoD accounting policy direction.

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

	<u>1997</u>	<u>1996</u>
A. Increases:		
1. Transfers-In:		
a. From Treasury	7,331	16,418
2. Unexpended Appropriations		
3. Donations Received		
4. Other Increases	<u>334,438</u>	<u>0</u>
5. Total Increases	<u>341,769</u>	<u>16,418</u>
B. Decreases		
1. Transfers-Out:		
a. To Treasury	166,000	322,000
2. Donations		
3. Other Decreases	<u>75</u>	<u>0</u>
4. Total Decreases	<u>166,075</u>	<u>322,000</u>
C. Net Non-Operating Changes (Transfers)	<u>175,694</u>	<u>(305,582)</u>

D. Other Information: Increases, Transfers-In from Treasury A(1)(a) \$7,331 thousand is attributable to the Foreign Military Loan Liquidating Account (FMLLA) to pay default claims on guaranteed loans made prior to FY 1992. Decreases, Other B(3) \$46 thousand is attributable to the Foreign Military Financing Direct Loan Financing Account (FMFDLFA), Subsidy available un-appropriated, transferred to the Treasury. Decreases, Transfer-Out to Treasury, B(1)(a), is the amount of authority to SDAF cash which was transferred to the Treasury's receipt account by DSAA during FY1997 as part of the de-capitalization of the fund. The remaining increases or decreases are for the 1080 appropriations. These figures are the net of operations less any money returned to Treasury due to canceled years.

## Footnotes

---

### Note 29. Intrafund Eliminations:

Not applicable

### Note 30. Contingencies:

Not applicable

### Note 31. Other Disclosures (in thousands):

UNMATCHED DISBURSEMENTS, NEGATIVE UNLIQUIDATED OBLIGATIONS, AND TOTALS.

<u>DSAA (11X8242)</u>	<u>SEP 1997</u>	<u>SEP 1996</u>	<u>CHANGE</u>	<u>% CHANGE</u>
Unmatched Disbursements	318,000	330,000	(12,000)	4.0
Negative Unliquidated Obligations	141,000	175,000	(34,000)	19.0
Aged In-Transit Disbursements	288,000	178,000	110,000	61.8
Totals	<u>747,000</u>	<u>683,000</u>	<u>(64,000)</u>	<u>9.4</u>

The increase in Aged In-Transit Disbursements was caused due to military departments suspense amounts not being included in the FY 96 position, but are now included in the FY 97 figure.

The Defense Finance and Accounting Service has reported material weaknesses in system controls. This is due to the numerous systems involved in the Department of Defense Finance and Accounting for Security Assistance where integration and reconciliations required result in inefficiencies. This has been reported in accordance with “United States Code, title 31, section 3512 (formerly the Federal Managers’ Financial Integrity Act of 1982, Public Law 97-225)”. These systemic problems resulted in \$200 million in disbursements not being identified to specific foreign customers as of September 30, 1997. This is an improvement of \$10 million from the September 30, 1996 position; however still constitutes a significant problem which we are working to resolve. There was also \$459 million in problem disbursements (excluding intransit disbursements) reported at field level as of September 30, 1997.

Numerous initiatives are being implemented to reduce problem disbursements, including: (1) Implementing procedures for Defense Accounting Offices (DAOs) and Operating Locations (OPLOCs) to correct contract payment notification rejects affecting the above the line mismatches, (2) Eliminating central procurement accounting system below the line edits, (3) Instituting procedures for DAOs/OPLOCs to correct negative unliquidated obligations, (4) Involving the DFAS-DE network in front end validation of Mechanization of Contract Administration Services (MOCAS) payments, (5) Automating prevalidation of MOCAS payments, and (6) Reducing the prevalidation threshold to \$25,000 for MOCAS payments, starting with contracts for FY97 and forward.

**Footnotes**

---



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

February 27, 1998

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

**SUBJECT: Disclaimer of Opinion on the Defense Security Assistance Agency  
Financial Statements for FY 1997 (Project No. 7FD-2011)**

The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. The Defense Security Assistance Agency (DSAA) is responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to DSAA funds. The Defense Finance and Accounting Service (DFAS) is responsible for establishing and maintaining the accounting system for DSAA funds. Our responsibility is to render an opinion on the financial statements based on our audit, and to determine whether internal controls are adequate and whether DSAA complied with applicable laws and regulations.

**Disclaimer of Opinion.** We were unable to render an opinion on the DSAA Financial Statements for FYs 1997 and 1996. Major deficiencies still exist, as identified in our audits of the DSAA Financial Statements for FYs 1992, 1995, and 1996. Because of deficiencies in the accounting systems and control procedures, DSAA could not provide reasonable assurance that the financial statements were reliable. Specifically, DSAA did not account for revenues and expenses from the sales of goods and services to foreign customers. Accounts receivable were overstated and inventories were not recorded. DSAA and DFAS provided management representation letters, but did not attest to the accuracy or completeness of the financial statements.

**Internal Controls.** Internal controls were not adequate. DFAS did not use a double-entry accounting system to account for DSAA foreign military sales transactions, and the systems used by the DFAS and the Military Departments were not transaction-driven. DFAS posted summary totals to individual accounts instead of using double-entry methods to record transactions. As a result, controls were not sufficient to detect accounting errors.

Controls did not adequately ensure that sufficient foreign customer funds were available before disbursements were made on behalf of those customers. In FY 1997, DFAS acknowledged that it disbursed \$450 million on behalf of DSAA customers without assurance that customer funds were available.

In our audit reports on the DSAA Financial Statements for FYs 1992, 1995, and 1996, we reported that the DFAS accounting system did not have adequate audit trails for disbursements. DFAS officials disagreed with our conclusion and stated that we would find the disbursement trails to be adequate if we took our sample from the Military Department systems rather than the DFAS system. In preliminary tests of FY 1997 data, we were able to follow the audit trails for foreign military sales disbursements of the Army and Air Force. However, we could not follow the audit trail for Navy foreign military sales disbursements.

**Compliance with Laws and Regulations.** The FY 1997 DSAA Financial Statements continued to be noncompliant with laws and regulations. The FY 1997 DSAA Financial Statements were not consolidated into the DoD financial statements. Revenues, expenses, and equity for the sales of goods and services to foreign customers were not reported as required by the Chief Financial Officers Act of 1990 (as amended by the Federal Financial Management Act of 1994) and OMB accounting standards. Other instances of noncompliance with OMB accounting standards included the overstatement of accounts receivable by \$1.87 billion and the omission of up to \$459 million of inventories purchased with foreign customer funds. Also, when reporting \$560 million of revenues and \$559 million of expenses applicable to the surcharges placed on foreign military sales, DFAS used cash accounting instead of accrual accounting methods.

Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements for Federal Financial Statements," January 16, 1998, our work disclosed that financial management systems did not comply with Federal financial management system requirements; applicable Federal accounting standards; and the United States Government Standard General Ledger at the transaction level.

**Additional Reports.** This memorandum briefly summarizes the major deficiencies affecting DSAA. We will issue subsequent reports with more details on internal controls and compliance with laws and regulations.

*David K. Steensma*

David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

## **Appendix D. Management and Legal Representation Letters**

This appendix (a total of 4 pages) consists of the management and representation letters for the Defense Security Assistance Agency Financial Statements for FY 1997.





DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

27 FEB 1998  
In reply refer to  
I-59671/98

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: Management Assurance Concerning Defense Security Assistance Agency Financial Statements for FY 1997

This is in regard to your audit of the Defense Security Assistance Agency FY 1997 Financial Statements (Project No. 7FD2011). For the purpose of expressing an opinion as to whether the financial statements are 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, and applicable portions of OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, I confirm, to the best of my knowledge and belief, the following representations.

I am responsible for the fair representation of the Defense Security Assistance Agency financial statements in accordance with OMB Bulletin No. 94-01 and applicable portions of OMB Bulletin No. 97-01.

All financial records and related data have been made available to you.

DFAS has reported material weaknesses in systems controls, which affect the accuracy and completeness of the DSAA Financial Statements (Atch 1, DFAS/DE Memorandum dated January 22, 1998).

I have no plans or intentions, other than those previously disclosed to you that may materially affect the carrying value or classification of assets and liabilities. Such classifications are determined by OSD(Comptroller).

I have no knowledge of any irregularities involving management or employees who have significant roles in the internal control structure.

I have no knowledge of any employee being involved in irregularities that could materially affect the financial statements.

I have received 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.

I have no knowledge of any violations or possible violations of laws or regulations that should be considered for disclosure in the financial statements or for recording a loss contingency.

There are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Federal Financial Accounting Standard (SFFAS) No. 5, "Accounting for Contingencies," December 1995.

There are no unasserted claims or assessments that our legal representative believes must be disclosed in accordance with SFFAS No. 5.

I have no knowledge of any material transactions that have not been properly recorded in the accounting records and reflected in the financial statements.

The Fund has satisfactory title to all assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

No events have occurred after the balance sheet date that would require adjustments to, or a disclosure in, the financial statements.

All adjustments that our activity or the DFAS made to account balances are fully documented and were made in accordance with applicable accounting standards.

Included as Attachment 2 is the legal representation letter for FY 1997.

Attachments  
As stated



MICHAEL S. DAVISON, JR.  
LIEUTENANT GENERAL, USA  
DIRECTOR

Prepd: S. Liberty. DSAA/COMPT-FM. 604-6562  
Typed: S. Liberty File Name CFO - MAT U  
Dist: FM SUBJ FM RF COMPT RF



DEFENSE FINANCE AND ACCOUNTING SERVICE  
DENVER CENTER  
6760 E. IRVINGTON PLACE  
DENVER, COLORADO 80279

JAN 22 1998

DFAS-DE/IRAD

MEMORANDUM FOR ACTING DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Defense Security Assistance Agency Chief Financial Officers  
(CFO) Act Fiscal Year (FY) 1997 Financial Statements

Attached are the Principal Statements and notes for Defense Security Assistance Agency FY 97 CFO Financial Statements required by Department of Defense Guidance on Form and Content of Financial Statements for FY 97 Financial Activity.

I hereby certify that the attached version 3 of the FY 97 Chief Financial Officers Act Principal Statements for the Defense Security Assistance Agency are a correct consolidation of accounting data provided to, or maintained by Defense Finance and Accounting Service Denver Center (DFAS-DE). Any adjustments made by DFAS-DE are fully documented.

The Defense Finance and Accounting Service has reported material weaknesses in system controls. This is due to the numerous systems involved in Department of Defense Finance and Accounting for Security Assistance where integration and reconciliations required result in inefficiencies. This has been reported in accordance with "United States Code, title 31, section 3512 (formerly the Federal Managers' Financial Integrity Act of 1982, Public Law 97-225)." These systemic problems resulted in \$200 million in disbursements not being identified to specific foreign customers as of September 30, 1997. This is an improvement of \$10 million from the September 30, 1996 position; however, this still constitutes a significant problem which we are working to resolve. There was also \$459 million in problem disbursements (excluding intransit disbursements) reported at field level as of September 30, 1997 (CFO Note 31).

The Department of Defense Inspector General has not recommended any audit adjustments to these FY 97 CFO principal statements.

Questions your staff may have concerning these financial statements may be directed to my project officer, Mr. Mike Kennedy, DFAS-DE/IR, commercial telephone (303) 676-6038 or DSN 926-6038.

David C. Harris  
Principal Deputy Director

Attachments:  
As stated





GENERAL COUNSEL  
DEFENSE SECURITY ASSISTANCE AGENCY  
WASHINGTON, DC 20301-3000

## DEFENSE LEGAL SERVICES

In reply refer to:  
98/60785

January 29, 1998

### MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Legal Representation Letter

During the period October 26, 1997 to January 29, 1998, in the course of performing legal services for the Defense Security Assistance Agency, I have become aware of no claims or assessments against the agency nor of any legal claims or assessments which probably will be asserted.

The claim filed against the Government of the United States by the Government of Iran in 1981 concerning unresolved issues involved in Iran's foreign military sales (FMS) program is not a claim against the Defense Security Assistance Agency. The extent of the liability of the FMS Trust Fund for that claim will be the same as if no claim had been filed. That is, at the final closure of Iran's FMS program, the residual funds in Iran's FMS Trust Fund account will be returned to the Government of Iran. The settlement of one part of the claim has already been paid. Any additional sums which may be adjudged by the Iran-U.S. Claims Tribunal at the Hague as due to Iran would only be payable from the Judgment Fund, the permanent indefinite appropriation under the control of General Accounting Office (GAO) which is available to satisfy this kind of obligation. The Department of State represents the United States before the Tribunal.

D. Kay Cannon



---

## **Appendix E. Laws and Regulations Reviewed**

Public Law 104-208, "Federal Financial Management Improvement Act of 1996," October 1, 1996

Public Law 103-356, "Government Management Reform Act of 1994," October 13, 1994 ("Federal Financial Management Act of 1994")

Public Law 103-62, "Government Performance and Results Act of 1994," August 3, 1993

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

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

Public Law 97-258, "Antideficiency Act," September 3, 1982 (Title 31, United States Code, section 1341, "Limitations on Expending and Obligating Amounts," and section 1517, "Prohibited Obligations and Expenditures")

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

Public Law 87-195, "Foreign Assistance Act of 1961," September 4, 1961

JFMIP "Core Financial System Requirements," September 1995 (part of the "Federal Financial Management System Requirements")

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

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

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

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

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

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

## **Appendix E. Laws and Regulations Reviewed**

---

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

DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, "Reporting Policy and Procedures," January 1998

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

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

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996

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

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

DFAS Regulation 5010.38-R, "Internal Management Control Program," February 1993

---

## **Appendix F. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller) and Chief Financial Officer  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Assistant Secretary of Defense for International Security Affairs  
Assistant Secretary of Defense (Public Affairs)  
Director, Defense Logistics Studies Information Exchange

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

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

### **Department of the Air Force**

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

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Finance and Accounting Service  
Director, Defense Finance and Accounting Service Denver Center  
Director, Defense Logistics Agency  
Director, Defense Security Assistance Agency

## **Non-Defense Federal Organizations and Individuals**

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

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

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

## **Part III. - Management Comments**

# Under Secretary of Defense (Comptroller) Comments



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

MAY 29 1998

MEMORANDUM FOR DEPUTY DIRECTOR, FINANCE AND ACCOUNTING  
DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Draft Audit Report on Internal Controls and Compliance with Laws and  
Regulations for the Defense Security Assistance Agency Financial Statements for  
FY 1997 (Project No. 7FD-2011.01)

This is the Office of the Under Secretary of Defense (Comptroller) response to the subject draft audit report. Detailed comments are attached and include comments from the Defense Finance and Accounting Service.

While this office generally concurs with the intent of the audit to enhance the reporting of transactions consummated on behalf of the Foreign Military Sales Trust Fund and other accounts of the Security Assistance Program, differences remain in the categorization of types of transactions within the program. This office is confident that the Department's treatment of accounts receivable and Cooperative Logistics Supply Support Arrangement transactions will satisfy audit requirements in recommendations D and E.

The resolution agreed among this office, the Office of the Inspector General, DoD, the Office of Management and Budget, and the General Accounting Office, whereby, the accounts reflected in this report will be included as a component in the category "Other Defense Organizations" of the DoD Consolidated Financial Statement, should be reflected in the audit report.

The Office of the Under Secretary of Defense (Comptroller) appreciates the opportunity to comment on the draft report.

My point of contact on this matter is Ms. Kay O'Brien. She may be contacted by e-mail: [obrienm@ousdc.osd.mil](mailto:obrienm@ousdc.osd.mil) or by telephone at (703) 697-0586.

  
Nelson Toye  
Deputy Chief Financial Officer

Attachment

**INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND  
REGULATIONS FOR THE DEFENSE SECURITY ASSISTANCE AGENCY  
FINANCIAL STATEMENTS FOR FY 1997  
PROJECT NO. 7FD-2011.01, DATED APRIL 29, 1998**

\*\*\*\*\*

**AUDIT BACKGROUND:** The introduction identifies the ten accounts as funds in the Defense Security Assistance Agency consolidated financial statements. Since the ten accounts are not funds (with the exception of the Foreign Military Sales (FMS) Trust Fund), the word "funds" should be substituted with the word "accounts" in three areas of the paragraph entitled "Introduction."

**FINDING B. EXPENDITURE AUTHORITY:** On page 17, Summary, first paragraph, the following sentence should be deleted: "Obtaining expenditure authority complicates and delays the disbursement process because DoD requirements and FMS disbursements are combined in many contractor invoices." There is neither a discussion nor any evidence included in the audit report to confirm the allegation that obtaining expenditure authority for FMS disbursements is complicated and delays the process. The simple fact that DoD requirements and FMS disbursements are combined does not mean the control mechanism of expenditure authorizations complicates or delays the disbursement process as cited in the audit report.

**OFFICE OF THE IG (OIG) RECOMMENDATION A.1:** We recommend that the Defense Finance and Accounting Service Denver Center (DFAS-DE) establish and document an audit trail for Foreign Military Sales Trust Fund disbursements. The audit trail should allow managers and auditors to have ready access to all data on disbursement transactions.

**DOD RESPONSE:** Concur. The disbursement audit trail will be established and documented by September 30, 1998. We are appreciative of the OIG's efforts to audit disbursement audit trails taking into account the hierarchical nature of the DoD accounting systems and the fact that data are summarized in departmental level systems on a monthly basis. The DFAS-DE will document and test the audit trail of cash transactions as agreed between the DFAS-DE and the OIG. The methodology will include transactions from any given disbursing station and for any selected accounting month as the transactions transition through the DFAS center for that disbursing station to Treasury, as well as to the cash general ledger account used for financial statements.

**OIG RECOMMENDATION A.2:** We recommend that the DFAS-DE test the audit trail to ensure that it provides an accurate method for tracing disbursements from the general ledger to source documents and from source documents to the general ledger.

**DOD RESPONSE:** Concur. The audit trail will be tested by September 30, 1998.

**OIG RECOMMENDATION B.1:** We recommend that the Director, Defense Finance and Accounting Service review disbursements from the FMS Trust Fund against disbursement authorization levels and total available cash to determine whether disbursements exceeded available cash at the country level. If disbursements exceeded country level cash deposits, the

## Under Secretary of Defense (Comptroller) Comments

administrative-control-of-funds type report required by DoD 7000.14-R should be submitted and action taken to obtain reimbursement and charge appropriate interest for the arrearages.

**DOD RESPONSE:** Concur. A review of monthly disbursements compared to total customer deposits on hand in Treasury and interest bearing accounts from March 1997 to February 1998 was conducted by DFAS-DE. There was no instance where disbursements exceeded a country's available cash deposits. Therefore, an administrative-control-of-funds report, additional reimbursement, or charge for interest are not required. This action is considered closed.

**OIG RECOMMENDATION B.2:** We recommend that the Director, Defense Finance and Accounting Service restrict the number of disbursing stations that are authorized to make disbursements from the Foreign Military (sic) Trust Fund.

**DOD RESPONSE:** Nonconcur. However, the number of disbursing stations will be reduced as a matter of consolidation within the Department. There are plans to consolidate disbursing functions and stations within the Department for further streamlining. When established in January 1991, DFAS capitalized approximately 320 disbursing offices operated by the Military Services. Initial consolidation actions included the establishment of operating locations (OPLOCs) and the consolidation of all DFAS owned disbursing and accounting functions of the capitalized offices (Defense Accounting Offices (DAOs)) into the larger OPLOCs. During 1996, the Indianapolis Center began consolidation of its OPLOC disbursing functions into the Indianapolis Center. In February 1997, the Director, DFAS directed consolidation of all disbursing functions of the OPLOCs into the respective centers. The objectives of consolidating the disbursing functions of the OPLOCs into the centers are to reduce the number of disbursing stations owned and operated by DFAS, to significantly reduce cross disbursing and transactions for others, and to generate savings through reduced operating costs, as well as to meet mandatory reduced staffing levels. DFAS anticipates that the disbursing consolidation to the five centers will be completed by the end of FY 1999.

**OIG RECOMMENDATION B.3:** We recommend that the Director, Defense Finance and Accounting Service designate the authorized disbursing stations and establish procedures to ensure that those disbursing stations always obtain expenditure authority before making Foreign Military Sales disbursements.

**DOD RESPONSE:** Concur in part. No new designations will be established for FMS specific. Current expenditure authority procedures will be modified to enhance compliance. Estimated completion date of draft policy and procedural changes is estimated at September 30, 1998. Should systems changes be required, the estimated date is September 30, 1999.

**REVIEW OF COMPLIANCE WITH LAWS AND REGULATIONS:** The views included in this entire section are based on previous ODODIG opinions with respect to the accounting treatment of revenue and expenses, accounts receivable, and inventory reporting and as such, are repeated in Findings C, D, and E. The opinions are not shared by the Office of the Under Secretary of Defense (Comptroller) as identified in previous audit reports and are re-addressed in the respective Findings and Recommendations.

**FINDING C. REVENUES AND EXPENSES:** The draft audit report should recognize the recent agreement among this office, the OIG, the Office of Management and Budget (OMB) and the General Accounting Office (GAO) on the procedures to be used for reporting FMS activity in DoD financial statements. A copy of the agreement is attached. This matter is considered closed.

**OIG RECOMMENDATION D:** We recommend that the Under Secretary of Defense (Comptroller) revise applicable sections of DoD 7000.14-R, the "DoD Financial Management Regulation," to state that accounts receivable arise as a result of an entity providing goods or services to a customer without the entity having received advance payment.

**DOD RESPONSE:** Nonconcur. The Statement of Federal Financial Accounting Standards (SFFAS), Number 1, paragraph 41, provides that "A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due), or goods or services provided." The offered and accepted FMS case is a binding requirement and calls for an advance of funds from the FMS customer, thus, a nonentity accounts receivable should be established when the due date for the advance payment is not met.

**OIG RECOMMENDATION E.1.a:** We recommend the Under Secretary of Defense (Comptroller) revise DoD 7000.14, the "DoD Financial Management Regulation," to require the Military Departments, beginning in FY 1998, to account for inventory purchased with funds from Cooperative Logistics Supply Support Arrangements.

**DOD RESPONSE:** Nonconcur. However, the Military Departments should recognize the influx of cash from the FMS customer as a deferred credit. The FMS customer does not own any inventory; it has only purchased the rights to order items at a later point in time. The deferred credit is not linked to any specific order and should not be classified as an unearned revenue as it will not be used to pay for any future supplies received. As such, this financing mechanism is not recognized in the budgetary accounts of the Military Services and should not be shown in the Military Department's budget execution reports. Instead, the advance of funds will be returned to the FMS customer at the conclusion of the FMS case, or may be used (reclassified) to pay for the last order of supply items.

**OIG RECOMMENDATION E.1.b:** We recommend the Under Secretary of Defense (Comptroller) revise DoD 7000.14-R, the "DoD Financial Management Regulation," to require the Military Departments, beginning in FY 1998, to report annually (as of September 30) to the DFAS-DE the value of on-hand inventory from Cooperative Logistics Supply Support Arrangements.

**DOD RESPONSE:** Nonconcur. However, as discussed in E.1.a. above, the FMS customer does not own any inventory nor does it have any claim to any inventory in U.S. stocks. It does, however, have financing funds on deposit with the Military Department. The liability for cash received should be reported in the Military Department's financial statements and footnoted to the extent required by form and content requirements.

**OIG RECOMMENDATION E.2:** We recommend that the Director, DFAS-DE designate and direct staff officials to work with the Military Departments to establish reporting procedures for all inventory from Cooperative Logistics Supply Support Arrangements.

**DOD RESPONSE:** Nonconcur. The principles identified in response to Recommendations E.1.a. and b. should be followed.



OFFICE OF THE SECRETARY OF DEFENSE  
WASHINGTON, DC 20301



Mr. Norwood J. Jackson, Jr.  
Deputy Comptroller  
Office of Federal Financial Management  
Office of Management and Budget  
Washington, DC 20503

MAR 31 1998

Dear Mr. Jackson:

We propose the following procedures be used for reporting Foreign Military Sales (FMS) activity in the DoD financial statements. Our proposal is based upon further discussion of the issues we discussed with your representative on March 18, 1998, and is subject to your approval. Specifically, we propose:

- All FMS fund activity of the Defense Security Assistance Agency (DSAA) will be included in the DoD consolidated financial statements, as a portion of Other Defense Organizations, General Funds, but separate stand alone financial statements for the DSAA will not be produced.
- Revenue and expense amounts for FMS procured by contract will not be reported, but the omission will be disclosed in a footnote to the financial statements. The footnote will state management's estimate of the amounts not reported. This footnote will meet the full disclosure requirements. Suggested wording of the footnote is, "Revenue and expense amounts pertaining to Foreign Military Sales (FMS) items provided by DoD contractors are not reported in the Statement of Net Cost. In FY XXXX, we estimate the amount of those revenues and expenses to be \$ \_\_\_\_\_. A Statement of Custodial Activity is provided which reports the amounts of cash receipts and disbursements of the FMS Trust Fund during the year."
- A Statement of Custodial Activity will be prepared for cash receipts and disbursements from the FMS Trust Fund and included in the DoD consolidated statements.
- Revenue and expense amounts pertaining to FMS goods or services provided from the stocks of the DoD Components on a reimbursable basis will continue to be reported in the financial statements of the applicable DoD Components and in the DoD consolidated financial statements. Revenue and expense amounts pertaining to FMS administrative expenses will be included in the DoD consolidated financial statements, as a portion of "Other Defense Organizations, General Funds."

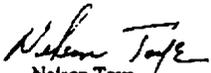


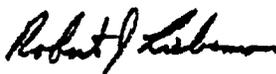
## Under Secretary of Defense (Comptroller) Comments

---

- Principal statements for allocations and authorities received from the Executive Office of the President (i.e., appropriated funds (11X1081, 11X1082, and 11X1089) and revolving funds (11-4116, 11-4121, and 11-4122) will be prepared and included in the "Other Accompanying Information" section of the DoD consolidated financial statement.

Thank you for your consideration of this proposal. Should you have any questions, please give us a call. Mr. Toye can be reached at (703) 697-0503 and Mr. Lieberman at (703) 604-8900.

  
Nelson Toye  
Deputy Chief Financial Officer

  
Robert J. Lieberman  
Assistant Inspector General  
for Auditing

APPROVED  5/14/98

## **Audit Team Members**

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD prepared this report.

F. Jay Lane  
Salvatore D. Guli  
Richard B. Bird  
Brice Harbert  
Mark Ives  
Gerald Montoya  
Andrew Hornbrook  
Lisa Dean  
Susanne B. Allen

