

Audit

Report



STEWARDSHIP REPORTING IN THE DOD AGENCY-WIDE
FINANCIAL STATEMENTS FOR FY 1998

Report No. 99-210

July 9, 1999

Office of the Inspector General
Department of Defense

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Acronyms

OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
RSSI	Required Supplementary Stewardship Information
SFFAS	Statement of Federal Financial Accounting Standards
USD(C)	Under Secretary of Defense (Comptroller)



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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July 9, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (ACQUISITION AND TECHNOLOGY)

UNDER SECRETARY OF DEFENSE (COMPTROLLER)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT. Audit Report on Stewardship Reporting in the DoD Agency-Wide Financial Statements for FY 1998 (Report No 99-210)

We are providing this report for review and comment. The Under Secretary of Defense (Comptroller), the Navy, and the Army did not comment on the draft report. The Assistant Secretary of the Air Force (Financial Management and Comptroller) sent us comments concurring with the draft report but the comments were received too late to be included in the final report.

DoD Directive 7650 3 requires that all recommendations be resolved promptly. We request comments from all addressees for each applicable finding and recommendation. Based on discussions with officials from the Office of the Under Secretary of Defense (Comptroller), the recommendations formerly addressed to the Under Secretary of Defense (Comptroller) are now addressed to the Under Secretary of Defense for Acquisition and Technology, in coordination with the Under Secretary of Defense (Comptroller). We request that all addressees provide comments by August 9, 1999.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr David F. Vincent at (703) 604-9110 (DSN 664-9110) (dvincent@dodig.osd.mil) or Mr. John A. Richards at (703) 604-9133 (DSN 664-9133) (jrichards@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 99-210
(Project No. 9FH-2004)

July 9, 1999

Stewardship Reporting in the DoD Agency-Wide Financial Statements for FY 1998

Executive Summary

Introduction. This audit was required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. This audit report addresses DoD guidance covering the presentation of FY 1998 required supplementary stewardship information and the accuracy of heritage asset data. DoD removed approximately \$698.7 billion of assets from its balance sheet and reported them in the required supplementary stewardship information as stewardship assets.

Statement of Federal Financial Accounting Standards No. 8, "Supplementary Stewardship Reporting," June 1996, requires one or more separate statements, if applicable to the reporting entity, to be included after the basic financial statements to present the required supplementary stewardship information. Required supplementary stewardship information is reported by three major categories: stewardship property, plant, and equipment; stewardship investments; and stewardship responsibilities. Stewardship property, plant, and equipment are further broken down into National Defense property, plant, and equipment; heritage assets; and stewardship land.

Objectives. Our objective was to determine whether National Defense property, plant, and equipment; heritage assets, stewardship land, and stewardship investments were presented on the financial statements accurately and in accordance with generally accepted accounting standards for Federal agencies. We also planned to assess management controls, compliance with laws and regulations, and performance indicators related to the financial statements. For this report, we performed oversight of the Military Department audit agencies' work on National Defense property, plant, and equipment and performed work in the areas of heritage assets and stewardship land. Because of uncertainty associated with the reporting requirements of the Statement of Federal Financial Accounting Standards and the Office of Management and Budget reduction of audit requirements, we revised our audit scope and objective to a review of heritage assets and stewardship land reporting and database accuracy.

Results. The DoD did not issue the Agency-Wide supplementary stewardship reports for FY 1998 until March 1, 1999. Therefore, we could not evaluate their ability to meet the Statement of Federal Financial Accounting Standards requirements before the statements were transmitted to the Office of Management and Budget. A contributing factor in DoD not preparing the statements was the changing guidance from the Federal Accounting Standards Advisory Board. Reviews of the DoD form and content guidance and the Military Department supplementary stewardship reports identified two areas that required management attention.

- DoD guidance for reporting collection-type heritage assets was not consistent with the Statement of Federal Financial Accounting Standards,

and the Military Departments did not apply the guidance consistently. As a result, financial statements did not provide clear, concise, and reliable data (finding A).

- Systems used to monitor collection-type heritage assets were incomplete and inaccurate. As a result, the Military Departments would not have a reliable information basis for reporting heritage assets on the financial statements for FY 1999 and beyond. See Appendix A for details of the results of our review of the management control program relating to the accountability over assets (finding B).

Summary of Recommendations. We recommend that the Under Secretary of Defense for Acquisition and Technology and the Under Secretary of Defense (Comptroller) coordinate on revising guidance to show collection-type heritage assets by number of items on future financial statements. In addition, we recommend that the Under Secretary of Defense (Comptroller), in coordination with each Military Department Assistant Secretary (Financial Management and Comptroller), review database systems to determine the feasibility of a database with standard DoD data elements within each military department or of a centralized DoD database.

Management Comments. Except for responsive Air Force comments received too late to be included in this report, we received no management comments to our draft report. Based on discussions with officials from the Office of the Under Secretary of Defense (Comptroller), the recommendations formerly addressed to the Under Secretary of Defense (Comptroller) are now addressed to the Under Secretary of Defense for Acquisition and Technology, in coordination with the Under Secretary of Defense (Comptroller). We request that the Under Secretary of Defense for Acquisition and Technology, the Under Secretary of Defense (Comptroller), and each Military Department Assistant Secretary (Financial Management and Comptroller), provide comments to the final report by August 9, 1999.

Table of Contents

Executive Summary	i
Introduction	
Background	1
Objectives	5
Findings	
A. Reporting of Collection-Type Heritage Assets	6
B. Heritage Asset Databases	11
Appendixes	
A. Audit Process	
Scope	15
Methodology	16
Management Control Program	17
B. Summary of Prior Coverage	19
C. Report Distribution	21

Background

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. This audit report addresses DoD guidance covering the presentation of FY 1998 required supplementary stewardship information and the accuracy of heritage asset data. DoD issued the Agency-Wide financial statements for FY 1998 on March 1, 1999. As a result, it was too late to audit the figures presented. DoD removed approximately \$698.7 billion of assets from its balance sheet and reported them in the required supplementary stewardship information as stewardship assets.

Statement of Federal Financial Accounting Standards (SFFAS) No. 6, "Accounting for Property, Plant and Equipment," November 1995, established two broad categories of Federal property, plant, and equipment (PP&E): general PP&E and stewardship PP&E. Stewardship PP&E was further defined into three categories: National Defense PP&E, heritage assets, and stewardship land. SFFAS No. 8, "Supplementary Stewardship Reporting," June 1996, defined two additional broad areas of stewardship reporting, stewardship investments and stewardship responsibilities. The standard also established reporting requirements for all stewardship categories. Both SFFAS No. 6 and SFFAS No. 8 became effective for fiscal periods beginning after September 30, 1997.

In February 1998, the Federal Accounting Standards Advisory Board (the Board) issued an Exposure Draft proposing to amend SFFAS Nos. 6 and 8 substantially. On August 7, 1998, the Board decided in principle to adopt the major points of the Exposure Draft, with certain issues to be addressed later. The result was SFFAS No. 11, "Amendments to Accounting for Property, Plant, and Equipment - Definitional Changes," December 1998, which became effective for FY 1999 with early implementation encouraged. The DoD was the department most affected by the SFFAS No. 11 changes and chose early implementation for FY 1998.

As with the three subcategories for stewardship PP&E, stewardship investments have three subcategories. Each of the six subcategories, if applicable to the reporting entity, has separate statements following the financial statements. SFFAS No. 8 gives the separate statements of stewardship information the designation "Required Supplementary Stewardship Information" (RSSI). RSSI on stewardship responsibilities is reported in the consolidated financial statements of the Federal Government only, not in the statements of individual components such as DoD. Therefore, this report does not cover stewardship responsibilities.

On January 25, 1999, the Office of Management and Budget (OMB) issued OMB Bulletin 99-08, "Amendments to OMB Bulletin 98-08, Audit Requirements for Federal Financial Statements." For FY 1998 only, OMB removed the requirement to audit RSSI for the purpose of rendering an opinion on it. Instead, auditors were to apply the less extensive procedures appropriate for required supplementary information. The OMB action recognized that financial reporting requirements were not final as late as December 1998 and that the resultant delays in preparing financial statements left little time to audit the statements. The delays were

especially significant for RSSI. As a result of the OMB action, we were not required to and did not render an opinion on RSSI for FY 1998.

Stewardship PP&E. Stewardship PP&E is distinguished from general PP&E in that it is not usually used to provide general Government services or goods (an exception is multi-use heritage assets as explained in this section). Therefore, capitalizing the assets on the balance sheet and depreciating the cost over an estimated useful life, as with other PP&E, is not meaningful for determining a cost of operations. For FY 1998, the first year for stewardship reporting, stewardship asset amounts previously shown as general PP&E were required to be removed from the balance sheet using a prior period adjustment.

National Defense PP&E. The National Defense PP&E category consists of weapon systems and support PP&E owned by DoD or its component entities for use in the performance of military missions and vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. The category was originally called "Federal Mission PP&E" and included space exploration equipment, which is found in agencies other than DoD. SFFAS No. 11 officially instituted the new designation "National Defense PP&E" and changed the definition. Among other changes, space exploration equipment is now classified as general PP&E.

In addition to the name and definitional change, DoD expected SFFAS No. 11 to implement most of the significant changes addressed in the Exposure Draft to SFFAS Nos. 6 and 8. Previously, the "Federal Mission PP&E" was to be reported in a separate RSSI statement at either total cost or latest acquisition cost, without depreciation. However, under the February 1998 Exposure Draft requirement, entities would have had to report quantities of National Defense PP&E rather than historical costs. Entities also would have had to report the investment in National Defense PP&E for the reporting year and the 4 preceding fiscal years. For the FY 1998 financial statements, only the current year's investment amounts were to be reported.

In December 1998, the Under Secretary of Defense (Comptroller) (USD(C)), directed the DoD Components to implement the amendments to SFFAS Nos. 6 and 8 early for preparation of its FY 1998 financial statements. USD(C) also directed DoD Components to add a footnote that some changes in reporting requirements would not be fully implemented until DoD was able to make needed changes to its property systems.

However, DoD implemented the fundamental part of the change that it expected from the Exposure Draft, that is, reporting quantities of items and annual investment rather than the historical cost of items.

We performed oversight of the Military Department audit agency efforts regarding National Defense PP&E for FY 1998, and we relied on their audit reports. We limited our oversight because none of the Military Department audit agencies were required to express an opinion on their respective National Defense PP&E for FY 1998. The Military Department audit agencies, together with the General Accounting Office, had projects to identify National Defense PP&E in advance for FY 1997, and those efforts continued for FY 1998. In addition, changing reporting requirements affected the audit approach that the Military

Department audit agencies used. Accordingly, the audit agencies did not actually test National Defense PP&E and instead concentrated on resolving previously identified problems.

Heritage Assets. Heritage assets are PP&E unique for historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage assets are divided into collection-type heritage assets, such as items in a museum, and noncollection-type assets, such as historic buildings. Reporting of heritage assets is in physical units, not dollars.

Multi-use heritage assets consist of PP&E items that have the properties of heritage assets and are also used in general Government operations. Because of the number of military installations using historic buildings operationally, DoD has a very large number of multi-use heritage assets. The Exposure Draft of February 1998 proposed that the assets remain on entity balance sheets, in dollars, as general PP&E, in addition to being reported on the heritage asset statement. However, SFFAS No. 11 does not include any coverage of heritage assets. Therefore, the original guidance of SFFAS Nos. 6 and 8 applies. Acquisition costs of multi-use heritage assets are still to be removed from the entity's balance sheet. Costs of renovation, improvement, or reconstruction directly related to the operational use of the multi-use heritage assets are to be capitalized on the balance sheet and depreciated. Other such costs of multi-use heritage assets, as well as new acquisition costs for heritage assets, are to be expensed in the current period and reflected in the statement of net costs.

DoD Regulation 7000.14-R, Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," December 1998, reflects the change according to the Exposure Draft. However, implementing the Exposure Draft criteria resulted in DoD noncompliance with SFFAS requirements. Because of differing interpretations between the Exposure Drafts and SFFAS No. 11, we are not addressing the presentation of multi-use heritage assets in this report.

Stewardship Land. Stewardship land is land owned by the Federal Government and not acquired for or in connection with general PP&E. Examples in SFFAS No. 6 are land used for forests and parks and land used for wildlife and grazing. Reporting is to be in physical units such as acres, not dollars.

In the beginning of FY 1998, the multi-agency Stewardship Guidance Project Working Group determined that stewardship land would include all land without an identifiable cost, such as donated land or land assigned to the Military Departments from the Federal public domain. The Working Group based its interpretation on SFFAS No. 6 guidance. Using that interpretation significantly added to the potential stewardship land for DoD. DoD adopted the working group's interpretation of stewardship land for presenting the DoD figures on the FY 1998 financial statements. Because the Working Group's interpretation was not formalized into SFFAS Stewardship guidance, uncertainty remains as to the land that was to be reported.

Stewardship Investments. Amounts in the stewardship investment category are represented in the statement of net cost, but they are reported again separately in RSSI to "... highlight their substantial investment and long-term benefit," according to SFFAS No. 8. The three types of stewardship investments are defined in the following paragraphs.

Non-Federal Physical Property. Investment in non-federal physical property is the amount spent by the Federal Government on property owned by state and local governments. Reporting is in dollars. Because of involvement with National Guard units, DoD is substantially represented in the category.

Human Capital. Investment in human capital is the amount spent on education and training activities for the benefit of the public intended to maintain or increase national productive capacity. The "public" in this case excludes Federal military and civilian personnel. The USD(C) determined that DoD would have nothing to report in that category.

Research and Development. Investment in research and development is the amount spent on "... research and development programs that are intended to increase or maintain national economic productive capacity or yield other future benefits." The DoD spends considerable amounts on research and development programs, all presumably intended to yield future benefits. The USD(C) originally determined that DoD would not have anything to report in the category. However, DoD Regulation 7000.14-R, Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," December 1998, instructed DoD Components to report that category.

Compliance With Accounting Standards

The DoD form and content was not in compliance with SFFAS in two areas. First, National Defense PP&E historical cost was not to be shown in RSSI. However, the SFFAS includes conflicting guidance between the original SFFAS No. 8, the Exposure Draft to SFFAS Nos. 6 and 8, and SFFAS No. 11, which officially amends SFFAS Nos. 6 and 8. In addition, the Federal Accounting Standards Advisory Board was still holding deliberations on whether or not to present historical cost for Stewardship assets.

Second, major support principal end item quantities were not reflected on stewardship reports. The DoD form and content did show the investment in major support principal end items, but not the quantities on hand. The dollar amounts represented by those quantities were to have been removed from the DoD Agency-Wide balance sheet per the DoD form and content, and, therefore, should be disclosed in the stewardship reports. The Department addresses support PP&E in the narrative portions of the DoD form and content but omits the category from the RSSI statement example that shows asset quantities. We addressed the omission in our October 5, 1998, response to the draft version of the DoD form and content, but it was not corrected. Again, however, the conflicting guidance within the SFFAS applies.

The guidance was still being developed. Accordingly, we have not presented findings or recommendations in this report for those two issues.

Objectives

Our objective was to determine whether National Defense PP&E, heritage assets, stewardship land, and investment in non-federal physical property were presented on the financial statements accurately and in accordance with generally accepted accounting standards for Federal agencies. We also planned to assess management controls, compliance with laws and regulations, and performance indicators related to the financial statements. Because of the uncertainty of SFFAS reporting requirements and the OMB reduction of audit requirements, we revised our objective to a review of heritage assets and stewardship land reporting and database accuracy. Appendix A provides discussion on scope, methodology, auditing standards, accounting principles and the management control program. Prior audit coverage is in Appendix B.

A. Reporting of Collection-Type Heritage Assets

Financial statements did not report heritage assets accurately or in accordance with Federal standards because the FY 1998 DoD guidance for reporting of collection-type heritage assets was not consistent with the underlying guidance in SFFAS No. 8. The DoD guidance requires DoD Components to report only the number of collections, not the number of items as required by SFFAS No. 8. In addition, the Military Departments reported heritage asset data inconsistently for FY 1998. The Army reported the number of items in museums, the Navy reported the number of locations with collection-type heritage assets, and the Air Force reported the number of collections. The DoD merely consolidated the figures on the FY 1998 financial statements for heritage type assets that represented the sum of the unlike categories. As a result, the financial statements did not present clear, concise, and reliable data.

Chief Financial Officers Act Reporting Requirements

Paragraph 46 of SFFAS No. 8, "Supplementary Stewardship Reporting," June 11, 1996, states, "Heritage assets shall be quantified in terms of physical units (for example, *the number of items in collections* . . . [emphasis added])." Paragraph 50 states the following:

[Agencies should report] the number of physical units added and withdrawn from the heritage asset records during the year and the end-of-year number of physical units for each type of heritage assets. Heritage assets consist of (1) collection-type heritage assets, such as objects gathered and maintained for exhibition, for example, museum collections, art collections, and library collections

The sample statement of heritage assets in Appendix B of SFFAS No. 8 uses the preceding three categories of collection-type heritage assets: museum collections, art collections, and library collections. The sample statement has quantities expressed in thousands, for example, 878,000 in the category "Museum Collections." That example clearly focuses on the number of items as opposed to number of collections.

OMB Bulletin 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998, is consistent with SFFAS No. 8 in requiring heritage assets to be reported in terms of physical units.

DoD Guidance

Reporting of the number of items in the statement of heritage assets does not impose any new requirements, but rather it reinforces existing requirements.

Regulations that existed before the implementation of SFFAS No. 8 require Military Department museums to have an accurate inventory of items.

- DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 4, "Accounting Policy and Procedures," January 1, 1995, defines historical items as fixed assets and requires a physical inventory of fixed assets other than real estate every 3 years.
- Army Regulation 870-20, "Museums and Historical Artifacts," January 9, 1987, requires establishing accountability of historical artifacts within 24 hours of receipt, accessioning of artifacts within 5 working days, and full cataloguing of artifacts within 30 days. It also requires all museums and historical holdings to conduct a biennial inventory of their collections and report any shortages or damages.
- Secretary of the Navy Instruction 5755.1.A, "Navy Museums," July 30, 1992, requires museums to enter accession and catalogue records into a central register maintained by the Director of Naval History for use by all Navy museums.
- Air Force Instruction 84-103, "Museum System," February 4, 1998, contains the same requirements and deadlines for establishing accountability, accessioning, and cataloguing as the Army Regulation. The instruction requires an annual physical inventory.

The Military Departments are working toward compliance with the regulations, and all use numbers of items for maintaining their records, although the records are not completely accurate. See finding B on needed improvements to the systems that track museum items.

DoD Form and Content Guidance for FY 1998

The specific guidance for DoD financial statements for FY 1998, DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," December 1998 (DoD Form and Content), is inconsistent with the SFFAS reporting guidance in the area. The guidance specifies that in the category of collection-type heritage assets, DoD Components are to report quantities of collections, rather than of individual items.

OMB Bulletin 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, states, "Because of the unique character of this information, agencies are encouraged to experiment with various narratives, tables, and schedules to satisfy the intent of Supplementary Stewardship Reporting." USD(C) personnel who prepared the DoD Form and Content, Chapter 11,

"Required Supplementary Stewardship Reporting" interpreted the OMB bulletin to mean that regulations generally allowed flexibility in stewardship reporting, including the unit of measure.

Although we agree that the guidance allows flexibility in stewardship reporting, we do not agree that the provision for flexibility applies to the reporting of collections. Specifically, USD(C) was not applying the flexibility to "narratives, tables, and

schedules,” but to the basic unit of measure reported. Additionally, the USD(C) guidance does not satisfy the intent of supplementary stewardship reporting because it contradicts the SFFAS guidance.

USD(C) personnel also stated that they thought that reporting the number of items in collections would provide an excessive and meaningless level of detail. We do not agree that reporting the number of items involves excessive detail, as explained in the following section of this report.

Significance of Reporting the Number of Items in Collections

Significance to the General Reader of Financial Statements. Museums need to have security and management control measures in place sufficient to counteract significant inherent risks. The objects in museums have been determined to be of such value in preserving our national heritage that they are to be catalogued, preserved, used in training and research, displayed when possible, and kept indefinitely. Many objects have a correspondingly high-dollar market value. The museums that we visited generally had only a fraction of their items on display; therefore, the majority of the items were in storage areas where absence or deterioration might not be readily detected. For all of those reasons, collection-type heritage assets are especially vulnerable to loss, theft, and neglect.

The heritage assets statement can provide awareness of the loss or deterioration of heritage assets, and it can serve as an inducement for museums to institute strong controls and security measures. In the future, the heritage assets statement was to report beginning balances, additions, deletions, and ending balances as required by SFFAS No. 8. The addition and deletion information was to include information on the methods of acquisition and disposal. When the method of disposal was loss, theft, or damage, financial statement readers would know the magnitude of the problem so that actions could be taken when necessary. In addition, the Heritage Assets Statement would also report on the condition of the assets and related deferred maintenance, if applicable. The reporting would provide financial statement readers with information on any significant deterioration of the assets. The disclosures would identify potential problems and the need for management action.

Significance to Persons With Particular Interest in Heritage Assets. Museums commonly report information on the number of objects in their collections in nonfinancial contexts. For example, pages 725 through 743 of the U.S. Government Manual, “Smithsonian Institution,” give a brief description of the various Smithsonian museums including, in most cases, the number of items in thousands or, in some cases, millions. Such figures for the DoD museums would satisfy the heritage asset reporting requirement. Further, if numbers of items are of interest to people looking up information about the Smithsonian museums, the number of items is likely to be of interest to readers of the heritage assets statement.

Reporting of Heritage Assets

Each Military Department reported heritage assets differently. Specifically, the Army reported by number of items, the Navy reported the number of locations, and the Air Force reported the number of collections. For FY 1998, DoD merely added the number of items, number of locations, and number of collections together and presented the totals in the financial statements. Accompanying the presentation was a note explaining that the three measurements were added together because that was "the manner in which each Military Department maintains control for safeguarding the asset." However, our review of Military Department systems show that each Military Department maintains control based on number of items.

Army. The Army reported the number of items. The Army stewardship reports showed a total of 312,371 collection-type heritage assets, which was broken down into Documents, 7,570; Works of Art, 8,739; Military Artifacts, 124,077; Non-Military Artifacts, 4; Classic Weapons Systems, 104; and Other, 171,877.

Navy. The Navy financial statements showed the six collection-type heritage assets line items by cubic feet or number of items. Specifically, the Navy reported 270,930 collection-type heritage assets, which were broken down into Documents, 60,674 cubic feet (not included in item total); Works of Art, 23,499; Military Artifacts, 239,233; Non-Military Artifacts, 3,778; Classic Weapon Systems, 4,420; and zero Other collection types. When DoD prepared the consolidated statements, they showed Documents, 5; Works of Art, 5; Military Artifacts, 14; Non-Military Artifacts, 14; and zero Classic Weapon Systems and Other collections. Navy Comptroller personnel stated that the change was directed by USD(C) personnel and represented the number of locations.

Air Force. The Air Force presented its heritage assets in a confusing manner. The Air Force reported the number of collections, not items, in the collection-type section of its statement of heritage assets for FY 1998. Specifically, the Air Force reported six collection-type heritage assets collections, consisting of Documents, 2; Works of Art, 2; Military Artifact, 1; and Classic Weapon System, 1. The 6 collection-type heritage assets reported for the Air Force are in contrast to the 312,371 reported for the Army and the 270,930 reported for the Navy and is misleading. The only explanation as to what the six collections represented was in the footnotes, which disclosed the number of items for each category complete with beginning and ending balances, to include additions and deletions. In the footnote, the reader can see that the Air Force actually had 70,501 collection-type heritage assets.

Conclusion

The Army correctly reported the number of items despite contrary DoD guidance. If DoD guidance remains the same for FY 1999, the Army may incorrectly not report the number of items, and the Air Force may only show item information in

footnotes as they did for FY 1998. By not reporting the number of items of collection-type heritage assets, the financial statements will not provide full disclosure of all DoD heritage assets. Reporting only the number of collections could allow losses or deterioration within collections to go unreported and lessen pressure to correct problems, which could eliminate much of the potential value of the statement of heritage assets.

Recommendation

Redirected Recommendation. Based on discussions with Under Secretary of Defense (Comptroller) personnel, the recommendation formerly addressed to the Under Secretary of Defense (Comptroller) is now addressed to the Under Secretary of Defense for Acquisition and Technology, in coordination with the Under Secretary of Defense (Comptroller).

A. We recommend that the Under Secretary of Defense for Acquisition and Technology, in coordination with the Under Secretary of Defense (Comptroller), amend DoD Regulation 7000.14-R, "Financial Management Regulation," Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," to state that for collection-type heritage assets, the number of items in collections should be reported.

Management Comments Required

The Under Secretary of Defense (Comptroller) did not comment on a draft of this report. Although not requested to comment, the Air Force provided responsive comments. However, the comments were received too late to be included in the final report. We request comments from the Under Secretary of Defense for Acquisition and Technology and the Under Secretary of Defense (Comptroller).

B. Heritage Asset Databases

Historical artifact databases were not accurate or complete. Database problems included 160,000 to 233,800 item omissions and 650 missing paintings, as well as incorrect location data, incorrect item identification data, and the failure to remove deaccessioned items. Databases were inaccurate and incomplete because of inadequate planning, inadequate database systems implementation, and insufficient staffing to meet workload needs. Centralized databases encompassing all types of historical artifacts were not in place when new requirements for reporting heritage asset data (to include historical artifacts) were implemented. As a result, the Military Departments would not have a reliable information basis for reporting heritage assets on the financial statements for FY 1999 and beyond.

Military Department Historical Artifact Databases

Military Department museums are required to maintain accurate inventories of the historical artifacts in their possession (see finding A). Previous audit reports and the results of our judgmental selections of historical artifact inventory sites and samples indicate that Military Department inventory databases are incomplete.

Army. The Army (64 major museums) reported 312,371 collection-type heritage assets in its RSSI Statements for FY 1998. The Army maintained a centralized database that includes both historical artifacts and artworks. We performed judgmental sampling of the inventory at nine Army locations, comparing items on hand with inventory records. In general, differences noted seemed minor or explainable. However, Army Historical Clearinghouse personnel estimated that they had 100,000 to 150,000 uncataloged items at the Anniston Army Depot. The possibility exists that many of the uncataloged items might not qualify as historical artifacts, but further analysis would be necessary to reach such conclusions. At 3 other locations, Chemical Corps Museum, Fort Sam Houston Museum, and John F. Kennedy Special Warfare Museum, more than 15,000 items had been cataloged but not loaded into the central database. In addition to the locations visited, at least nine other locations (two museums and seven historical holdings) had data on catalogued items that were not loaded into the central database.

Navy. The Navy (11 major museums, including 1 Marine Corps museum) reported 270,930 collection-type heritage assets in its RSSI Statements for FY 1998. Both the Navy and the Marine Corps had decentralized databases for separately tracking historical artifacts and artworks, and they were implementing new database systems for tracking historical artifacts. We performed judgmental sampling of the inventory at four Navy locations and at one Marine Corps location, comparing items on hand with local inventory records. In general, except for 27 lost items out of a judgmental sample of 687, the differences noted seemed minor or explainable. However, Naval Historical Center personnel readily admitted that their database, the largest for tracking naval historical artifacts, was 30 to 40 percent inaccurate. The inaccuracies related both to omitted item records and to

wrong locations. The Naval Historical Center Annual Report for 1997 states that 650 paintings in the artworks database could not be located. The paintings still had not been located as of March 1999.

Air Force. The Air Force (15 museums plus 6 other major holdings) reported 70,501 collection-type heritage assets in its RSSI Statements for FY 1998. The Air Force had a centralized inventory database for historical artifacts, and, except for artwork valued at more than \$5,000, decentralized databases for artworks. The Air Force recently began to implement new database software for the centralized database of historical artifacts. We performed judgmental sampling of the inventory at 12 Air Force locations, comparing inventory records with items on hand. At nine of the inventory locations, the inventory differences were minor. However, three locations contained notable differences. The U.S. Air Force Academy Art Collection and Historical Property Holdings, with 3,114 items on its local database, was shown with only 17 items in the central historical artifacts database, and with 196 items in the Air Force Art Program artworks database. The Security Police Museum, located at Lackland Air Force Base, Texas, with 594 items in its local database, was shown with only 83 items in the central historical artifacts database. The Armament Museum, located at Eglin Air Force Base, Florida, with 910 items in its local database, was shown with 689 items in the central historical artifacts database. The situation at the Armament Museum was complicated by an unresolved dispute between the managers of the central historical artifacts database and the museum managers regarding the baseline inventory for the museum. Air Force Museum personnel admitted that a large percentage of historical artifacts are not shown in the central historical artifacts database. The Air Force Audit Agency identified the management of historical property in the Air Force museum system as a material weakness in September 1996. The material weakness was also reported as an open item in the Air Force FY 1998 annual statement required under the Federal Financial Managers' Integrity Act of 1982.

Reporting Requirements

Under the authority of United States Code, title 31, section 3515(d), the OMB Director prescribed in OMB Bulletin No. 97-01 the form and content of the audited financial statements to be presented annually by the heads of designated executive agencies. The bulletin incorporates the concepts and standards contained in the two Statements of Federal Financial Accounting Concepts and in the eight SFFAS recommended by the Federal Accounting Standards Advisory Board and issued by OMB as of the date of the bulletin or its revisions. The reporting concepts and accounting standards are central to effectively meeting the financial management improvement goals of the Chief Financial Officers Act of 1990, as amended.

Additional stated purposes of the Chief Financial Officers Act include "[To] provide for the production of complete, reliable, timely, and consistent financial information for use by the executive branch of the Government and Congress in the financing, management, and evaluation of Federal programs."

Until the implementation of SFFAS No. 6 and SFFAS No. 8, beginning in FY 1998, no specific reporting requirement existed for quantities of historical

artifacts. Historical artifacts are included within the SFFAS definition of heritage assets. Heritage assets are generally expected to be preserved indefinitely. SFFAS No. 6 states that heritage assets are PP&E that are unique for one or more of the following reasons:

- historical or natural significance;
- cultural, educational, or artistic (for example, aesthetic) importance; or
- significant architectural characteristics.

SFFAS No. 8 requires the following:

Heritage assets shall be reported as required supplementary stewardship information accompanying the financial statements of the Federal Government and the component units of the Federal Government responsible for such assets in terms of physical units. Heritage assets shall be reported in terms of physical units rather than cost, fair value, or other monetary values.

Planning for New Reporting Requirements

In previous years, Military Department auditors reported problems in the systems used for the tracking and control of historical artifacts. Museum managers indicated that they have been hindered in attempts to implement the audit recommendations by funding and staffing limitations, increased workloads resulting from Defense base realignment and closure operations, and a growing number of historical artifacts. The main recommendation in each of the prior audit reports was to improve accountability over heritage assets. To address the issue, the Military Departments have begun implementation of improved database software to reduce backlogs of items omitted from databases.

The current heritage asset reporting requirements have been required by SFFAS No. 8 since June 1996. The DoD and the individual Military Departments should have had sufficient time to plan for the FY 1998 requirements. However, as of August 1998, some historical artifacts program managers indicated that they had no knowledge of the new reporting requirements. As a result, the new requirements implementation meant that reporting data had to be generated from the systems in place. In the case of the Navy, for example, until new databases were implemented, data for the 10 Navy museums and 5 Marine Corps museums would have to be collected manually. The new requirements highlighted that comprehensive heritage asset reporting structures were not in place for the Military Departments.

Conclusion

An overall lack of planning was indicated by the lack of knowledge among program managers regarding the new reporting requirements. A lack of

planning was also apparent in the failure to implement improved database systems and provide staffing sufficient to cope with work backlogs in preparation for the new requirements.

The omission of historical artifacts and artworks from Military Department databases increases the risk for misappropriation of the omitted items, and results in an inability to accurately and concisely report heritage-type assets on the financial statements for FY 1999 and beyond.

Recommendations

Redirected Recommendation. Based on discussions with Under Secretary of Defense (Comptroller) personnel, the recommendations formerly addressed to the Under Secretary of Defense (Comptroller) are now addressed as shown below.

B. We recommend that the Under Secretary of Defense for Acquisition and Technology, in coordination with the Under Secretary of Defense (Comptroller) and with each Military Department Assistant Secretary (Financial Management and Comptroller), review database systems in use by the Military Departments for historical artifacts to determine the feasibility of:

- 1. Centralized databases having DoD standard data elements within each of the Military Departments.**
- 2. Development of a centralized database within the Department of Defense.**

Management Comments Required

Air Force comments received too late to be included in this final report were responsive. We received no management comments to our draft report. We request comments from the Under Secretary of Defense for Acquisition and Technology, the Under Secretary of Defense (Comptroller) and each Military Department Assistant Secretary (Financial Management and Comptroller). If additional comments are not provided from the Air Force, we will consider the comments received as the response to the final report

Appendix A. Audit Process

Scope

Work Performed. We attempted to review the FY 1998 RSSI that DoD submitted. The RSSI consists of Statements of National Defense PP&E, Statements of Heritage Assets, Statements of Stewardship land, Statements of Investment in Non-Federal Physical Property, and Statements of Research and Development.

We judgmentally sampled data at 26 sites and concentrated our efforts on heritage assets, particularly the 653,802 collection-type heritage assets reported by the FY 1998 RSSI statements for the Military Departments. We performed oversight of the Military Department audit agencies in their efforts on National Defense PP&E. We performed a limited review of noncollection-type heritage assets and stewardship land and did no work in investment in non-Federal physical property or investments in research and development. We interviewed personnel and reviewed records at the Military Department audit agencies, museums, museum activities, and base real estate offices.

Limitations to Audit Scope. Preparation and auditing of RSSI for FY 1998 were delayed by the uncertainty of guidance, mainly in the area of National Defense PP&E, and, to a lesser extent, in the area of heritage assets. The Federal Accounting Standards Advisory Board approved an Exposure Draft with changes in both of those areas in August 1998 and partially finalized it into a new SFFAS in December 1998. The SFFAS implements only part of what the Exposure Draft proposed on National Defense PP&E and none of what it proposed on heritage assets. The remaining points in the Exposure Draft are still under deliberation.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, DoD established 6 DoD-Wide corporate-level performance objectives and 14 goals for meeting the objectives. This report pertains to achievement of the following objective and goal:

Objective: Fundamentally reengineer the Department and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required capabilities across DoD mission areas. (DoD-6)

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

- **Financial Management Functional Area. Objective:** Reengineer DoD business practices. **Goals:** Standardize, reduce, clarify, and reissue financial management policies. (FM-4.1) Improve data standardization of finance and accounting data items. (FM-4.4)

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- **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act of 1982. (FM-5.3)

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

Methodology

Use of Computer-Processed Data. We used the databases that the Army, Navy, Air Force, and Marine Corps use to track items in their museum collections. We traced items from the databases to physical location and traced physically located items to the databases. We found few problems with being unable to find the items that were entered into the databases. However, personnel responsible for inventorying heritage assets indicated that significant numbers of items were not included in the databases. See finding B for a discussion of the problems noted in the databases.

Universe and Sample. Our audit universe consisted of the items in the museums of the Army, Navy, Air Force, and Marine Corps. We selected museums based on a combination of materiality, geographic clustering, and attempts to cover different major commands within the Services. Our samples of items at museum locations were judgmental and were based on a combination of apparent materiality and random selection. Although we found few problems with items actually entered into the databases, we could not project the results for an evaluation of the databases as a whole because we used judgmental sampling and the universe was unknown. However, based on our results from the floor to records inventory, estimates made by museum personnel of uncataloged assets, and observations made during the field work, we had sufficient evidence to conclude that the databases were significantly incomplete.

Audit Period and Locations. We conducted this audit from October 1998 through April 1999 at various Military Department museum organizations, base real estate offices, and Military Department audit agency offices.

Auditing Standards. We conducted this financial statement audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin No. 98-08, as amended by OMB Bulletin No. 99-08. For FY 1998 only, those standards require that we review RSSI with the same procedures normally applied to required supplementary information, as delineated in Statement of Auditing Standards, Section 558. The guidance requires general inquiries as to the source of the data and comparison of the RSSI information presented in statements for reasonableness and consistency with information obtained during the audit. OMB Bulletin No. 99-08 specifically excludes auditing RSSI for the purpose of rendering an opinion.

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

Management Control Program

DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. Because of the evolving requirements covering stewardship reporting and Military Department disclosures of previously identified weaknesses, we did not conduct a comprehensive review of the management control program or management's self-evaluation of their programs. However, we reviewed the management controls related to asset accountability and safeguarding.

Scope of the Review of the Management Controls. We reviewed the adequacy of management controls over heritage assets reporting, database accuracy, and physical safeguarding of assets. Specifically, we reviewed controls over the recording and maintenance of records to track the acquisition, description location, and disposal of museum collection items. We also reviewed reporting practices of the Military Departments and of DoD for museum collection items. In addition, we reviewed Military Department audit reports and management's annual assessments for disclosures of material weaknesses at the Department level. Both the Navy and the Air Force identified material weaknesses in their museum operations.

A 1997 Army Audit Agency report identified weaknesses in the Center of Military History's accounting for the historical artifacts and art of the Army. The material weaknesses identified were not reported in ensuing Army-Wide Federal Financial Managers' Financial Integrity Act of 1982 annual statements of assurance.

A 1995 Naval Audit Service report on the FY 1994 Principal Financial Statements of the Office of Naval Records and History Fund identified material weaknesses including material omissions and inaccuracies in financial reporting, noncompliance with the intent of the legal statute that created the fund, and an ineffective management control program. The material weaknesses identified were not reported in ensuing Navy-wide Federal Financial Managers' Financial Integrity Act of 1982 annual statements of assurance. An August 1998 letter from the Naval Inspector General identified material weaknesses in the oversight and direction of the Navy Art Collection. The Director, Naval Historical Center, reported the material weakness, to the Chief of Naval Operations during the Navy Management Control Certification annual review. The Director's letter was issued in September 1998, which was too late for inclusion in the FY 1998 Navy-Wide Annual Statement of Assurance under the Federal Financial Managers' Integrity Act of 1982. Except for the accountability issue, the material weaknesses that were addressed have either been corrected or overcome by events. Corrective actions concerned with the accountability issue have a planned completion date of FY 2004, by which time a complete one-time benchmark inventory was to be completed.

Since 1996, the Air Force reported the management of historical property in the Air Force Museum System as a material weakness in its Federal Financial Managers' Integrity Act of 1982 annual statements of assurance. Ongoing corrective efforts were scheduled for completion in FY 1999.

Adequacy of Management Controls. Management controls covering asset accountability were not adequate. The inability to load all assets into the databases reduces the controls for monitoring museum assets. The Army reported that the Center of Military History did not adequately account for historical artifacts and art under its control. The Navy and the Air Force reported asset accountability weaknesses at the museum or installation level. The recommendations in this report, if implemented, will help correct the material weaknesses. The audit report will be issued to senior officials in charge of management controls for each Military Department.

Appendix B. Summary of Prior Coverage

Department of Defense

Inspector General, DoD, Report No. 99-097, "Internal Controls and Compliance With Laws and Regulation for the DoD Agency-Wide Financial Statements for FY 1998," March 1, 1999.

Army

Army Audit Agency Report No. AA 99-191, "Army's Principal Financial Statements for Fiscal Year 1998-Supplemental Stewardship Reporting of National Defense Equipment," March 24, 1999.

Army Audit Agency Report No. AA 99-112, "Army's Principal Financial Statements for Fiscal Years 1998 and 1997-Financial Reporting of Equipment-Follow-up Issues," January 15, 1999.

Army Audit Agency Report No. AA 99-108, "Army's Principal Financial Statements for Fiscal Years 1998 and 1997-Financial Reporting of Equipment-Reportable Item Control Codes," December 31, 1998.

Army Audit Agency Report No. AA 98-172, "Army's Principal Financial Statements for Fiscal Years 1997 and 1996 - Accountability for Army Mission Equipment," May 4, 1998.

Army Audit Agency Report No. AA 97-291, "Property Exchange Transactions-Center of Military History," September 30, 1997.

Army Audit Agency Report No. AA 97-290, "Center Operations - Center of Military History," September 30, 1997.

Army Audit Agency Report No. AA 97-287, "Property Accountability - Center of Military History," August 28, 1997.

Navy

Naval Audit Service Report No. 028-99, "Department of the Navy Principal Statements for Fiscal Year 1998: Reports on Internal Controls and Compliance with Laws and Regulations," February 22, 1999

Navy (cont'd)

Naval Audit Service Report No. 024-99, "Department of the Navy Principal Statements for Fiscal Year 1998: Report on Auditor's Opinion," February 10, 1999.

Naval Audit Service Report No. 031-98, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Reports on Internal Controls and Compliance With Laws and Regulations," March 31, 1998.

Naval Audit Service Report No. 025-98, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: Report on Auditor's Opinion," February 27, 1998.

Naval Audit Service Report No. 046-95, "Fiscal Year 1994 Principal Financial Statements at the Office of Naval Records and History Fund," May 31, 1995.

Air Force

Air Force Audit Agency Project No. 98053008, "Supplementary Stewardship Reporting, Fiscal Year 1998, Air Force Consolidated Financial Statements," February 11, 1999.

Air Force Audit Agency Project No. 97053008, "Supplementary Stewardship Reporting, Fiscal Year 1997, Air Force Consolidated Financial Statements," July 22, 1998.

Air Force Audit Agency Project No. 97264012, "Report of Audit 26497036, Management of Museum Property, 37th Training Wing, Lackland AFB [Air Force Base], Texas," April 10, 1997.

Air Force Audit Agency Project No. 96051028, "USAF [U.S. Air Force] Museum System," September 4, 1996.

Air Force Audit Agency Project No. 96904018, "Report of Audit 90496020, Management of Air Force Art Work, 3d Wing Elmendorf AFB [Air Force Base], Alaska," February 16, 1996.

Air Force Audit Agency Project No. 96506011, "Report of Audit 50696014, Air Force Museum System Property, 171st Air Refueling Wing," January 22, 1996.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
 Commandant, Defense System Management College
 Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
 Deputy Chief Financial Officer
 Director for Accounting Policy
 Deputy Comptroller (Program/Budget)

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

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
 Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

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

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