

Audit

Report



INTERNAL CONTROLS AND COMPLIANCE WITH LAWS AND
REGULATIONS FOR THE DEFENSE FINANCE AND ACCOUNTING
SERVICE WORKING CAPITAL FUND FINANCIAL STATEMENTS
FOR FY 1998

Report Number 99-090

March 1, 1999

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Acronyms

CFO	Chief Financial Officers
DBMS	Defense Business Management System
DFAS	Defense Finance and Accounting Service
DPAS	Defense Property Accountability System
FFMIA	Federal Financial Management Improvement Act
FMFIA	Federal Managers' Financial Integrity Act
GPRA	Government Performance and Results Act
OMB	Office of Management and Budget
SAS	Statement of Auditing Standards
USGSL	U.S. Government Standard General Ledger
WCF	Working Capital Fund



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

March 1, 1999

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

SUBJECT: Audit Report on Internal Controls and Compliance With Laws and
Regulations for the Defense Finance and Accounting Service Working
Capital Fund Financial Statements for FY 1998 (Report No. 99-090)

We are providing this report for your review and comment. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspector General, DoD, and prescribes the responsibility of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations.

The audit was conducted to render an opinion on the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1998 and to report on internal controls and compliance with laws and regulations. We were unable to render an opinion on the financial statements because of continued deficiencies in accounting systems and control procedures. This report discusses material weaknesses in internal controls and instances of noncompliance with laws and regulations.

The Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service, did not comment on a draft of this report. Office of Management and Budget Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended on January 25, 1999, requires comments on the findings in this report, including corrective actions taken or planned and comments on the status of corrective actions taken on prior findings. Accordingly, we request the Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service, provide comments on the final report by March 31, 1999.

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) or Mr. Carmelo G. Ventimiglia at (317) 510-3852 (DSN 699-3852) (e-mail cventimiglia@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

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Office of the Inspector General, DoD

Report No. 99-090
(Project No. 8FI-2028.01)

March 1, 1999

Internal Controls and Compliance With Laws and Regulations for the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1998

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and auditors for financial statements, internal controls, and compliance with laws and regulations. The Director, Defense Finance and Accounting Service (DFAS), who is the fund manager of the DFAS Working Capital Fund, is responsible for establishing and maintaining adequate internal controls and for complying with applicable laws and regulations. Our responsibility is to render an opinion on the financial statements and to determine whether internal controls were adequate and whether management complied with applicable laws and regulations.

Before FY 1992, DoD operated a significant number of commercial and industrial facilities under a revolving fund concept. In FY 1992, the revolving funds were consolidated to form the Defense Business Operations Fund. In December 1996, the Under Secretary of Defense (Comptroller) restructured the Defense Business Operations Fund into separate working capital funds. The DFAS Working Capital Fund provides funding for centralized finance and accounting services and systems support for all DoD Components. In FY 1998, the DFAS Working Capital Fund reported assets of \$662.9 million, liabilities of \$518.6 million, and revenue of \$1.7 billion.

Objectives. The overall objective of our audit was to determine whether the DFAS Working Capital Fund Financial Statements for FY 1998 were presented fairly and in accordance with Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended on November 20, 1998. We determined whether internal controls were adequate to ensure that the DFAS Working Capital Fund financial statements were free of material error. We also assessed compliance with laws and regulations for transactions and events that had a direct and material effect on the financial statements.

Disclaimer of Opinion. We were unable to render an opinion on the DFAS Working Capital Fund Financial Statements for FY 1998 because of uncorrected deficiencies in accounting systems and control procedures. These problems materially affected the information in the DFAS Working Capital Fund FY 1998 financial statements. Although DFAS was taking actions to correct the problems, the actions were not completed in FY 1998. As a result, we were unable to conduct a comprehensive audit of the DFAS Working Capital Fund. See Exhibit 3 for our disclaimer of opinion and the financial statements.

Review of Internal Controls. The DFAS Working Capital Fund needed to strengthen internal controls over accounting for fixed assets and revenue. Most of the deficiencies

cited in our internal controls and compliance audit for FY 1997 remain uncorrected. For the FY 1998 financial statements, \$46.2 million of the \$705.3 million of fixed assets recorded in the general ledgers were not recorded in the subsidiary ledgers, and revenue in FY 1998 was overstated by at least \$142.9 million. About \$49.4 million of revenue was recognized in an incorrect accounting period, and out of the \$165.1 million in revenue exchanged between the two DFAS Working Capital Fund business areas, \$93.5 million was not eliminated. In addition, significant portions of the Fund Balance With Treasury account, Accounts Payable, and Accounts Receivable were unverifiable. As a result, we were unable to attest to the reliability of the financial statements. See our Review of Internal Controls.

Review of Compliance With Laws and Regulations. DFAS needed to improve compliance with laws and regulations concerning disclosure in the financial statements and accounting for financial information. The DFAS Working Capital Fund Financial Statements for FY 1998 did not disclose all significant information as required by Office of Management and Budget Bulletin No. 97-01, and the accounting systems did not substantially comply with the Federal Financial Management Improvement Act of 1996. As a result, the financial statements were not fully informative and had account balances that were not always verifiable. DFAS also did not follow DoD guidance when it performed \$61.9 million in work without funded customer orders and did not promptly follow up with those customers. See our Review of Compliance With Laws and Regulations. Appendix C lists the laws and regulations tested.

Management Comments. The Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service, did not comment on a draft of this report, issued February 10, 1999. Office of Management and Budget Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended on January 25, 1999, requires comments on the findings in this report, including corrective actions taken or planned and comments on the status of corrective actions taken on prior findings. Accordingly, we request the Under Secretary of Defense (Comptroller) and the Director, Defense Finance and Accounting Service, provide comments on the final report by March 31, 1999.

Table of Contents

Executive Summary	i
Introduction	
Background	1
Objectives	2
Review of Internal Controls	
Introduction	3
Reportable Conditions	5
Review of Compliance With Laws and Regulations	
Introduction	10
Reportable Conditions	10
Appendixes	
A. Audit Process	
Scope	17
Methodology	20
B. Summary of Prior Coverage	21
C. Laws and Regulations Reviewed	22
D. Report Distribution	23
Exhibits	
1. Management Representation Letter	
2. Legal Representation Letter	
3. Financial Statements and Auditor Opinion	

Introduction

Background

Introduction. This audit was performed to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Government Management Reform Act of 1994," October 13, 1994. The legislation requires financial statement audits by the Inspectors General and prescribes the responsibility of management and the auditors with respect to the financial statements, internal controls, and compliance with laws and regulations. Management is responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to DoD financial accounting and reporting. Auditors are responsible for rendering an opinion on the financial statements and determining whether internal controls are adequate and whether the reporting entity complied with applicable laws and regulations.

Accounting Functions and Responsibilities. A working capital fund is a revolving fund that operates as an accounting entity. Within each working capital fund, business areas are financed through customer reimbursements rather than direct appropriations. Assets of each business area are capitalized under the working capital fund, and most income is derived from collections from fund operations.

The Defense Finance and Accounting Service (DFAS) Working Capital Fund (WCF) consists of two business areas: Financial Operations and Information Systems. The business areas provide centralized finance and accounting services and systems support for all DoD Components. The DFAS Columbus Center, Columbus, Ohio, performs accounting functions and prepares financial statements for the DFAS WCF. In FY 1998, the DFAS WCF reported assets of \$662.9 million, liabilities of \$518.6 million, and revenues of \$1.7 billion. The Director, DFAS, is the fund manager for the DFAS WCF.

Accounting Policies. DFAS WCF Financial Statements for FY 1998 were to be prepared in accordance with the Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended on November 20, 1998. Note 1 of the DFAS WCF Financial Statements for FY 1998 discusses the significant accounting policies that DFAS used in preparing the financial statements.

Disclaimer of Opinion. We disclaimed an opinion on the DFAS WCF Financial Statements for FY 1998 because of deficiencies in accounting systems and control procedures. Our disclaimer of opinion was issued in a separate memorandum and included in the DFAS WCF Financial Statements for FY 1998. See Exhibit 3 for our disclaimer of opinion and the financial statements.

Objectives

The overall objective of our audit was to determine whether the DFAS WCF Financial Statements for FY 1998 were presented fairly and in accordance with OMB Bulletin No. 97-01. We determined whether internal controls were adequate to ensure that the DFAS WCF financial statements were free of material error. We also assessed compliance with laws and regulations for transactions and events that had a direct and material effect on the financial statements. Appendix A gives the audit scope and methodology, accounting principles, and auditing standards. Appendix B summarizes prior coverage related to the audit objectives.

Review of Internal Controls

Introduction

Management Responsibilities. DFAS management is responsible for establishing and maintaining internal controls over the DFAS WCF. 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 that could have a direct and material effect on the financial statements, including those related to obligations and costs, are executed in compliance with laws and regulations directly related to the statements and with any laws and regulations that the OMB, DFAS management, or the Inspector General, DoD, have identified as being significant and for which compliance can be objectively measured and evaluated.

Internal Control Components. Statement on Auditing Standards (SAS) No. 78, "Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55," revises the definition and description of internal control contained in SAS No. 55. SAS No. 78 defines internal control as a process affected by the entity's board of directors, management, or other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

In the past, SAS No. 55 stated that the internal control structure was composed of three elements: control environment, accounting systems, and control procedures. SAS No. 78 amends this description by stating that internal control consists of five interrelated components:

- control environment,
- risk assessment,
- control activities,

-
- information and communication, and
 - monitoring.

Control Environment. The control environment includes factors that set the tone of an organization, influencing the control consciousness of its employees. The control environment includes seven factors:

- integrity and ethical values,
- commitment to competence,
- human resource policies and practices,
- assignment of authority and responsibility,
- management's philosophy and operating style,
- board of directors or audit committee participation, and
- organizational structure.

Risk Assessment. For financial reporting purposes, an entity's risk assessment is its identification, analysis, and management of risks relevant to the preparation of financial statements following generally accepted accounting principles (or other comprehensive basis of accounting). The following risks may affect an entity's ability to properly record, process, summarize, and report financial data:

- changes in the operating environment;
- new personnel;
- new information systems;
- rapid growth;
- new technology;
- new lines, products, or activities;
- corporate restructuring;
- foreign operations; and
- accounting pronouncements.

Control Activities. Control activities are the various policies and procedures that help ensure that necessary actions are taken to address risks to achieving the entity's objectives. These policies and procedures include:

-
- performance reviews (reviews of actual performance against expected performance);
 - information processing (controls that check accuracy, completeness, and authorization of transactions);
 - physical controls (activities that assure the physical security of assets and records); and
 - segregation of duties (separate authorization, recordkeeping, and custody).

Information and Communication. Information and communication includes the accounting system, consisting of the methods established to record, process, summarize, and report the entity's transactions and to maintain accountability of the related assets and liabilities. To be effective, the information and communication system must accomplish the following goals for transactions:

- identify and record all valid transactions,
- describe transactions on a timely basis,
- measure the value of transactions properly,
- record transactions in the proper time period,
- properly present and disclose transactions, and
- communicate responsibilities to employees.

Monitoring. Monitoring assesses the quality of internal control performance over time. Monitoring activities may be ongoing or separate evaluations or a combination of the two.

Reportable Conditions

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

Followup on Prior Audit. During the audit, we followed up on reportable conditions and material weaknesses in Inspector General, DoD, Report No. 98-151, "Internal Controls and Compliance With Laws and Regulations for the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1997," June 12, 1998. Our review showed that despite commendable actions taken by DFAS personnel to correct internal control deficiencies, most of the deficiencies had not been corrected as of September 30, 1998. Material weaknesses continued to exist in accounting for fixed assets and revenue and in the preparation of financial statements. Undistributed disbursements and collections continue to cause significant portions of the Fund Balance With Treasury account, Accounts Payable, and Accounts Receivable to be unverifiable. DFAS personnel were working on solutions that should improve the reporting of financial operations in FY 1999.

Accounting for Fixed Assets. Internal controls were not adequate to ensure the accurate reporting of fixed assets on the DFAS WCF Financial Statements for FY 1998. As a result, fixed assets, valued at \$705.3 million, were not properly valued, classified, and presented in the financial statements.

Subsidiary Ledger Trial Balances. Material differences existed between the amounts recorded for fixed assets in the general ledger trial balances produced by the Defense Business Management System (DBMS) and in the subsidiary ledger trial balances produced by the Defense Property Accountability System (DPAS). DPAS did not account for \$46.2 million of the \$705.3 million of fixed assets recorded in DBMS. About \$21.5 million of the \$46.2 million related to General Property, Plant, and Equipment; the balance (\$24.7 million) related to Equipment Not in Use.¹ About \$18.5 million of the \$21.5 million (86 percent) of the General Property, Plant, and Equipment not recorded in DPAS was related to Construction in Progress.² The difference between the amounts recorded as Construction in Progress in DPAS and DBMS was \$186.4 million. However, DFAS Columbus Center personnel stated that \$167.9 million of the \$186.4 million was reported as Work in Process in DPAS. In FY 1998, DFAS Columbus Center personnel established a Construction in Progress subsidiary ledger in DPAS to reconcile to the DBMS Construction in Progress account.

DPAS also did not account for \$26.9 million (80 percent) of the \$33.8 million of Equipment Not in Use.³ DFAS Columbus Center personnel stated that most of the \$26.9 million in Equipment Not in Use had been reclassified in DPAS and had been depreciated. However, reconciliations of the information in DPAS and DBMS had not been completed. Differences existed between DBMS and DPAS

¹The Consolidated Balance Sheet classifies property held but not in use as Other Assets.

²The Construction in Progress accounts are used to accumulate the costs of all capital assets developed or manufactured for use by the business area. These accounts include real property construction projects and software development.

³About \$2.2 million of the \$26.9 million in Equipment Not in Use was reported as General Property, Plant, and Equipment rather than as Other Assets.

because the systems did not interface, planned reconciliations of the systems' differences had not been completed, and procedures for ensuring that the systems contained similar data had not been fully implemented.

Financial Statement Presentation. Internal controls were not sufficient to ensure that fixed assets were properly classified and presented in the financial statements. For example, Equipment Not in Use was inconsistently classified in the Balance Sheet for the two business areas in the DFAS WCF. In the Information Systems business area, about \$8.9 million of equipment not in use was inappropriately reported as General Property, Plant, and Equipment in the version 2 financial statements provided to us on January 15, 1999. In the Financial Services business area, Equipment Not in Use was reported as Other Assets. Further, the property and financial records did not include real property that DFAS used in providing its services but did not own. DFAS recognized problems with fixed assets, including the lack of supporting documentation and the need for periodic inventories of property, plant, and equipment, and had taken some corrective actions in FY 1998. However, those actions had not been completed as of the end of FY 1998. For example, DFAS issued specific policies and procedures for maintaining DPAS as a subsidiary ledger to DBMS on November 9, 1998 (FY 1999).

Accounting for Revenue. Internal controls did not ensure that revenue was recognized and reported in the same accounting period as when work was performed. About \$49.4 million of revenue reported as earned in FY 1998 was earned before FY 1998. In addition, for first 9 months of FY 1998, the workload counts used by DFAS activities to determine reimbursements earned were not reported consistently and did not always represent outputs produced by DFAS in the accounting period. We did not quantify the effect of incorrectly reporting the workload counts on the financial statements because we considered it impractical. In July 1998, the DFAS Columbus Center adopted the Automated Workcount System and the Automated Billing System. We were informed that these systems improved the process of accumulating workload counts and billing for reimbursable accounts receivable for the last 3 months of FY 1998.

Verification of Account Balances. Deficiencies in accounting systems prevented us from verifying significant portions of the account balances for the Fund Balance With Treasury account, Accounts Payable, and Accounts Receivable because the disbursements and collections that DFAS Columbus Center personnel used to compute the balances originated in the financial network and could not be reconciled to accounting records or traced to supporting transactions. The Fund Balance With Treasury account, which had an abnormal balance of negative \$146.6 million, included \$101.9 million in undistributed disbursements and \$19.7 million in undistributed collections. Undistributed disbursements (\$71.6 million) and an associated adjustment (\$4.1 million) reduced the \$435.6 million balance in the Accounts Payable general ledger. Further, weak control procedures caused some balances in the Accounts Payable general ledger to be unsupported. Accounts Receivable were reduced by undistributed collections (\$1.9 million) and increased by an associated adjustment (\$6.5 million). The adjustments for disbursement discrepancies (\$4.1 million) and collection discrepancies (\$6.5 million) were also used to compute the

Obligated Balance, Net - End of Period on the Statement of Budgetary Resources. Consequently, \$2.4 million (\$6.5 million minus \$4.1 million) of the obligated balance at the end of FY 1998 was unverifiable.

In April 1998, in accordance with the March 30, 1998, plan developed by the Director, DFAS, to obtain an unqualified opinion on the DFAS WCF Financial Statements for FY 1999, DFAS Columbus Center personnel began an intensive effort to research and correct undistributed balances. Personnel at each DFAS Center began reviewing accounts payable and accounts receivable to ensure support for recorded account balances. These actions significantly reduced undistributed disbursements and collections. In November 1998, the DFAS Columbus Center took further actions to improve the clearance process for transactions for others. These actions should give the DFAS Columbus Center better visibility over the disbursements and collections that had been reported to the U.S. Treasury but not recorded in accounting records.

Preparation of Financial Statements. Procedures and controls did not ensure that the financial statements were accurately prepared. In preparing the financial statements, the account balances in the general ledger financial statements were adjusted by unsupported adjustments. Supporting documentation was unavailable at the DFAS Columbus Center for three adjustments valued at \$129.5 million. The financial information on the Balance Sheet was not presented consistently for the two business areas. In addition to the \$8.9 million of Equipment Not in Use that was inappropriately reported as General Property, Plant, and Equipment in the Information Systems business area, Accrued Annual Leave (\$161,258) for employees in the Information Systems business area was inappropriately identified as Program Costs (Intragovernmental) on the Statement of Net Cost (version 2). This presentation differed from the disclosure of similar information on the Statement of Net Cost in the Financial Services business area. Additionally, Unallocated Labor Costs (\$159,705) were not included in the Statement of Net Cost.

The consolidating financial statements we audited (version 2) were not always properly adjusted for amounts shown as eliminations between the two business areas of the DFAS WCF. DFAS Columbus Center personnel used incorrect data when eliminating revenue from the Statement of Net Cost. They incorrectly assumed that the \$71.6 million in revenue received from the Defense Logistics Agency was received from one of the business areas. Based on data provided to us by DFAS Columbus Center personnel, the amount of the elimination was understated by \$93.5 million. At least \$165.1 million in revenue should have been eliminated, and a corresponding amount should have been eliminated from program costs. DFAS also inappropriately reported three financial transactions valued at \$233.8 million as eliminations. Because the information supporting the transactions was not requested in a manner that allowed the associated dollar amounts to be divided between the two business areas, the eliminations column of each of the consolidating financial statements was added to the value of the respective line items. For example, about \$61.7 million of Imputed Financing associated with the benefits owed to DFAS employees was shown in the eliminations column for Program Costs (With the Public) on the Consolidating Statement of Net Cost and for Imputed Financing on the Consolidating Statement of Changes in Net Position. That amount should have been divided between the

two business areas, not shown in the eliminations column of the consolidating financial statements. Other amounts shown as eliminations on those two consolidating financial statements were calculated to make them balance.

Management Acknowledgement of Reportable Conditions. We received a management representation letter from the Director of Resource Management, DFAS, dated March 1, 1999, regarding the DFAS WCF Financial Statements for FY 1998. The management representation letter stated that DFAS cannot provide reasonable assurance that the accounting and nonaccounting systems used to produce the financial statements are reliable because not all of the systems meet DoD and OMB requirements. Exhibit 1 is the management representation letter.

Review of Compliance With Laws and Regulations

Introduction

We audited selected financial data in the DFAS WCF financial statements for material instances of noncompliance with laws and regulations for the year ended September 30, 1998. Our purpose was not to render an opinion on overall compliance with laws and regulations. The Director, DFAS, is responsible for ensuring compliance with laws and regulations applicable to the DFAS WCF. As part of obtaining reasonable assurance on whether the financial statements were free of material misstatements, we tested compliance with laws and regulations listed in Appendix C. Such tests are required by the Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994. We did not accomplish all tests necessary to determine whether the DFAS WCF fully complied with all applicable laws and regulations. Therefore, we could not determine the range and magnitude of noncompliance with laws and regulations that may affect the reliability of the DFAS WCF Financial Statements for FY 1998. However, we were able to identify instances of material noncompliance with laws and regulations.

Reportable Conditions

Material instances of noncompliance are failures to follow requirements, laws, or regulations that would 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.

Followup on Prior Audit. We followed up on compliance problems previously reported in Inspector General, DoD, Report No. 98-151. Our followup review showed that DFAS accounting systems still did not comply with OMB requirements or with key accounting requirements of DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993. DFAS also needed to continue improving compliance with laws and regulations concerning disclosure in financial statements, charging agencies for work performed, and requirements for accounting systems. DFAS did not disclose all significant information in the financial statements, as required by OMB Bulletin No. 97-01. As a result, the financial statements were not fully informative and were sometimes misleading. Also, DFAS performed services for other DoD agencies without customer orders, contrary to DoD Regulation 7000.14-R, volume 11B, "Reimbursable Operations, Policy and Procedures - Defense Business Operations Fund," December 1994. As a result, DFAS must recoup the unbilled costs from those customers.

Compliance Issues for DFAS Working Capital Fund. We identified instances of noncompliance with laws and regulations in the DFAS WCF. We did not perform all tests necessary to determine whether the DFAS WCF fully complied with all applicable laws and regulations. Therefore, we could not determine the range and magnitude of noncompliance with laws and regulations that may affect the reliability of the DFAS WCF Financial Statements for FY 1998.

Title 31, United States Code, 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 of 1996." Under the Federal Financial Management Improvement Act (FFMIA) of 1996, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger (USGSL) at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for the FFMIA included in Appendix D of OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended on January 25, 1999.

Our tests disclosed instances, described below, where the agency's financial management systems did not substantially comply with the three requirements in the preceding paragraph. DFAS is responsible for the financial management systems that support the DFAS WCF. DFAS used data from DBMS and other sources to compile the DFAS WCF Financial Statements for FY 1998.

Federal Financial Management System Requirements. Federal financial management system requirements have been well-established in OMB Circular No. A-127, "Financial Management Systems," July 23, 1993. Financial management systems are 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. In addition, the Joint Financial Management Improvement Program has published a series of "Federal Financial Management System Requirements" that establish standard requirements for Federal agencies' integrated financial management systems. For FY 1998, DBMS did not substantially comply with Federal financial management system requirements.

One area of noncompliance with Federal financial management system requirements was that DBMS, which used information from other sources to prepare the annual financial statements, was not linked effectively with other systems to support DFAS financial management needs. For example, the DoD financial network continued to be the source of undistributed disbursements and collections, which represented a significant part of Fund Balance With Treasury. The DBMS general ledger did not support the Fund Balance With Treasury reported in the DFAS financial statements. Also, DBMS used a chart of accounts that did not comply with the USGSL. Further, user access to DBMS and other systems was not appropriately controlled. A review by DFAS Columbus Center personnel identified user authorizations that were not updated when changes in

personnel occurred. Consequently, personnel had access to DBMS and other systems, although they were no longer employed by DFAS or had transferred to jobs within DFAS that did not require access.

Federal Accounting Standards. Federal agencies reporting under the Government Management Reform Act of 1994 are to follow the nine Statements of Federal Financial Accounting Standards and two Statements of Federal Financial Accounting Concepts agreed to by the Director of the OMB, the Comptroller General, and the Secretary of the Treasury. DBMS did not substantially comply with Federal accounting standards and the key requirements of DoD Regulation 7000.14-R, volume 1, for general ledger control, financial reporting, property accounting, and audit trails.

Account Structure. Key Accounting Requirement No. 1, "General Ledger Control and Financial Reporting," requires that the system maintain an appropriate account structure approved by DoD. However, DBMS did not use the DoD Standard General Ledger, but instead used a nonstandard account structure that required a crosswalk to the DoD Standard General Ledger.

Disclosure. Key Accounting Requirement No. 1 also requires full financial disclosure, adequate financial information, and reports for management information. DBMS did not provide the information necessary to make the financial statements fully informative and not misleading. For example, DBMS could not provide the information needed to properly eliminate revenue between the two business areas.

Property Accounting. Key Accounting Requirement No. 2, "Property and Inventory Accounting," requires subsidiary property records to be reconciled periodically to general ledger accounts. DPAS did not have an automated interface with DBMS, and significant differences continued to exist between DPAS and DBMS.

Audit Trails. Key Accounting Requirement No. 8, "Audit Trails," requires that all transactions be traceable to individual source records. However, we could not trace undistributed collections and disbursements to supporting transactions for Fund Balance With Treasury. Further, we could not trace amounts recorded in budgetary and proprietary accounts to supporting transactions because transactions that had been disbursed and finalized were deleted from DBMS on a quarterly basis. The DFAS Columbus Center developed a series of databases that would maintain visibility over transaction-level data after DBMS deleted the original transaction data. Despite these efforts, the databases did not provide a usable audit trail for validation of the account balances in the DFAS WCF financial statements. The databases proved unusable because they were not available for the entire fiscal year, contained duplicate and invalid transactions, and could not be validated to the monthly consolidated trial balances.

U.S. Government Standard General Ledger at the Transaction Level. The OMB requires Federal agencies to implement the USGSGL in their financial systems. The USGSGL must be implemented at the transaction level. Federal agencies can supplement their application of the USGSGL to meet

agency-specific requirements. However, agency standard general ledgers must maintain consistency with the USGSGL. DBMS did not use the accounts and data elements of the USGSGL. Further, the DBMS general ledger accounts and data elements were not crosswalked to the USGSGL.

In September 1998, DoD published the first DoD Biennial Financial Management Improvement Plan (the Biennial Plan), which identified many impediments to achieving auditable financial statements, including financial management system deficiencies. The Biennial Plan was intended to be a strategic financial improvement plan that addresses financial management systems. The Biennial Plan contained an initiative to improve DBMS to make it compliant with the Federal Managers' Financial Integrity Act (FMFIA) of 1982 and the CFO Act and capable of supporting all accounting requirements. The initiative was to correct weaknesses that had a critical impact on financial operations and required excessive overrides, work-arounds, and manual intervention to comply with regulations. The milestone date for meeting the key accounting requirements was October 2001. In FY 1997, DFAS contracted for an analysis of an alternatives study to identify a migratory system strategy to replace existing working capital fund financial systems, including DBMS. While awaiting a decision on a standard migratory strategy, DFAS minimized funding for upgrades to existing systems. In a March 6, 1998, briefing to the Acting Director, Systems Integration Directorate, DFAS, the contractor recommended Oracle Government Financials, a commercial off-the-shelf system, to replace DBMS and three other migratory accounting systems. A request for proposal was issued in August 1998 to purchase the replacement accounting system; however, contract action was delayed because of a bid protest. DFAS personnel could not provide an estimated date for deployment of the replacement system until the bid protest is resolved and a contract awarded.

Title 31, United States Code (U.S.C.), section 501, Chief Financial Officers Act of 1990. The CFO Act, as amended by the Government Management Reform Act of 1994, requires DoD to prepare audited financial statements and submit them to OMB no later than March 1, 1999. With the Biennial Plan, DoD met the CFO Act requirement for a 5-year plan. We received version 2 of the financial statements on January 15, 1999, after the agreed-upon date of December 24, 1998. As a result, we did not have sufficient time to conduct necessary audit procedures.

Title 31, U.S.C., section 65, Federal Managers' Financial Integrity Act of 1982. The FMFIA requires DoD to evaluate its systems of internal accounting and administrative controls to determine whether such systems comply with the FMFIA, and to prepare an Annual Statement of Assurance for the President and the Congress stating whether DoD systems of internal accounting and administrative control are in compliance with the FMFIA. DoD met part of the FMFIA requirement by including the discussion of financial management system deficiencies, usually published as section 4 of the Annual Statement of Assurance,

in its Biennial Plan. The DBMS initiative in the Biennial Plan was to correct weaknesses that had a critical impact on financial operations and required excessive overrides, work-arounds, and manual intervention.

The FY 1998 Annual Statement of Assurance for DFAS identified as repeat material weaknesses within DoD many of the reportable conditions we identified in the DFAS WCF, such as inadequate financial accounting processes and deficiencies in systems. In FY 1998, the Accounting Directorate, DFAS Columbus Center reported material weaknesses in accounting for undistributed disbursements and collections and in reconciling information on fixed assets in DBMS with information in the subsidiary ledger trial balances produced by DPAS. However, the weaknesses were not included in the DFAS Columbus Center Annual Statement of Assurance for FY 1998.

Title 31, U.S.C., section 1101, Government Performance and Results Act of 1993. The Government Performance and Results Act (GPRA) of 1993 was enacted to improve the confidence of the American people in the capability of the Federal Government by systematically holding Federal agencies accountable for achieving program results. GPRA requires each Federal agency to submit to Congress and the Director, OMB, a strategic plan for program activities. Basically, the strategic plan should include:

- a comprehensive mission statement covering the major functions and operations of the agency;
- general goals and objectives, including outcome-related goals and objectives, for the major functions and operations of the agency; and
- a description of how the goals and objectives are to be achieved, including a description of the operational processes, skills, and technology, and the human, capital, information, and other resources required to meet those goals and objectives.

GPRA also requires each Federal agency to prepare an annual performance plan for each program activity in the agency's budget. The performance plan should:

- establish performance goals in an objective, quantifiable, and measurable form;
- briefly describe the resources necessary to meet the goals;
- establish performance indicators to be used in measuring or assessing the outcomes of program activity; and
- provide a basis for comparing actual program results with the established performance goals.

DoD Regulation 7000.14-R, volume 6B, "Form and Content of the DoD Audited Financial Statements," December 1998, requires that the DFAS WCF include a discussion of its GPRA performance measures, consistent with the DoD GPRA

Performance Plan as published in the Annual Defense Report, in the Overview section of the financial statements. We did not obtain an understanding of the design of internal controls related to the performance measures because we did not receive Supplemental Financial and Management Information until January 15, 1999. However, the performance measures related to assets, liabilities, expenses, and revenues did not appear to match the information contained in the financial statements.

OMB Bulletin No. 97-01. DFAS did not disclose all significant information in footnotes to the financial statements, as required by OMB Bulletin No. 97-01. We identified noncompliance issues in disclosing financial information related to issues such as Fund Balance With Treasury and the use of eliminations in the consolidating financial statements.

Fund Balance With Treasury. DFAS did not fully comply with OMB Bulletin No. 97-01 because it did not disclose the information necessary to understand the nature of fund balances. Note 2 did not adequately disclose what the Fund Balance With Treasury represented in the DFAS WCF and did not describe how the reported balance was calculated. The reported balances of disbursements and collections made in FY 1998 did not match those in the consolidated trial balance, and note 2 did not identify the difference and explain why it existed. Further, note 2 did not disclose that DFAS Columbus Center personnel used the Cash Management Report as the basis for comparing the amounts of disbursements and collections recorded in the general ledger. Note 2 should discuss how the Cash Management Report was used in the cash reconciliation process. Also, although note 2 stated that undistributed collections increased Accounts Receivable, and undistributed disbursements increased Accounts Payable, the opposite was true. Undistributed amounts decreased both Accounts Receivable and Accounts Payable.

Eliminations. The DFAS WCF had sales of goods and services to other DoD entities that were not disclosed in note 22 of the financial statements. Note 22 did not report \$1.7 billion in revenue and \$98.7 million in accounts receivable with other DoD entities. Note 22 only reported interagency eliminations with other Federal agencies. The information in note 22 was of little value to users of the financial statements. Inadequate guidance in DoD Regulation 7000.14-R, volume 6B, affected the DFAS Columbus Center's ability to prepare an informative footnote.

Other Disclosures. The disclosures in note 1 did not show how the footnote applied to the DFAS WCF. Note 1 should have summarized the accounting principles and methods of applying those principles that management concluded were appropriate for presenting significant information about the DFAS WCF. Instead, the information was general and often did not state how it applied to the DFAS WCF. Note 18B on the Statement of Changes in Net Position did not discuss the abnormal balance of \$7.6 million recorded for Line 2.E., Transfers-In. Note 18B should have discussed the abnormal balance. Further, note 20 did not disclose any required information about the Statement of Financing. DFAS planned to review the footnotes for compliance with DoD 7000.14-R, volume 6B, before issuing version 3 of the financial statements.

DoD Regulation 7000.14-R. DFAS did not follow the procedures in DoD Regulation 7000.14-R, volume 11B, on performing work before receiving funded customer orders. The Regulation states that as a general rule, no work or service should be performed by a Defense WCF activity except on the basis of reimbursable orders received and accepted, which constitute obligations of Federal Government ordering activities. Working capital fund activities generate financial resources to replenish the initial working capital and permit continuing operations by accepting customer orders. The Defense WCF Improvement Plan submitted to Congress in September 1997 included procedures for resolving nonreceipt of funded customer orders. As of September 30, 1998, DFAS records showed that DFAS activities performed \$61.9 million in services without funded customer orders. For example, \$25.5 million of the \$61.9 million of unfunded work was performed in FY 1997 by the DFAS Indianapolis Center, Indianapolis, Indiana. Review of available documentation showed that a Military Interdepartmental Purchase Request was received and entered in DBMS in September 1998. In response to Inspector General, DoD, Report No. 98-151, the Director for Accounting, DFAS, agreed to issue procedures to resolve nonreceipt of funded customer orders. Those procedures were issued to the DFAS Centers on October 27, 1998. The DFAS Indianapolis Center issued guidance on December 10, 1998.

Appendix A. Audit Process

Scope

Statements Reviewed. We performed a limited scope audit of the DFAS WCF Financial Statements for FY 1998, which reported assets of \$662.9 million, liabilities of \$518.6 million, and revenue of \$1.7 billion. We determined whether amounts reported for major accounts were verifiable; we reviewed management disclosures made in the financial statements and annual statements of assurance; and we evaluated DFAS financial systems for compliance with Federal accounting requirements. We also followed up on prior audit reports on the DFAS WCF and DBMS. We reviewed version 2 of the financial statements, which were provided to us on January 15, 1999. The DFAS WCF Financial Statements for FY 1998 included the Consolidated Operations Overview, the Consolidated Operations Principal Statements, and the Footnotes to the Consolidated Operations Principal Statements. The Consolidated Operations Principal Statements included:

- the Consolidated Balance Sheet,
- the Consolidated Statement of Net Cost,
- the Consolidated Statement of Changes in Net Position,
- the Combined Statement of Budgetary Resources, and
- the Combined Statement of Financing.

For the Consolidated Balance Sheet, we evaluated the DFAS process for reconciling and reporting the Fund Balance With Treasury account; recording and disclosing undistributed disbursements and collections, accounts receivable, and accounts payable; and accounting for property, plant, and equipment and other entity assets. For the Consolidated Statement of Net Cost, we reviewed the DFAS Centers' accounting for revenue and expenses, and charges for services provided to other agencies. For the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing, we limited our review to the DFAS preparation of the statements and an analysis of the line items in the statements. For the Consolidated Balance Sheet, Consolidated Statement of Net Cost, and Consolidated Statement of Changes in Net Position, we reviewed the process for consolidating the financial information in the two DFAS WCF business areas. We also assessed whether audit trails were adequate to identify all FY 1998 transactions. We reviewed the footnotes to the Consolidated Operations Principal Statements for consistency with the Principal Statements and for disclosure of essential information.

Scope Limitations. Because of deficiencies in accounting systems and control procedures, it was not feasible for us to plan and perform a complete financial

statement audit, as defined by Government auditing standards. The final version of the financial statements was not available in time to be considered in rendering our opinion. We did not obtain an understanding of the design of internal controls related to the performance measures because we did not receive Supplemental Financial and Management Information until January 15, 1999. However, we compared the performance measures related to assets, liabilities, expenses, and revenues with the information in the financial statements. Further, the financial statements were not required to present figures from previous financial statements for comparative purposes; therefore, we did not audit FY 1997 data.

Accounting Principles. Accounting principles and standards for the Federal Government are continually being refined and amended. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to three officials for approval. Those three 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, nine accounting standards and two accounting concepts have been published in final form. Those standards and concepts constitute generally accepted accounting principles for the Federal Government. OMB Bulletin No. 97-01 incorporates these standards and concepts and should be used by Federal agencies to prepare financial statements.

Agencies were required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01. A summary of the hierarchy follows:

- standards agreed to by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States;
- interpretations of standards issued by OMB and the Comptroller General;
- requirements in OMB Bulletin No. 97-01 for the form and content of financial statements; 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 reviewed aspects of internal controls of the DFAS WCF and obtained an understanding of the internal control policies and procedures related to accounting systems; the Fund Balance With Treasury account; accounts receivable; property, plant, and equipment; accounts payable; expenses; revenue; and over the preparation of the financial statements. Our consideration of internal controls would not necessarily

disclose all matters that might be reportable conditions and would not necessarily disclose all reportable conditions that are also considered material weaknesses.

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 controls. Because DoD did not have sound internal controls, we revised our audit approach to focus on specific internal controls. We obtained an understanding of management's process for evaluating and reporting on the internal controls and accounting systems, and we compared the material weaknesses in financial reporting, as reported in the entity's Annual Statement of Assurance for FY 1998, to the material weaknesses and reportable conditions we found. A copy of this report will be provided to the Under Secretary of Defense (Comptroller), who is the senior official in charge of management controls for DoD.

Review of Compliance With Laws and Regulations. DFAS managers are responsible for compliance with laws and regulations. To obtain reasonable assurance that the DFAS WCF Financial Statements for FY 1998 were free of material misstatements, we reviewed compliance with laws and regulations that may directly affect the financial statements, and we also reviewed other laws and regulations designated by OMB and DoD. Our review of laws and regulations was not intended to and would not disclose all instances of noncompliance with laws and regulations that might exist. See Appendix C for a list of laws and regulations reviewed.

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

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

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

- **Financial Management Functional Area. Objective:** Consolidate finance and accounting systems. **Goal:** Reduce and improve accounting systems. **(FM-2.2)**
- **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

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

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 Inspector General, DoD, and OMB Bulletin No. 98-08. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatements. We relied on the guidelines suggested by the General Accounting Office and our professional judgment in assessing the materiality of matters affecting the fair presentation of the financial statements, related internal controls, and compliance with laws and regulations.

Computer-Processed Data. To achieve our audit objective, we relied on computer-processed data without testing the general and application controls. We compared the data on the financial statements as of September 30, 1998, to the general ledger trial balances produced by DBMS and the subsidiary ledger trial balances produced by DPAS. We performed no statistical sampling, and no projections were made from the data. Not evaluating the controls did not affect the results of the audit.

Audit Period and Locations. The audit was conducted from September 1998 through January 1999 at Headquarters, DFAS, Arlington, Virginia; the DFAS Columbus Center; and the DFAS Indianapolis Center.

Representation Letters. We received a management representation letter from the Director of Resource Management, DFAS, dated March 1, 1999, regarding the DFAS WCF Financial Statements for FY 1998. DFAS addressed deficiencies in its financial management systems in the management representation letter for FY 1998. Exhibit 1 is the management representation letter. We received an interim legal representation letter from the DFAS General Counsel, dated December 15, 1998. The legal representation letter identified no pending or threatened litigation, claims, or assessments involving DFAS. Exhibit 2 is the interim legal representation letter.

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

Appendix B. Summary of Prior Coverage

During the last 5 years, the Inspector General, DoD, performed one audit to render an opinion on the financial statements of the DFAS WCF. In addition, the Inspector General, DoD, has issued audit reports that identified internal control deficiencies pertaining to selected DFAS WCF accounts.

Report No. 98-151, "Internal Controls and Compliance With Laws and Regulations for the Defense Finance and Accounting Service Working Capital Fund Financial Statements for FY 1997," June 12, 1998.

Report No. 98-100, "Fund Balance With Treasury Account in the FY 1996 Financial Statements of the Defense Business Operations Fund," April 2, 1998.

Report No. 97-178, "Internal Controls and Compliance With Laws and Regulations for the Defense Business Operations Fund Consolidated Financial Statements for FY 1996," June 26, 1997.

Report No. 96-124, "Selected General Controls Over the Defense Business Management System," May 21, 1996.

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

Appendix C. Laws and Regulations Reviewed

Public Law 104-208, "Federal Financial Management Improvement Act of 1996," September 30, 1996.

Public Law 103-356, "Government Management Reform Act of 1994," October 13, 1994 (Title IV of this Act may be cited as the "Federal Financial Management Act of 1994").

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

OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended on January 25, 1999.

OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended on November 20, 1998.

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

Joint Financial Management Improvement Program Core Financial System Requirements, Federal Financial Management System Requirements - 1, September 1995.

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," volume 6B, "Form and Content of the DoD Audited Financial Statements," December 1998.

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

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

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

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller) and Chief Financial Officer
Deputy Chief Financial Officer
Director, Accounting Policy
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
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 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

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

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

**Exhibit 1. Management Representation
Letter**



DFAS-HQ/CFP

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

MAR 1 1999

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: Management Assurance Concerning FY 1998 Financial
Statements of the Defense Finance and Accounting
Service Working Capital Fund

This letter is in connection with your audit of the FY 1998 Financial Statements of the Defense Finance and Accounting Service (DFAS) Working Capital Fund (Project No. 8FI-2028). The financial statements include the Principal Statements (which consist of the Balance Sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, the Statement of Financing, and the notes to the Principal Statements) and the Required Supplementary Stewardship Information, as of September 30, 1998. This letter addresses the audit purposes of (1) expressing an opinion as to whether the financial statements and required supplementary stewardship information are presented fairly, in all material respects, in conformity with Federal accounting standards, and (2) reporting whether the agency's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (SGL) at the transaction level as of September 30, 1998.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit, that these representations are accurate as of the date of your auditor's report and pertain to the period covered by the principal financial statements.

- 1) We are responsible for the fair presentation of the FY 1998 Financial Statements of the DFAS Working Capital Fund in conformity with Federal accounting standards.
- 2) The FY 1998 Financial Statements of the DFAS Working Capital Fund are fairly presented in conformity with Federal accounting standards.
- 3) We have made available to you all financial records and related data. This includes, where applicable, minutes of meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not

been prepared, and communications from the Office of Management and Budget (OMB) concerning noncompliance with or deficiencies in financial reporting practices.

- 4) There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements or disclosed in the notes to the financial statements.
- 5) DFAS has satisfactory title to all owned assets, plant, and equipment; such assets have no liens or encumbrances, nor have any assets been pledged.
- 6) We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
- 7) Guarantees under which the agency is contingently liable have been properly reported or disclosed.
- 8) Related party transactions and related accounts receivable or payable, including assessments, loans, and guarantees, have been properly recorded and disclosed.
- 9) All intra-governmental transactions and activities have been appropriately recorded, reported, and disclosed.
- 10) There are no:
 - a) possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency;
 - b) material liabilities or gain or loss contingencies that are required to be accrued or disclosed, that have not been accrued or disclosed; or
 - c) unasserted claims or assessments that our legal representatives have advised us must be disclosed, that have not been disclosed.
- 11) We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

- 12) No material events or transactions have occurred after September 30, 1998, that have not been properly recorded in the financial statements and Required Supplementary Stewardship Information or disclosed in the notes thereto.
- 13) There has been no material fraud (intentional misstatements or omissions of amounts or disclosures in financial statements and misappropriation of assets that could have a material effect on the financial statements) or any fraud involving management or employees who have significant roles in the internal control structure.
- 14) We are responsible for establishing and maintaining internal controls.
- 15) Pursuant to the Federal Managers Financial Integrity Act, we have assessed the effectiveness of DFAS internal controls in achieving the following objectives:
 - a) Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and Required Supplementary Stewardship Information in accordance with Federal accounting standards, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition.
 - b) Compliance with applicable laws and regulations - transactions are executed in accordance with (i) laws governing the use of budgetary authority and other laws and regulations that could have a direct and material effect on the financial statements, and (ii) any other laws, regulations, and governmentwide policies identified by the OMB in Appendix C of OMB Bulletin No. 98-08.
 - c) Reliability of performance reporting - transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

- 16) Those controls in place on September 30, 1998, provided reasonable assurance that the foregoing objectives were met except for the effects of the material weaknesses discussed below.
- 17) We are responsible for implementing and maintaining financial management systems that comply substantially with Federal financial management systems requirements contained in OMB Circular No. A-127, "Financial Management Systems," applicable Federal accounting standards, and the U.S. Government SGL at the transaction level.
- 18) We have assessed the financial management systems to determine whether they comply substantially with these Federal financial management systems requirements. Our assessments were based on criteria established under OMB Circular No. A-127 and guidance issued by OMB and included in Appendix D of OMB Bulletin No. 98-08.
- 19) We cannot provide reasonable assurance that the accounting and non-accounting systems used to produce the financial statements are reliable because not all those systems meet DoD and OMB system standards. Where possible, manual workarounds have been put in place to provide some assurance that the information is correct.
- 20) We are responsible for DFAS compliance with applicable laws and regulations.
- 21) We have identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.
- 22) We have disclosed to you all known instances of noncompliance with laws and regulations.



Bruce M. Carnes
Director of Resource Management

Exhibit 2. Legal Representation Letter



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

DEC 15 1998

DFAS-HQ/C

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE
DEPUTY GENERAL COUNSEL (FTSCAL), DEPARTMENT OF
DEFENSE

SUBJECT: Legal Representation Letters for the FY 1998 Financial
Statements of the Defense Finance and Accounting
Service Working Capital Fund

This is the interim legal representation letter in response
to your memorandum dated October 27, 1998.

This office, including all lawyers over whom this office
exercises supervision, is not aware of any pending or threatened
litigation, claims, and assessments, involving the Defense
Finance and Accounting Service for the year ended September 30,
1998, that are in amounts material to the fund. Per discussions
with the Office of the Deputy General Counsel (Fiscal), DoD, the
materiality threshold was established at \$100 million.


John S. Mester
General Counsel

**Exhibit 3. Financial Statements and Auditor
Opinion**



COMPTROLLER

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

JAN 15 1999

MEMORANDUM FOR DIRECTOR FOR FINANCE AND ACCOUNTING, ASSISTANT
INSPECTOR GENERAL FOR AUDITING, OFFICE OF THE
INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Defense Finance and Accounting Service Working Capital Fund Version 2,
FY 1998 Financial Statements

Attached are the version 2 FY 1998 financial statements for the Defense Finance and
Accounting Service Working Capital Fund.

My staff contact for this action is Mr. Thomas Tresslar. He may be reached by
e-mail: tresslat@osd.pentagon.mil or by telephone at (703) 693-6502.

A handwritten signature in black ink, appearing to read "De W. Ritchie, Jr.", is positioned above the printed name.

De W. Ritchie, Jr.
Director for Accounting Policy

Attachments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

JAN 14 1999

DFAS-HQ/CFP

MEMORANDUM FOR DoD DEPUTY CHIEF FINANCIAL OFFICER

SUBJECT: Fiscal Year (FY) 1998 Defense Finance and Accounting Service (DFAS), Defense Working Capital Fund (DWCF) Overview, Principal Statements and Supplemental Financial Management Information

Attached are an Overview, Principal Statements and Supplemental Financial Information for the DFAS FY 1998 Chief Financial Officer's Act (CFO) Financial Statements required by attachment 1 of the DFAS-HQ/ASF memorandum dated November 20, 1998, subject, FY 1998 Chief Financial Officers (CFO) Reporting Schedule, Requirements, and Other Reference Information.

I hereby certify that the attached Fiscal Year 1998 Chief Financial Officer's Act Principal Statements for the Defense Finance and Accounting Service, Defense Working Capital Fund, are supported by trial balances, feeder reports and other information. The Defense Chief Financial Officer's Act Statements are a correct consolidation of such supporting information. Adjustments are fully documented.

My point of contact for these statements is Mr. Wayne Ebaugh, on (703) 602-5511.

Bruce M Carnes
Director of Resource Management

Attachments
As stated

Defense Finance and Accounting Service

Working Capital Fund

Table of Contents

Operations Overview	1
Operations Principal Statements	29
Footnotes to the Operations Principal Statements	44
Supplemental Financial and Management Information	62

Message from the Director

I am pleased to present the Fiscal Year (FY) 1998 Financial Statements for the Defense Finance and Accounting Service (DFAS), prepared in accordance with the Chief Financial Officer's Act of 1990.

DFAS consists of two business areas: Financial Operations and Information Systems. These two areas are responsible for centralized finance and accounting services and systems support for all DoD Components. The FY 1998 Financial Statements are presented in a consolidated statement format with intra-departmental transactions eliminated.

DFAS is a Defense Working Capital Fund (DWCF) activity, financed by its customers. The Chief Financial Officers Act, along with the creation of DWCF, established accounting and finance principles which necessitated a shift from traditional fund management (i.e., obligation and outlays) to a more business-oriented approach.

DFAS provides effective and efficient finance and accounting services during times of peace and conflict. As a result of the current Administration's emphasis on financial management reform, DFAS also has ongoing initiatives in three areas: business process reengineering, systems standardization, and consolidation of operations.

In addition to providing finance and accounting support, DFAS continues to place significant emphasis on its service. Service is more than just a part of the DFAS name; it is our commitment to our customers.

I believe these financial statements present fairly, in all material respects, the financial position of the Defense Finance and Accounting Service as of September 30, 1998.

Gary W. Amlin
Director

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

OPERATIONS

OVERVIEW

**DEFENSE FINANCE AND ACCOUNTING SERVICE
CONSOLIDATED OPERATIONS
DEFENSE WORKING CAPITAL FUND
OVERVIEW OF THE REPORTING ENTITY**

These financial statements report on the financial position and results of operations of the Defense Finance and Accounting Service (DFAS) Financial Operations and Information Systems business areas of the Defense Working Capital Fund (DWCF) for FY 1998. They are prepared pursuant to the requirements of the Chief Financial Officers Act of 1990 (CFO) and Department of Defense (DoD) implementing guidance.

The financial statements include all aspects of DFAS commercial operations. They do not include any other appropriated, trust, or revolving funds. The principal statements are prepared from the same sources as are reports used to monitor and control budgetary resources.

Description of the Reporting Entity

DFAS operations consist of two business areas, Financial Operations and Information Systems. These two business areas contribute to the agency's ability to provide effective and efficient finance and accounting services during times of peace and conflict.

When DFAS was established in FY 1991, DoD took a giant step forward in streamlining financial systems. DFAS became the pivotal agent for key financial management reforms. During FY 1992, DFAS Financial Operations capitalized over 16,000 additional finance and accounting personnel at more than 300 locations in the continental United States. A major streamlining milestone was the announcement in May 1994, by the Deputy Secretary of Defense, of the consolidation of finance and accounting operations. Since that announcement, 332 DoD field offices have been closed and their processes consolidated at 19 DFAS Operating Locations, five DFAS Centers, and a Headquarters in the Washington, DC area. The final round of consolidations was completed by the end of FY 1998. This initiative and other savings helped DFAS achieve a reduction in its end strength of 8,000 spaces since FY 1992. With consolidation completed, savings are expected to total \$120 million per year.

The DFAS workforce consists of civilians and military members from the Army, Air Force, Navy, and Marine Corps. The size of the military and civilian workforce employed by DFAS as of September 30, 1998 is:

Military	1,523
Civilian	18,085

DFAS has taken aggressive measures to respond favorably to the DoD manpower requirement to downsize both the military and civilian end strength levels. For the past four years, DFAS has exceeded the OSD mandatory civilian and military reduction goals. Since its inception in January 1991 through September 30, 1998, DFAS has capitalized over 31,000 positions. However by consolidating operations, standardizing systems, and reengineering business processes, DFAS has been able to eliminate over 8,000 positions. DFAS civilian and military end strength are scheduled to decline by 39 percent from the FY 1994 baseline of 26,453 to 16,169 in FY 2003.

The DFAS Financial Services Organization (FSO) functions as a fee-for-service operation under the DWCF Information Systems business area. The FSO provides software development/modernization and systems maintenance support to over 100 Automated Information Systems (AIS). In addition, it provides overall technical support in a number of system-related areas. The primary areas of emphasis are the acquisition, deployment, and support for the DFAS information technology (I/T) infrastructure.

The FSO operates as a single organization with a small headquarters contingent located in Indianapolis and subordinate Financial Systems Activities (FSAs) in Cleveland, Columbus, Pensacola, Indianapolis, Kansas City, and Denver. During FY 1996, the FSO delivered over 2.5 million direct labor hours in accomplishing its software development and maintenance mission.

The DFAS Consolidated Principal Statements consist of both the Financial Operations and the Information Systems Operations results. The consolidated statements have been adjusted to reflect the elimination of intra-departmental transactions between the two entities.

FINANCIAL OPERATIONS

Description of the Reporting Entity

The Financial Operations Activity provides effective and efficient finance and accounting services during times of peace and conflict. Prior to January 1991, the DoD had a decentralized mode of operation. Reflecting that reality, the three military departments and major Defense Agencies have, until recent reforms began, always managed their own budget, finance, and accounting systems. As a result, they developed their own processes and business practices, geared to their particular mission, with little compatibility with other DoD operations. As Defense missions became more complex, and DoD organizations were required to interact more with each other, systems compatibility and lack of standardization took a toll. Rather than redesigning its organization or standardizing its multitude of systems, the Department developed increasingly complex business practices to link its systems.

Such complexity left DoD financial systems prone to error or to demands that could not be achieved by the systems, personnel, or in the time available. No matter how knowledgeable and qualified the people operating the systems were, problems were inevitable. Moreover, there

was an inherent inefficiency in having scores of incompatible systems performing virtually identical functions. In December 1991, DoD created DFAS to assume management responsibility for DoD components' accounting operations and to consolidate those operations into a limited number of locations in order to realize significant savings. With the establishment of DFAS, DoD took a giant step forward in streamlining financial systems. DFAS became DoD's pivotal agent for key financial management reforms.

By streamlining and standardizing DoD's finance and accounting policies, systems, and operations and eliminating redundancies, DFAS has improved finance and accounting operations and reduced costs. DFAS was charged with providing finance and accounting services to the Army, Navy, Air Force, Marine Corps, Defense Logistics Agency (DLA), and the Washington Headquarters Service. Prior to the establishment of DFAS, each military department operated its own finance and accounting network, focused on its own requirements, using its own unique systems. Initially, the focus of the individual DFAS Centers did not change. Centers provided pay and financial management support to a single military department or agency. But as DFAS standardization and consolidation initiatives are implemented, Center missions are expanding and changing to support functions throughout DoD.

Human Resources Initiatives

In 1996, the Human Resources Directorate initiated an HR Regionalization Program. The Personnel Support Organization (PSO), headed by the Deputy Director for Human Resources, was approved in September 1995 as the umbrella organization for all DFAS Human Resources services. Under the PSO are one Regional Service Center (RSC) located in Indianapolis, Indiana, and six Customer Support Units (CSUs) located at the five DFAS Centers and DFAS Headquarters. The RSC officially opened August 7, 1996. The RSC supports the CSUs by performing personnel services that do not require face-to-face contact with customers, such as personnel recordkeeping, system input, and vacancy announcements. The CSUs work directly with customers, advising and assisting DFAS managers and employees on personnel-related issues. Workload was moved from the CSUs to the RSC, which resulted in efficiencies from economy of scale.

Additionally, as part of the Department of Defense regionalization and modernization initiatives, DFAS is partnering with the Defense Contract Audit Agency (DCAA) and the Defense Information Systems Agency (DISA) to perform their regionalized personal services. Servicing of DCAA began in August 1998, and DISA servicing is scheduled for FY 1999.

With the commencement of consolidation of DFAS field activities in 1995, the Responsible Employer Program (REP) was created. The REP greatly reduced the number of involuntary separations throughout DFAS by giving employees options they would otherwise not have had. Before the REP, employees' only option was to register in the Department of Defense Priority Placement Program or accept separation incentives, if offered. The REP allowed employees to remain with DFAS if they were willing to relocate. As a result, 22 percent of the affected employees relocated.

In FY 1995, only 2 percent of those employees affected by the consolidation were separated. However, from 1996 through 1998, due to general government downsizing, there were fewer positions in the local commuting area available for people unwilling to relocate. Still, less than 5 percent have been involuntarily separated. Without REP, this number would have been higher.

Project REFOCUS, a Headquarters Reinvention initiative, relieves managers of most of the administrative chores associated with such needs as staffing their offices and giving awards to their people. This gives them more time to effectively manage their programs. Directorates are serviced by designated specialists who provide advice and assistance in all areas of personnel management. Project REFOCUS provides one-stop personnel service to better serve customers. Managers can request HR assistance by e-mail and no longer need to fill out Standard Form 52s to request personnel actions.

With a smaller work force, relevant training and education become more important. DFAS is currently undertaking a Competency-Based Career Development program; by the end of FY 1998, 14 Career Development Plans have been developed. Plans for the Financial Management Career field were developed first and served as the prototype for the other career fields. The plans provide a road map for civilians to grow, advance, or even change career fields and include professional and technical as well as leadership and management competencies. The plans set up a systematic process to develop DFAS employees from accession to separation through education, rotational assignments, and self-development initiatives. The plans will be accessible through an automated system that will allow DFAS supervisors to manage employees training and development through the use of Individual Development Plans.

The Human Resource Directorate developed and implemented an agency career management system to identify guidelines and processes for the acquisition, training and development, maintenance, and advancement of DFAS employees in all occupational series as set forth in the DFAS Career Development Plans and the Career Program Management Guide. This comprehensive program will develop and retain a well-trained work force with the competencies and education to adapt successfully to our changing work environment. Key positions will be filled by employees with the training/education, rotational/organizational assignments, and professional and leadership certification to meet these challenges. The components of the Career Management System include but are not limited to Career Development Plans, the Career Intern Program, Professional and Leadership Certification Program, Customer Service, Professional Development and Acquisition Training, Human Resources Generalist Certification Program and Training, Career Learning Centers, Financial Management Education and Training contract, Functional and Systems Training, and the Executive Training Suite.

The DFAS Professional and Leadership Certification Program is a competitive training and development program for eligible GS 12 through 15s and military equivalents. It provides a framework for developing leaders and preparing a cadre of highly trained, professional

supervisors, managers, and executives to lead DFAS into the 21st Century. The program has four components: Educational Advancement, Professional Credentials, Career Broadening Assignments, and Leadership Competencies. Participants will complete leadership and assessment programs and our Executive Training Suite (e.g., Staircase, Frameworks, Cornerstone, and DLAMP).

Developing leadership competencies is the basis for the Executive Training Suite provided to all those in leadership roles.

- Staircase is a four and a half day training program designed for DFAS GS-11s and all GS-12s. This course is designed to help participants understand what it means to be a leader, as well as to assess and develop each individual's leadership potential. Staircase addresses leadership skills, coaching, program analysis, conflict resolution, team-building, and creativity in the workplace.
- Frameworks is targeted for all GS-13s. This four and a half day training program was created to improve leadership competencies. It focuses on labor relations, empowerment, customer service, program analysis, and decision-making. The course is designed to educate employees at the critical GS-13 level by enhancing their current competencies and preparing them for higher level responsibilities.
- Cornerstone is for all GS-14s and GS-15s. This two-week course develops the competencies required for all Senior Executives: Leading Change, Leading People, Building Coalitions/Communication, Results-Driven, and Business Acumen (administering human resources, financial management, and information services within the organization). Specific topics covered in the course address leadership skills, strategic planning, decision making, problem analysis, conflict resolution, team building, and creativity in the workplace.
- DFAS is the executive agent for all Defense Agencies (all DoD Components that are not part of a military service) for the Defense Leadership and Management Program (DLAMP). Implementing recommendations of the Commission on Roles and Missions of the Armed Forces, DLAMP is a systematic, Department-wide program of "joint" civilian leadership training, education, and development within and across DoD Components. It provides the framework for developing future civilian leaders with a DoD-wide capability. It also fosters an environment that nurtures a shared understanding and sense of mission among civilian employees and military personnel. Participation in the initial DLAMP class is limited to individuals in GS-14, GS-15, or equivalent positions. The first class began in early 1998. The program was expanded to accept
- GS-13 participants in the September 1998 class and plans are being developed to include GS-12 participants in later years.
- DFAS has established Career Learning Centers (CLCs) to provide the tools used by employees to use the Career Development Plans, and training information to develop

automated Individual Development Plans. The CLCs offer career development support and opportunities for self development and organizational assignments using assessment tools, career development tools, certification reviews, continuing professional education, and college courses through satellite, multimedia, and other distance learning technologies. DMRD 985, Financial Management Education and Training, required the establishment of model Career Learning Centers at all DFAS locations. The Career Learning Centers provide one-stop locations for competency assessment, career planning, training, and education for all DFAS employees.

Business Processing Reengineering

In past years, numerous nonstandard financial management policies have been promulgated within the Department. This environment often resulted in the application of different standards for similar circumstances, thereby producing inconsistent or incompatible information or reports. In response to this situation, the Department developed a single "DoD Financial Management Regulation" to be used on a DoD-wide basis. The Department issued all 15 volumes by March 1997, replacing a myriad of existing policy guidance, clarifying existing guidance where appropriate, and including additional guidance as needed.

In April 1995, the Office of General Counsel initiated a business process reengineering (BPR) study of the Garnishment Operations Directorate which was being consolidated at the DFAS Cleveland Center. The consolidation, completed in October 1996, streamlines and standardizes the processing of garnishment orders for child support, alimony, commercial debts, and divisions of retired pay pursuant to the Uniformed Services Former Spouses' Protection Act. When consolidation began, we estimated a staffing level of 225 personnel, including sufficient staff to accommodate the new workload attributable to garnishments and military involuntary allotments for commercial debts authorized by the Hatch Act Reform Amendments of 1993, Public Law No. 104-93. Upon completion of the BPR study, we estimated a staffing level of 125 personnel. As the Garnishment Operations Directorate implements the recommendations from the BPR study, the estimated staffing level has been reduced to 114 personnel. The recommendations include enhancement to the payroll locator file system, development of an integrated garnishment system, and development of an electronic document management (imaging) system.

In FY 1995, DFAS combined two Office of Management and Budget (OMB) reporting requirements in a single document, the Chief Financial Officers Act Financial Management Five-Year Plan. This plan reflected the OMB A-130 Information Management strategic plan requirement as well as the OMB A-127 and CFO Act Financial Management Five-Year Plan requirement. In FY 1996, we also combined the Federal Manager's Financial Compliance Report into this plan. These reports were combined to eliminate redundancy and date-related conflicts.

In FY 1995, DFAS began a full and active OMB Circular A-76, Commercial Activities Program by initiating two studies in the areas of Debt and Claims Management and Facilities, Logistics, and Administration.

During FY 1996, the Debt and Claims Management study was terminated following an Internal Revenue Service ruling. DFAS, however, implemented the Government's Most Efficient Organization (MEO) in May 1997, consolidating the Debt and Claims Management functions at the Denver Center and saving over \$8.5 million annually. The Facilities, Logistics, and Administration study, completed in May 1997, resulted in the implementation of the Government's MEO. The MEO, which was implemented prior to the beginning of FY 1998, generated an annual savings of over \$4 million. The DECA Vendor Payment Study completed in September 1997, also resulted in the implementation of the MEO. The MEO, which was implemented during FY98, generated an annual savings of over \$10 million.

Currently DFAS has active A-76 studies in the areas of Defense Commissary Accounting, DoD Transportation Accounting, DoD Depot Maintenance Accounting, Civilian Payroll, and Military Retired and Annuitant Payroll. These studies, which are scheduled for completion in FYs 1999 and 2000, are expected to yield annual savings of over \$28 million. DFAS will continue to conduct A-76 studies in an effort to provide better service and reduce costs.

The Electronic Document Management (EDM) Program provides users with online access to financial documents and information, advances application of new methods and technologies, resolves management of large volumes of hard-copy documents, ensures the consistent implementation of business practices throughout DFAS, improves customer service, and reduces operating costs. EDM involves the collective application of three technologies: imaging, electronic foldering, and workflow. Together, these technologies automate the presentation of material, the integration of business applications, and the standardization of business processes. EDM has been successfully prototyped in the Vendor Pay area and is deployed at three locations. Two additional DFAS Vendor Pay sites are planned. For ease of development and deployment, EDM support for Contract Pay was separated into two releases. Release 1 supports contract input, and release 2 provides workflow. Both releases have been successfully prototyped and are scheduled for deployment through the Columbus Center. Release 2 development and prototyping continues. EDM is also being developed to support Payroll Services. An EDM system was installed on October 1, 1998, in the Garnishment Operations Directorate at the DFAS Cleveland Center. Further, the Program Manager continually evaluates other business operations which can benefit from the use of these technologies.

A major element of the EDM Program is Electronic Document Access (EDA), which uses Internet and World Wide Web (WWW) technology to share documents across the Department. DFAS has partnered with the Service and DoD Agency acquisition communities, the Defense Information Systems Agency (DISA), and the Defense Automated Printing Service (DAPS) to develop and implement an Intranet application that assures DoD-wide, online access to contracts and other documents stored at remote locations. EDA offers read-only access to

official contract documents in a common file format that minimizes the need for DoD users to maintain hard-copy files. With the early success of contracts and Government Bills of Lading (GBLs) on the Web, EDA is being expanded to include payment vouchers and contract deficiency reports. In addition, we are continually evaluating new document types for inclusion in the EDA effort.

DFAS has established an Electronic Commerce Program Office to identify and implement EC/EDI and Electronic Funds Transfer (EFT) across the financial management community. Some of the highest EC/EDI priorities include: develop electronic processes to validate funds and record commitments in the accounting systems; create electronic contracts and contract modifications in the contract writing systems and record them in the payment and accounting systems; process electronic receiving reports to the payment and accounting systems; accept and process electronic invoices from vendors in the payment systems; and automate the prevalidation of payments against obligations prior to disbursement. In addition, the project will increase the use of EFT, register small vendors to accept EC/EDI, and establish DoD standard implementation conventions for the financial community. Most of the Department's major vendor payment systems today already are transmitting EFT payments. The Garnishment Operations Directorate at the Cleveland Center is also involved in a pilot project with Lockheed Martin to send and receive child support garnishments via EC/EDI.

Another important example of DoD reengineering is the Government Purchase Card. This program is playing a major role in the Department's efforts to streamline the acquisition process and cut the costs of performing finance and accounting support for processing commercial invoices. The program allows individual government cardholders, using a Government Purchase Card, to purchase items or services -- primarily those \$2,500 or less called "micropurchases"-- from vendors. Under the current government-wide contract, the First Bank System reimburses the individual vendors for these purchases and the Department makes consolidated payments to First Bank.

In 1996, DFAS processed about 9.9 million commercial invoices. Although an estimated 7.7 million invoices met the micropurchase threshold, only about 1.2 million of these invoices were associated with the use of the Government Purchase Card.

The Department currently is reengineering its policies and procedures on using the charge card. Many of the acquisition preapprovals and procedures are being streamlined. The Government Purchase Card Program, as it is known today, is expected to result in a faster and simpler procurement process, faster payments to the vendors, faster processing of commercial invoices, and a reduction in workload for processing financial and procurement documents. This is a win-win situation. The government is able to procure its needs quicker and easier; the commercial vendors are reimbursed faster; and interest payments are virtually eliminated. These changes should result in an overall reduction in costs to the government both in dollars and manpower.

The acquisition changes will be accompanied by other changes in the finance and accounting world. Procedural changes and reengineering business practices by DFAS and DoD

customers will increase the use of the charge card and generate millions of dollars of savings within the Department.

Reengineering practices include:

- Use of bulk commitments and/or obligations in the accounting systems for micro-purchases.
- Use of summary level accounting in the vendor pay systems for groups of purchases instead of detailed lines of accounting for each transaction or purchase.
- Use of an accelerated invoice reconciliation and certification process for disbursing against commercial invoices.
- Use of an automated reconciliation process provided by the banks for customers to track individual micropurchases against summary commercial invoice data.

The Government Purchase Card reengineering initiative is consistent with the goals and objectives of the National Performance Review. The ongoing changes will enhance the Department's ability to provide less costly and improved finance and accounting services to its customers.

Problem Disbursements

Under the direction of the Under Secretary of Defense (Comptroller), DFAS, in coordination with the affected DoD Components, established a project to reduce problem disbursements and in-transits. This effort focused on resolving existing unmatched transactions, negative unliquidated obligations, and intransit transactions, and on making improvements in existing procedures and systems to prevent the occurrence of these problems. The project had a goal of reducing problem disbursements and in-transits by approximately 50 percent by the summer of 1994. This goal was achieved through the joint efforts of all parties involved. On June 30, 1995, the Under Secretary of Defense (Comptroller) issued a comprehensive set of procedures for researching and correcting problem disbursements. Between June 1996 and August 1998, the total absolute value of unmatched disbursements and negative unliquidated obligations was reduced by 20 percent from \$10.1 billion to \$8.1 billion. Additionally, aged intransits were reduced from a net value of \$5.5 billion to \$2.2 billion, a 60 percent drop since reporting aged intransit values was changed from modified absolute to net in May 1997.

Cross Disbursements

The DoD Cross Disbursement processing procedures were approved by OUSD(C) on February 28, 1996. Those procedures apply to all DoD Components and include cross disbursed

cash transactions except Interfund transactions, centralized transportation payments at the DFAS Indianapolis Center, and open allotment transactions. The DFAS goal is to significantly reduce and eliminate cross disbursements through accounting systems enhancements, including the elimination of paper flow within the DFAS network.

In an effort to improve the disbursement process so as to minimize intransit disbursements, DFAS has developed short- and long-term solutions to eliminate intransits.

In the short-term, DFAS is converting business processes that produce "for others" transactions to processes that produce "for self" transactions. One example is the implementation of Transactions for Others (TFO) Cells for vendor payments. This process allows payments to be prepared and collected at one accounting office and disbursed by another accounting office, thus simultaneously updating the accounting records. In addition, to improve the timeliness of recording intransits, DFAS is implementing automated processes to electronically transmit collections, disbursements, and reimbursables between DFAS accounting offices.

In the long-term, DFAS will prevalidate every disbursement to ensure the payment can be matched to an obligation before the payment is made. The Department is gradually lowering the threshold to zero for all payments. Further, DFAS is testing a system to route the relevant accounting data from a disbursing process to the relevant accounting office. This process will improve the accuracy of the data through edit criteria and the timeliness of updating the accounting records.

CFO Reporting

DFAS has a major responsibility to ensure that accurate, consistent, and auditable FY 1998 CFO Financial Statements are prepared. DFAS has taken action for the preparation of standard CFO financial statements and footnotes across the DoD. The DFAS Indianapolis Center provides special support to the DoD Chief Financial Officer, including the preparation of the DoD Agency-wide consolidated financial statements, supporting schedules, and notes.

The Statement of Federal Financial Accounting Standard (SFFAS) Number 4 – Managerial Cost Accounting Concepts and Standards, SFFAS Number 6 – Accounting for Property, Plant and Equipment, SFFAS Number 7 – Accounting for Revenue and Other Financing Sources, and SFFAS Number 8 – Supplementary Stewardship Reporting became effective beginning with the FY 1998 CFO Act financial statements.

DFAS hosted a DoD CFO Workshop in June 1998 with representatives from all functional areas involved in the CFO reporting process. These representatives included DFAS, our customers, the audit community, and the Office of Deputy Chief Financial Officers (ODCFO). The issues addressed during the workshop included numerous areas of concern and lessons learned from the FY 1997 CFO reporting process.

DFAS continues to work with our customers, the ODCFO (Accounting Policy), and the audit community to improve the CFO reporting guidance, requirements, process, and schedule. This working relationship should improve the quality and timeliness of the DoD's CFO statements.

To improve future CFO reporting DFAS has established a CFO After Action Report, which will identify the lessons learned, the planned versus actual completion dates of required CFO actions, and policy issues that require resolution before the next CFO reporting process.

Proactive Fraud Detection and Prevention

Operation Mongoose is DoD's fraud detection and prevention unit. It was established to minimize fraud against DoD financial assets. Operation Mongoose is managed by a DFAS program management team and involves several other DoD organizations. Computer matching techniques are used to compare various dissimilar computer systems operated by financial organizations within the Department to identify anomalies that occur when data that should be the same fails to match from one system to another. Areas of current interest include validation of vendor payments, military, civilian, and retired/annuitant payrolls, transportation payments, and payment system intrusion.

The Operation Mongoose methodology includes the combined team efforts of DFAS, the Defense Manpower Data Center (DMDC) in Monterey, California, and the DoD Inspector General's Office, including the Defense Criminal Investigative Service (DCIS). These three organizations are working together to develop fraud indicators that are generated by the discrepancies between systems, collect and compare data from all over DoD, detect the presence of anomalies within the DoD systems, examine the appropriate records to determine if the anomalies actually are a result of fraud, and pursue criminal charges against the people responsible for the fraud. The objective is to establish a permanently structured organization that will detect and prevent fraud by actively seeking it out, rather than waiting for it to surface by chance, be identified by informants, or be detected by random reviews that allow too great an opportunity for concealment of the crime.

The Operation Mongoose program manager has established a network that includes personnel already in place at the DFAS Centers, especially in their internal review organizations, in DoD financial and law enforcement agencies, and in several outside agencies including the U. S. Secret Service. The reviews have eliminated millions of dollars of suspected fraudulent and erroneous regular payments. Operation Mongoose is presently completing the development of a tracking and reporting system that will increase the ability to monitor and control the cases under consideration and keep responsible organizations informed of the investigation's status.

Finance and Accounting Initiatives

DFAS will modify, as necessary, and deploy standard finance and accounting systems for use DoD-wide. Standard migration systems will evolve incrementally into a vision-driven financial management system able to support decisionmaking by all DoD managers and operating activities. Through these initiatives, DFAS expects increased standardization of DoD finance and accounting systems over the next five years, resulting in substantial savings for the taxpayer.

The DFAS Five-Year Plan is to systematically streamline the finance and accounting process by reducing the number of applications within the Defense environment. The following chart provides an overview of our current status and goals:

DoD Accounting and Finance System Inventory

	<u>FY 91</u>	<u>FY 92</u>	<u>FY 93</u>	<u>FY 94</u>	<u>FY 95</u>	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98*</u>
Accounting	197	192	176	173	164	150	122	91
Finance	<u>127</u>	<u>120</u>	<u>102</u>	<u>97</u>	<u>92</u>	<u>67</u>	<u>34</u>	<u>18</u>
Total	324	312	278	270	256	217	156	109
Reduction (cumulative)		12	46	54	68	107	168	215
Percent (cumulative)		4%	14%	17%	21%	33%	52%	66%

*Represents core/critical systems reported to OMB per OMB Circular A-11, Section 15.5.

Accounting Systems

DFAS has undertaken a major effort toward reducing the number of DoD accounting systems and improving their compliance with Federal requirements. When DFAS was established, installation level accounting generally was performed at various military installations in decentralized field activity offices, using a variety of financial management information systems. These systems were tailored to meet the needs of the many diverse activities and frequently were integrated with the business operations that the applicable activities performed.

The complexity of accounting operations and the wide variety of automated information systems currently in use has shaped the Department's plan for migrating to standard DoD accounting systems.

By the end of FY 1998, DFAS had reduced the number of accounting systems to 91 core/critical systems from a high of 197 in FY 1991. This reduction was accomplished through

the elimination and consolidation of redundant systems. DFAS will reduce the number of accounting systems to no more than 23 by FY 2003.

On April 17, 1996, DFAS established a Defense Accounting System Project Management Office (DAS PMO). In 1998 the DAS PMO was reconstituted as the Systems Integration Directorate. It is responsible for all migratory, interim migratory, and legacy accounting systems that DFAS owns and operates. The Systems Integration Directorate's mission is to manage the reduction of existing accounting systems. The DFAS goal is to provide accurate, timely, and effective customer support at the lowest possible cost. The overall objective is to field electronically linked accounting systems that comply with generally accepted government accounting principles and standards, comply with the Chief Financial Officers Act of 1990, and produce complete and accurate installation, command, DoD Component, and departmental-level accounting reports and financial statements. The mission includes the elimination of unneeded or obsolete legacy systems and the modification of systems, where necessary, to meet accounting system requirements. Specific objectives of the Systems Integration Directorate are to:

- Design the optimum system architecture and reduce costs and manpower necessary to operate and maintain accounting systems.
- Interface or integrate accounting systems with other accounting, pay, and reporting systems.
- Replace current legacy systems throughout the Department with standard consolidated systems using technologically advanced data processing techniques and telecommunications capabilities; and
- Standardize accounting data and processes, where appropriate.

**Accounting Core/Critical Systems By Category
Fiscal Year 1998**

Accounting Systems

- Working Capital Funds	48
- General Funds	19
- Foreign Military Sales	8
- Departmental Reporting	9
- Cash Accountability	6
- Trust Funds	1
Total	91

Finance Systems

DFAS has made substantial progress toward the consolidation and standardization of financial systems to meet DoD ever changing requirements. DFAS consolidated retiree and annuitant pay operations on one standard system, the Defense Retiree and Annuitant Pay System, with a resulting cost reduction of \$10 million per year. DFAS also implemented a single standard system and consolidated into one operating location its out-of-service debt management functions. System costs were reduced by \$1 million per year while the consolidated operation resulted in a \$8.5 million annual savings. Travel computation software was standardized across DFAS, Defense Agencies, and all Military Services. DFAS has consolidated the printing of all savings bonds for the Department from over 190 bond issuing sites, using 20 different systems, to two DFAS Centers, using one system. DFAS also has a standard automated process of safekeeping savings bonds for active duty military members. DFAS has completed implementation of a standard system for processing civilian pay, the Defense Civilian Pay System (DCPS). This initiative has allowed the Department to close 349 payroll offices and eliminate 26 legacy civilian pay systems. Approximately 730,000 civilians are now paid using DCPS. The Department also has made substantial progress in moving to standard military pay systems, eliminating 18 of its former 22 military pay systems. The active component of Navy moved to the standard Defense Joint Military Pay System in February 1998, and the Reserve component will move in 1999. By the end of FY 2001, the Department will operate only two military pay systems. DFAS is also developing a Defense Standard Disbursing System (DSDS) strategy that will standardize the current disbursing business process.

Financial Systems By Category

Finance Systems

- Civilian Pay	1
- Military/Retired Pay	5
- Disbursing	4
- Transportation Pay	2
- Contract/Vendor Pay	4
- Travel Pay	1
- Debt Management	1
Total	18

*Represents core/critical systems reported to OMB per OMB Circular A-11, Section 15.5.

Some specific achievements are discussed below:

Defense Civilian Pay System (DCPS)

In June 1998, DFAS completed the implementation of all civilian payroll accounts to the Defense Civilian Pay System (DCPS), closing 349 civilian payroll offices and eliminating 26 legacy civilian pay systems. Approximately 730,000 DoD civilian employees and 1,500 Executive Office of the President employees are paid from three DFAS locations at DFAS Denver, Charleston, and Pensacola.

Modifications were made during FY 1998 to DCPS to support civilian pay processing in the Year 2000. Year 2000 contingency planning and end-to-end testing with selected trading partners are well underway. DCPS system modifications were also made to accommodate the Army and Air Force demonstration projects and implementation of the Department's new policy for Compensatory Time.

In 1999, DCPS on-line history will increase from 13 pay periods to 26 pay periods, which will give DCPS a full year of retroactive processing. This feature provides payroll offices and Customer Service Representatives a greater overview of the employee data for researching and resolving employees pay issues. System modifications will also be made to implement significant changes in the firefighter pay calculations contained in the Firefighter Overtime Pay Reform Act of 1998. Initiatives are also underway which will allow employees to change selected data via the World Wide Web and to receive their Leave and Earnings Statements electronically.

Defense Joint Military Pay (DJMS) System

DFAS has a strategic initiative to standardize and consolidate the automated systems that support military pay under two systems: the Defense Joint Military Pay System (DJMS) and Marine Corps Total Force System (MCTFS). All Army, Navy, and Air Force military pay functions will be under the DJMS. Because the Marine Corps has an integrated military personnel and pay system, its Active Duty and Reserve military pay are supported by MCTFS. Both DJMS and MCTFS will become a part of the Office of the Undersecretary of Defense for Personnel and Readiness (OUSDP&R) initiative to fully integrate personnel and pay in the Department of Defense. Significant savings are expected from standardizing military personnel and pay policies, procedures, and systems.

The Department's military pay operations support about 3 million uniformed men and women in the following categories, each with its own statutes, rules, regulations, and unique support structures: Active Duty, Reserve and National Guard, Academy Cadets and Midshipmen, Reserve Officer Training Corps (ROTC), Junior Reserve Officer Training Corps (JROTC), and Armed Forces Health Professionals Scholarship Program (AFHPSP). About 1.5 million active duty personnel are paid twice a month (97 percent via EFT), while most of the other categories are paid on an "as required" basis.

In conjunction with the consolidation and standardization of the automated military pay systems, DFAS is conducting a Business Process Review (BPR) study to document current military pay work methods, flows, staffing, and technology in use at the four Military Pay centers (Cleveland, Denver, Indianapolis, and Kansas City). The purpose of the BPR is to achieve the best, most cost-efficient operation possible for servicing the 3 million military personnel paid by DFAS.

Defense Retiree and Annuitant Pay System (DRAS)

All military retiree and annuitant pay has been consolidated into the Defense Retiree and Annuitant Pay System (DRAS), with all retirees paid at the DFAS Cleveland Center and all annuitants paid at the DFAS Denver Center. This consolidation not only standardized policies and procedures across the Military Services, but most importantly, reduced the costs of maintaining multiple systems. The DRAS consolidation, completed on April 1, 1995, effectively replaced eight systems. To accommodate growth in the customer base, the Department continues enhancing technology and operations. In February 1996, a Business Process Review (BPR) of the DRAS electronic document management process was initiated. The purpose of this BPR was to develop options for implementing a standard business process to maximize automation and enhance the workflow operations. As a result of the study, an Imaging Replacement Plan was developed and approved in December 1997. Initial funding to support associated software began in FY 1998. Funding to complete the project is budgeted for FY 1999.

Defense Travel System (DTS)

In 1995, DoD established a Travel Reengineering Task Force to streamline temporary duty travel. Based on the recommendations of the task force, the Deputy Secretary of Defense directed sweeping changes in the Department's travel processes. The first action was to establish a Reengineering Travel Transition Office to formulate policies and procedures for temporary duty travel. In September 1995, a Program Management Office was formed to design and acquire a new Defense Travel System (DTS). The contract was awarded on May 7, 1998, however, it was not effective until September 30, 1998. Projected date for the implementation of the new DTS, under the direction of the OUSD Project Management Office (PMO), is May 1999. The PMO will phase in the new system over a three-year period. The target date for completion is 2002.

Integrated Automated Travel System (IATS) 5.1 provides a standard travel computation system for DFAS, Defense Agencies, and Military Services. IATS 5.1 provides EFT and split disbursement capability among its many improvements over earlier versions. During implementation of the DTS, IATS will continue to compute travel vouchers not covered under the DTS umbrella. As additional entitlement sections of the DoD travel regulations are simplified (i.e., reserve and permanent change of station), those types of travel will shift from IATS to DTS.

Defense Transportation Payment System (DTRS)

The Transportation Information Payment System was chosen as the standard DoD-wide transportation payment system on December 10, 1992. Renamed the Defense Transportation Payment System (DTRS), it supports the DoD initiative to consolidate and standardize transportation payments

and will interface with the DoD standard accounting and disbursing systems. The DTRS includes the following features:

- Receives transportation GBL and invoices via EDI.
- Performs a prepayment audit of transportation bills.
- Disburses using EFT.
- Manages claims and collections.

The implementation schedule for DTRS is currently under review.

Mechanization of Contract Administration Services (MOCAS)

Payments on approximately 96 percent of the 1.4 million invoices for the nearly 400,000 centrally-managed, high-dollar contracts are made by the DFAS Columbus Center. These payments are made primarily through an integrated contract management and payment system—MOCAS. Although MOCAS is no longer identified as the standard DoD contract payment migration system, it remains active and serves as the DoD contract payment legacy system. The proposed standardized DoD system for contract payments (under development) is the Defense Procurement Payment System (DPPS). One of the key elements of DPPS will be the systems integration with the Standard Procurement System and the Shared Procurement Data Warehouse System. In addition to determining contractor entitlements and disbursing payments, the Columbus Center also builds and maintains the MOCAS database used by the DoD's contract administration community. Seventy percent of the dollar value of these major contracts is paid using EFT.

DFAS is also implementing EC/EDI in the contract pay area. Currently, efforts are underway to transmit contract data from eight major contract writing systems to the contract payment system, MOCAS (five are implemented, three underway), and seven accounting systems (all are underway). This automated effort will eliminate duplicate data entry and provide timely distribution of contract and financial information. In addition, MOCAS has the capability of receiving contractor invoices transmitted via EDI. This effort will reduce the duplication of input by DFAS personnel and input errors.

Defense Debt Management System (DDMS)

Debt management is an integral part of current military pay, retiree and annuitant pay, civilian pay, travel pay, and disbursing systems for those individuals "in-service" owing money to the government. Similarly, for contractor debts, initial debt collection activities are an integral part of current transportation payment, vendor payment, and contract payment systems. Debt collection procedures are designated to facilitate the prompt collection of debts from individuals and contractors, while providing full due process in accordance with the Debt Collection Act of 1982. The debt collection process has been further improved with the implementation of the Debt Collection Improvement Act (DCIA) of 1996, which allows for the expeditious recovery of certain debts resulting from routine pay adjustments. DFAS currently accomplishes a myriad of file searches, data matches, and reconciliations both internal and external to DFAS pay systems. The purpose of these efforts is to

detect potential overpayments, erroneous payments, and possible fraudulent activity; implement corrective actions; and collect resulting debts. DFAS also includes the Department's delinquent debt in the Treasury's National Interactive Delinquent Debtor Database (NID3) for debts to be matched against all federal payments. This process will implement the administrative offset provisions of the DCIA, providing yet another tool to increase debt collection within the federal government.

For individuals not receiving pay within the department (out-of-service), debt management is centralized at the DFAS Denver Center with over 200,000 cases processed annually. Delinquent contractor debts are managed at the DFAS Columbus Center with approximately 3,000 delinquent debts valued at over \$2.8 billion. It should be noted that approximately \$1.9 billion of the total contractor debt is not legally enforceable for debt collection, mainly, because these debts are in deferment or pending deferment by the Armed Services Appeal Board of Contract Appeals. Both operations use the Defense Debt Management System (DDMS), hosted at the DFAS Denver Center, to maintain and manage their debt portfolios. DDMS uses a wide range of collection techniques to collect DoD debt, including sending dunning letters to debtors, reporting delinquent debtors to credit bureaus, and referring delinquent debtors to collection agencies for collection assistance and to the Internal Revenue Service for offset against an individual's federal income tax refund. In FY98, DDMS recovered over \$193 million in individual and contractor debts due the Department.

Defense Standard Disbursing System (DSDS)

The program mission of the DSDS is to develop a strategy to modernize business processes as well as define standard data that can be shared. The system currently under development will replace existing service/center specific disbursing systems and modules with a single automated information system. DSDS will be a standard disbursing system that will be used DFAS-wide to make payments, accept collections, and maintain accountability for public funds.

DSDS, through the DFAS Corporate Data Base (DCD), will operate in concert with interim and migratory DoD entitlement and accounting systems to produce accurate disbursing transactions and reports. While DSDS will be capable of creating disbursing transactions itself (through manual input), it will primarily import data from these entitlement systems to automatically generate payments and collections. DSDS will then export, back to the DCD, relevant data to the appropriate accounting systems for balancing and reporting.

Manpower

DFAS has taken aggressive measures to respond favorably to the DoD manpower requirement to downsize both the military and civilian workyear levels. For the last four years, DFAS has exceeded the OUSD(C) mandatory civilian and military reduction goals.

The military and civilian workyears employed at DFAS as of September 30, 1998:

Military 1,438

Civilian 16,694

Organization

DFAS Finance and Accounting Centers:

DFAS Headquarters, Arlington, VA.

DFAS Cleveland Center, Cleveland, OH.

DFAS Columbus Center, Columbus, OH.

DFAS Denver Center, Denver, CO.

DFAS Indianapolis Center, Indianapolis, IN.

DFAS Kansas City Center, Kansas City, MO.

In addition to their own operation, several Centers have responsibility for field locations throughout the United States. The following is the current Center responsibility list:

Responsible Center

Operating Location

Cleveland

Charleston, SC
Pacific (formerly Honolulu, HI)
Norfolk, VA
Oakland, CA
Pensacola, FL
San Diego, CA

Denver

Dayton, OH
Limestone, ME
Omaha, NE
San Antonio, TX
San Bernardino, CA

Indianapolis

Orlando, FL
Lawton, OK
Lexington, KY
Rock Island, IL
Seaside, CA
St. Louis, MO
Rome, NY
Memphis, TN

A standard operational structure aids the implementation of new technologies and business practices. Thus, DFAS OPLOCs, which focus primarily on installation accounting and vendor pay, have standard organizations and procedures. In addition to a director and principal deputy director, each OPLOC has three Directorates: accounting, finance, and administration. The three OPLOCs with civilian pay functions also have civilian pay Directorates.

At the end of FY 1998, DFAS consists of a headquarters located in Arlington, Virginia, with five centers located in Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri; and 19 OPLOCs located nationwide. Consolidation of field activities into no more than 24 was completed by July 1998. Studies are underway to consolidate overseas locations.

All the above activities directly support major DFAS programs, promoting effective and efficient finance and accounting services during times of peace and conflict.

Fiscal Year 1998

Total FY 1998 DFAS revenue for the Financial Operations business area was \$1.564 billion, a 12 percent decrease from the FY 1996 level of \$1.770 billion. Expenses decreased 3.6 percent to \$1.585.8 billion in FY 1998 compared to \$1.645 billion in FY 1997.

Source of Funds

During FY 1998, the principal source of funds for DFAS was revenue received from DoD components for which DFAS performed finance and accounting services. The sources of DFAS revenue were as follows:

	Amount (Dollars in Millions)
Army	\$552.5
Air Force	327.0
Navy	366.0
Marine Corps	68.6
Defense Agencies	209.5
Foreign Military Sales (FMS)	40.4
Total	\$1,564.0

DFAS Earned Authority

(Dollars in Millions)

Total Earned Authority	\$1,628.5
Total Expenses	\$1,585.8
Difference	\$42.7
Percent of Earned Authority	97.4%

In FY 1998 as in FY 1997, DFAS successfully executed its mission at total costs well below its available earned authority, reflecting the Agency's continuing efforts to control costs. For the majority of output measures, costs were either under or slightly above the target. Three targets showed significant overages: Civilian Pay, Transportation Bills Paid, and Standard Automated Material Management System (SAMMS) Invoices.

DFAS has been studying an alternative way to measure the costs of accounting services. Currently, most of these costs are captured in Monthly Trial Balances Maintained output. DFAS is reviewing the use of billable hours as a better means of capturing and evaluating accounting costs. Initial testing of Direct Billable Hours (DBH) began in FY 1997. Testing will continue into FY 1999, with a proposal to implement the use of DBH in FY 2000. DFAS is also continuing to explore ways to pass on savings to our customers from new technologies like electronic commerce and through improved business practices like the use of the purchase card. Incentive rates have been proposed for use of electronic commerce in the areas of Commercial Invoices Paid - Mechanization of Contract Administration Services, Commercial Invoices Paid - Standard Automated Material Management System, and Travel Vouchers Paid. Additionally, the use of the DoD Purchase Card is projected to provide dramatic savings in the future as it is implemented by our customers.

Unit Cost Improvements

Unit cost improvements have occurred due to the consolidation and integration of a variety of financial management and accounting systems. Productivity has increased as business processes have been standardized and reengineered, to include financial information in a greater number of program management systems. Efficiencies have been gained through centralizing civilian and military pay functions among the Centers and Operating Locations. Structural organization changes have proven to be successful and have improved coordination among the various field activities and commercial vendors with regards to invoicing and commercial payments. Policy changes have allowed for greater consistency in the categorization of assets and associated valuation methods as they relate to inventory and property. Although DFAS has accomplished much, more improvements continue to be done in the areas of systems development, electronic commerce, and electronic data interchange that should allow for even greater efficiency gains in the future.

**OPERATING EFFICIENCY
UNIT COST GOALS TO ACTUALS**

FINANCIAL OPERATIONS	GOAL	ACTUAL	PERCENT OF GOAL
CIV PAY ACCT MAINT	3.19	3.32	104%
CIV PAY-DBMS PARTIAL	N/A	11.67	N/A
ACT MIL PAY ACCT	7.98	8.41	105%
RET MIL PAY ACCT	2.22	2.26	102%
RES MIL PAY ACCT	3.18	3.32	104%
CNTRCT INV-MOCAS	104.49	95.72	92%
TRAVEL VOUCHERS PD	15.99	14.58	91%
TRANS BILL PD	13.85	16.91	122%
COMMERCIAL INV PD	15.02	15.65	104%
OOS DEBT CASES	125.48	106.62	85%
MON TRIAL BAL MAINT.	1294.82	1097.03	85%
ACCTG & FIN SPT.	2460.11	2447.48	99%
FMS CASES MANAGED	167.47	159.77	95%
CNTRCT INV-SAMMS	8.12	9.35	115%
INCREMENTAL MIL PAY	11.57	12.36	107%
OTHER OUTPUTS			
SUPPORT TO OTHERS	106,100,000	52,581,179	49.56%

DFAS Issues to the Year 2000 and Beyond

DFAS is a service organization and must be flexible to meet the changing needs of customers supported with efficient operations in peacetime and the ability to expand rapidly to meet any type of military emergency. As the size of the military establishment is reduced, the workload of DFAS will also be reduced. Major efforts will be required to adjust operations to produce cost-effective products that are required by law or for which customers are willing to pay.

The finance and accounting business processes are being revolutionized in the 1990s, both vertically within the finance and accounting functional areas and laterally across functional lines. The business processes are being improved on a phased basis in conjunction with fielding migratory systems and evolving new systems, and implementing corporate information management functional requirements and concepts. Finance and accounting systems are being standardized and integrated and operations will be centralized at a small number of locations. Use of technology is being applied to reduce or eliminate paper and improve efficiency. At the same time, the quality of service and internal controls is being improved.

A major challenge is downsizing staff with minimum impact on people and operations while upgrading the qualification of the remaining work force. With so much change both within DFAS and the organizations it serves, extraordinary measures are being taken to avoid problems in internal controls and services as standard migratory systems are implemented and operations are relocated to central sites.

DFAS has made significant progress within the past seven years toward consolidating and standardizing finance and accounting within DoD, but much remains to be done to achieve financial management reform. Major challenges still lie ahead. DFAS will play a key role in the DoD-wide efforts in future financial management challenges.

FINANCIAL SYSTEMS ORGANIZATION

Description of the Reporting Entity

The Defense Finance and Accounting Service (DFAS) Information Services Activity functions as a fee-for-service operation in the DWCF. Organizations within this Activity provide software development/modernization and systems maintenance support to over 100 Automated Information Systems (AIS). Additionally, they provide overall technical support in a number of system-related areas including the acquisition of information technology, systems deployment, and support for the DFAS information technology (I/T) infrastructure.

The Activity is comprised of organizations located in Cleveland, Ohio; Columbus, Ohio; Pensacola, Florida; Indianapolis, Indiana; Kansas City, Missouri; Lexington Park, Maryland; and Denver, Colorado. During FY 1998, the Activity delivered over 2.5 million direct labor hours in accomplishing its software development and maintenance mission.

In addition to providing much of the technical support that resulted in many of the accomplishments noted in the DFAS Financial Operations section of this report, the Activity's major initiatives during FY 1998 included:

Realignment of the five Financial Systems Activities located in Cleveland, Columbus, Denver, Indianapolis, and Kansas City with the collocated DFAS Center. This realignment reflects DFAS recognition and implementation of National and Defense legislation and strategic direction related to the information and technology functional area by providing the following business process changes.

- Placing the responsibility for both Financial Operations and Information Service under one manager.
- Establishing a Center Director for Information and Technology within each DFAS Center to serve as the Center Chief Information Officer and oversee all information and technology activities of the Center/OPLOC.

The Patuxent River Navy Central Design Activity was capitalized by DFAS and brought into the FSO Activity in February 1998. Since that date, the activity's authorized workyears have increased; workload priority has been aligned with the customer's requirements; a review of their internal business processes has been conducted; and several other initiatives to improve their productivity and reduce their cost have been implemented.

The Activity's Software Process Improvement (SPI) program is a continuous, multiyear effort to standardize and improve software development processes and practices. The Capability Maturity Model (CMM) developed by Software Engineering Institute (SEI) continues as the basis for this program which achieved an overall CMM Level II status in FY 1997. During FY 1998 the strategy and plans for the Software Process Improvement (SPI) Level 3 prototype sites to attain CMM Level III status were developed, and two Capability Maturity Model Based Appraisal Internal Process Improvement (CBAIPI) workshops for the SPI Level 3 prototype sites were held. Additionally, plans were coordinated to perform the first DFAS SPI Level 3 evaluation for Software Engineering Organization Pensacola in January 1998.

During FY 1998 the Activity continued its information technology (IT) support in assessing and changing many DFAS applications in the area of Year 2000 (Y2K) compliance. The Y2K problem impacts DFAS' Automated Information Systems (AIS) and its AIS hardware. The DFAS overall goal is to provide a DFAS-wide coordinated effort that ensures no system is adversely affected by Y2K problems. This goal will allow the DFAS components the flexibility to implement solutions as deemed appropriate while benefiting from best practices in a coordinated effort. DFAS has completed the awareness and assessment phases. Y2K points of contact have been assigned at multiple levels throughout the organization to coordinate all Y2K efforts. An inventory of the DFAS AIS has been created and all have been analyzed for potential Y2K impact. Of the systems currently being tracked, approximately one-third are being repaired, one-third are scheduled for replacement, and one-third are already compliant or are in development. DFAS is on schedule to meet its goal of having all systems certified as Y2K compliant and implemented not later than March 31, 1999.

Manpower

The FSO Activity was given an additional 100 workyears in FY 1998 to avoid growth in its dependence on expensive contractor augmentation. Although some savings were realized from this initiative, the demand for skilled information technology workers in the private sector frustrated our efforts to fully recruit this workforce.

The military and civilian end strength was:

Military	88
Civilian	1,351

Selected Financial Data:

	FY97	FY98	Net Change
Revenues (\$M)	\$204.1	\$208.9	\$4.8
Expenses (\$M)			
Direct Billable Labor Hour	145.1	132.8	-12.4
Support to Others	56.1	72.1	16.0
Total	201.2	204.9	3.7
Net Operating Result (\$M)	2.9	4.0	1.1
Unit Cost per Hour	\$56.71	\$52.60	\$-4.11

The decrease in the Direct Billable Hour expenses between FY 97 and FY 98 are primarily attributable to relatively constant workload, increased availability of civilian workyears, reduction in General and Administrative expenses, and reductions in DISA's billing rates. The growth in the Support to Others program is the result of the new Patuxent River mission.

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

OPERATIONS

PRINCIPAL STATEMENTS

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATED BALANCE SHEET
As of September 30, 1998

FY
1998

ASSETS

1 Entity Assets:

A. Intragovernmental	
1. Fund Balance With Treasury (Note 2)	(146,597,588.59)
2. Investments (Note 4)	0.00
3. Accounts Receivable, Net (Note 5)	103,535,632.95
4. Other Assets (Note 6)	0.00
B. Total Intragovernmental	<u>(43,061,955.64)</u>
C. Investments (Note 4)	0.00
D. Accounts Receivable, Net (Note 5)	32,524.34
E. Loans Receivables and Related Foreclosed Property, Net (Note 7)	0.00
F. Cash and Other Monetary Assets (Note 3)	0.00
G. Inventory and Related Property, Net (Note 8)	0.00
H. General Property, Plant and Equipment (Note 9)	680,346,733.33
I. Stewardship Assets (National Defense PP&E, etc)	0.00
J. Other Assets (Note 6)	25,565,278.39
K. Total Entity Assets	<u>662,882,580.42</u>

2 Non-Entity Assets:

A. Intragovernmental	
1. Fund Balance With Treasury (Note 2)	0.00
2. Accounts Receivable, Net (Note 5)	0.00
3. Other Assets (Note 6)	0.00
B. Total Intragovernmental	<u>0.00</u>
C. Accounts Receivable, Net (Note 5)	
D. Cash and Other Monetary Assets (Note 3)	0.00
E. Other Assets (Note 6)	0.00
F. Total Non-Entity Assets	<u>0.00</u>

3 Total Assets

662,882,580.42

The accompanying notes are an integral part of these statements

Department of Defense
 Defense Working Capital Fund, Defense Finance and Accounting Services
CONSOLIDATED BALANCE SHEET
 As of 30 September 1998

FY
 1998

LIABILITIES

4 Liabilities Covered by Budgetary Resources:

A.	Intragovernmental:	
1.	Accounts Payable	219,075,860.74
2.	Environmental Cleanup (Note 11)	0.00
3.	Debt (Note 10)	0.00
4.	Other Liabilities (Notes 11, 12 and 15)	0.00
B.	Total Intragovernmental	<u>219,075,860.74</u>
C.	Accounts Payable	145,516,186.81
D.	Liabilities for Loan Guarantees	0.00
E.	Military Retirement Benefits and other Employment	0.00
F.	Environmental Cleanup (Note 11)	
G.	Other Liabilities (Notes 11, 12 and 15)	13,473,875.65
H.	Total Liabilities Covered by Budgetary Resources	<u>378,065,923.20</u>

5 Liabilities not Covered by Budgetary Resources:

A.	Intragovernmental:	
1.	Accounts Payable	0.00
2.	Debt (Note 10)	0.00
3.	Environmental Cleanup (Note 11)	0.00
4.	Other Liabilities (Notes 11, 12 and 15)	0.00
B.	Total Intragovernmental	<u>0.00</u>
C.	Accounts Payable	0.00
D.	Debt (Note 10)	0.00
E.	Military Retirement Benefits and other Employment	0.00
F.	Environmental Cleanup (Note 11)	0.00
G.	Other Liabilities (Notes 11, 12 and 15)	140,505,840.18
H.	Total Liabilities not Covered by Budgetary Resources	<u>140,505,840.18</u>

6 Total Liabilities 518,571,763.38

NET POSITION

7	Unexpended Appropriations (Note 14)	0.00
8	Cumulative Results of Operations	144,310,817.04
9	Total Net Position	<u>144,310,817.04</u>
10	Total Liabilities and Net Position	<u>662,882,580.42</u>

The accompanying notes are an integral part of these statements

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATED STATEMENT OF NET COST
For the period ending September 30, 1998

	FY 1998
1 Program Costs	
A. Intragovernmental	1,040,545,342.65
B. With the Public	746,355,596.90
C. Total Program Cost	<u>1,786,900,939.55</u>
D. Less: Earned Revenues	<u>(1,701,289,958.37)</u>
E. Net Program Costs	<u>85,610,981.18</u>
2 Costs Not Assigned to Programs	0.00
3 Less: Earned Revenues Not Attributable to Programs	0.00
4 Deferred Maintenance (Note 17)	0.00
5 Net Cost Of Operations	<u><u>85,610,981.18</u></u>

Additional information included in Note 16.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the period ending September 30, 1998

	FY 1998
1 Net Cost of Operations	85,610,981.18
2 Financing Sources (Other than Exchange Revenues):	
A. Appropriations Used	0.00
B. Taxes (and Other Non-exchange Revenue)	0.00
C. Donations (Non-exchange Revenue)	0.00
D. Imputed Financing	61,694,830.00
E. Transfers-In	(7,589,588.85)
F. Transfers-Out	(67,849,938.08)
3 Net Results of Operations (Line 2 less Line 1)	<u>(99,355,678.11)</u>
4 Prior Period Adjustments (Note 18)	<u>105,359,991.03</u>
5 Net Change in Cumulative Results of Operations	6,004,312.92
6 Increase (Decrease) in Unexpended Appropriations	<u>0.00</u>
7 Change in Net Position	6,004,312.92
8 Net Position-Beginning of Period	<u>138,306,504.12</u>
9 Net Position-End of Period	<u><u>144,310,817.04</u></u>

Additional information included in Note 18.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the period ending September 30, 1998

		FY 1998
BUDGETARY RESOURCES:		
1	Budget Authority	126,086,319.67
2	Unobligated Balance - Beginning of Period	(2,628,736.41)
3	Net Transfers Prior-Year Balance, Actual (+/-)	0.00
4	Spending Authority from Offsetting Collections	1,792,472,958.36
5	Adjustments	0.00
6	Total Budgetary Resources	<u>1,915,930,541.62</u>

STATUS OF BUDGETARY RESOURCES:

7	Obligations Incurred	1,784,489,279.78
8	Unobligated Balances - Available	131,441,261.84
9	Unobligated Balances - Not Available	0.00
10	Total, Status of Budgetary Resources	<u>1,915,930,541.62</u>

OUTLAYS:

11.	Obligations Incurred	1,784,489,279.78
12.	Less: Spending Authority From Offsetting Collections and Adjustments	<u>(1,792,472,958.36)</u>
13.	Obligated Balance, Net - Beginning of Period	582,066,879.39
14.	Obligated Balance Transferred, Net	0.00
15.	Less: Obligated Balance, Net - End of Period	(427,485,612.22)
16.	Total Outlays	<u>146,597,588.59</u>

Additional Information included in Note 19.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
COMBINED STATEMENT OF FINANCING
For the period ending September 30, 1998

	FY 1998
1 OBLIGATIONS AND NONBUDGETARY RESOURCES:	
A. Obligations Incurred	1,784,489,279.78
B. Less: Spending Authority for Offsetting Collections and Adjustments	(1,792,472,958.36)
C. Donations Not in the Entity's Budget	0.00
D. Financing Imputed for Cost Subsidies	61,694,830.00
E. Transfers-In (Out)	(75,439,526.93)
F. Exchange Revenue Not in the Entity's Budget	0.00
G. Other	0.00
H. Total Obligations as Adjusted and Nonbudgetary Resources	<u>(21,728,375.51)</u>
2 RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:	
A. Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided	(15,049,811.75)
B. Costs Capitalized on the Balance Sheet	(50,644,265.55)
C. Financing Sources That Fund Costs of Prior Periods	105,268,224.14
D. Other	6,100,409.71
E. Total Resources That Do Not Fund Net Costs of Operations	<u>45,674,556.55</u>
3 COSTS THAT DO NOT REQUIRE RESOURCES:	
A. Depreciation and Amortization	178,079,613.03
B. Revaluation of Assets and Liabilities	0.00
C. Other	4,299,575.37
D. Total Costs That Do Not Require Resources	<u>182,379,188.40</u>
4 Financing Sources Yet to be Provided	<u>(120,714,388.26)</u>
5 Net Cost of Operations	<u><u>85,610,981.18</u></u>

Additional information included in Note 20.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATING BALANCE SHEET
As of September 30, 1998

	Fin Oper	FSO	Elimination's	Grand Total
ASSETS				
1 Entity Assets:				
A. Intragovernmental				
1. Fund Balance With Treasury (Note 2)	(145,886,328.72)	(711,259.87)		(146,597,588.59)
2. Investments (Note 4)	0.00	0.00		0.00
3. Accounts Receivable, Net (Note 5)	63,787,216.20	43,271,674.29	(3,523,257.54)	103,535,632.95
4. Other Assets (Note 6)	0.00	0.00		0.00
B. Total Intragovernmental	(82,099,112.52)	42,560,414.42	(3,523,257.54)	(43,061,955.64)
C. Investments (Note 4)	0.00	0.00		0.00
D. Accounts Receivable, Net (Note 5)	32,524.34	0.00		32,524.34
E. Loans Receivables and Related Foreclosed Property, Net (Note 7)	0.00	0.00		0.00
F. Cash and Other Monetary Assets (Note 3)	0.00	0.00		0.00
G. Inventory and Related Property, Net (Note 8)	0.00	0.00		0.00
H. General Property, Plant and Equipment (Note 9)	650,596,654.25	29,750,079.08		680,346,733.33
J. Stewardship Assets (National Defense PP&E, etc)	0.00	0.00		0.00
I. Other Assets (Note 6)	25,559,370.85	5,907.54		25,565,278.39
K. Total Entity Assets	594,089,436.92	72,316,401.04	(3,523,257.54)	662,882,580.42
2 Non-Entity Assets:				
A. Intragovernmental				
1. Fund Balance With Treasury (Note 2)	0.00	0.00		0.00
2. Accounts Receivable, Net (Note 5)	0.00	0.00		0.00
3. Other Assets (Note 6)	0.00	0.00		0.00
B. Total Intragovernmental	0.00	0.00	0.00	0.00
C. Accounts Receivable, Net (Note 5)				
D. Cash and Other Monetary Assets (Note 3)	0.00	0.00		0.00
E. Other Assets (Note 6)	0.00	0.00		0.00
F. Total Non-Entity Assets	0.00	0.00	0.00	0.00
3 Total Assets	594,089,436.92	72,316,401.04	(3,523,257.54)	662,882,580.42

The accompanying notes are an integral part of these statements

Defense Working Capital Fund, Defense Finance and Accounting Services
CONSOLIDATING BALANCE SHEET
As of 30 September 1998

	Fin Oper	FSO	Elimination's	Grand Total
LIABILITIES				
4 Liabilities Covered by Budgetary Resources:				
A. Intragovernmental Liabilities:				
1. Accounts Payable	201,579,708.12	21,019,410.16	(3,523,257.54)	219,075,860.74
2. Interest Payable	0.00	0.00		0.00
3. Debt (Note 10)	0.00	0.00		0.00
4. Other Intragovernmental Liabilities (Note 11)	0.00	0.00		0.00
B. Total Intragovernmental:	201,579,708.12	21,019,410.16	(3,523,257.54)	219,075,860.74
C. Accounts Payable	123,617,222.49	21,898,964.32		145,516,186.81
D. Liabilities for Loan Guarantees	0.00	0.00		0.00
E. Military Retirement Benefits and other Employment				
Post-Employment Related Actuarial Liabilities	0.00	0.00		0.00
Benefits (Note 13) (Note 13)				
F. Environmental Cleanup (Note 11)				
G. Other Liabilities (Notes 11 and 12)	12,078,328.81	1,395,546.84		13,473,875.65
H. Total Liabilities Covered by Budgetary Resources	337,275,259.42	44,313,921.32	(3,523,257.54)	378,065,923.20
5 Liabilities not Covered by Budgetary Resources:				
A. Intragovernmental Liabilities:				
1. Accounts Payable	0.00	0.00		0.00
2. Debt (Note 9)	0.00	0.00		0.00
3. Environmental Cleanup (Note 11)	0.00	0.00		0.00
4. Other Liabilities (Notes 11 and 12)	0.00	0.00		0.00
B. Total Intragovernmental	0.00	0.00	0.00	0.00
C. Accounts Payable	0.00	0.00		0.00
D. Debt (Note 9)	0.00	0.00		0.00
E. Military Retirement Benefits and other Employment				
Post-Employment Related Actuarial Liabilities	0.00	0.00		0.00
Benefits (Note 13) (Note 13)				
F. Environmental Cleanup (Note 11)	0.00			0.00
G. Other Liabilities (Notes 11 and 12)	45,336,256.85	6,084,173.62	89,085,409.71	140,505,840.18
H. Total Liabilities not Covered by Budgetary Resources	45,336,256.85	6,084,173.62	89,085,409.71	140,505,840.18
6 Total Liabilities	382,611,516.27	50,398,094.94	85,562,152.17	518,571,763.38
NET POSITION				
7 Unexpended Appropriations (Note 14)	0.00	0.00		0.00
8 Cumulative Results of Operations	211,477,920.65	21,918,306.10	(89,085,409.71)	144,310,817.04
9 Total Net Position	211,477,920.65	21,918,306.10	(89,085,409.71)	144,310,817.04
10 Total Liabilities and Net Position	594,089,436.92	72,316,401.04	(3,523,257.54)	662,882,580.42

The accompanying notes are an integral part of these statements

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATING STATEMENT OF NET COST
For the period ending September 30, 1998

	Fin Oper	FSO	Inter-agency Eliminations	Consolidated Totals
1 Program Costs				
A. Intragovernmental	985,187,947.12	120,890,850.20	(65,533,454.67)	1,040,545,342.65
B. With the Public	600,651,871.00	84,008,895.90	61,694,830.00	746,355,596.90
C. Total Program Cost	1,585,839,818.12	204,899,746.10	(3,838,624.67)	1,786,900,939.55
D. Less: Earned Revenues	(1,563,999,213.75)	(208,924,609.00)	71,633,864.38	(1,701,289,958.37)
E. Net Program Costs	21,840,604.37	(4,024,862.90)	67,795,239.71	85,610,981.18
2 Costs Not Assigned to Programs	0.00	0.00		0.00
3 Less: Earned Revenues Not Attributable to Programs	0.00	0.00		0.00
4 Deferred Maintenance (Note 17)	0.00	0.00		0.00
5 Net Cost Of Operations	21,840,604.37	(4,024,862.90)	67,795,239.71	85,610,981.18

Additional information included in Note 16.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the period ending September 30, 1998

	Fin Oper	FSO	Inter-agency Eliminations	Consolidated Total
1 Net Cost of Operations	21,840,604.37	(4,024,862.90)	67,795,239.71	85,610,981.18
2 Financing Sources (Other than Exchange Revenues):				
A. Appropriations Used	0.00	0.00		0.00
B. Taxes (and Other Non-exchange Revenue)	0.00	0.00		0.00
C. Donations (Non-exchange Revenue)	0.00	0.00		0.00
D. Imputed Financing	0.00	0.00	61,694,830.00	61,694,830.00
E. Transfers-In	(8,087,736.87)	498,148.02		(7,589,588.85)
F. Transfers-Out	(66,350,953.35)	(1,498,984.73)		(67,849,938.08)
3 Net Results of Operations(Line 2 less Line 1)	(96,279,294.59)	3,024,026.19	(6,100,409.71)	(99,355,678.11)
4 Prior Period Adjustments (Note 18)	105,313,958.24	46,032.79		105,359,991.03
5 Net Change in Cumulative Results of Operations	9,034,663.65	3,070,058.98	(6,100,409.71)	6,004,312.92
6 Increase (Decrease) in Unexpended Appropriations	0.00	0.00		0.00
7 Change in Net Position	9,034,663.65	3,070,058.98	(6,100,409.71)	6,004,312.92
8 Net Position-Beginning of Period	202,443,257.00	18,848,247.12	(82,985,000.00)	138,306,504.12
9 Net Position-End of Period	211,477,920.65	21,918,306.10	(89,085,409.71)	144,310,817.04

Additional information included in Note 18.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
CONSOLIDATING STATEMENT OF BUDGETARY RESOURCES
As of 30 September 1998

BUDGETARY RESOURCES:		Fin Oper	FSO	Elimination's	Grand Total
1	Budget Authority	124,673,822.29	1,412,497.38		126,086,319.67
2	Unobligated Balance - Beginning of Period	(28,411,883.68)	25,783,147.27		(2,628,736.41)
3	Net Transfers Prior-Year Balance, Actual (+/-)	0.00	0.00		0.00
4	Spending Authority from Offsetting Collections	1,563,465,071.69	229,007,886.67		1,792,472,958.36
5	Adjustments	0.00	0.00		0.00
6	Total Budgetary Resources	1,659,727,010.30	256,203,531.32	0.00	1,915,930,541.62

STATUS OF BUDGETARY RESOURCES:

7	Obligations Incurred	1,579,397,922.43	205,091,357.35		1,784,489,279.78
8	Unobligated Balances - Available	80,329,087.87	51,112,173.97		131,441,261.84
9	Unobligated Balances - Not Available	0.00	0.00		0.00
10	Total, Status of Budgetary Resources	1,659,727,010.30	256,203,531.32	0.00	1,915,930,541.62

OUTLAYS:

11.	Obligations Incurred	1,579,397,922.43	205,091,357.35		1,784,489,279.78
12.	Less: Spending Authority From Offsetting Collections and Adjustments	(1,563,465,071.69)	(229,007,886.67)		(1,792,472,958.36)
13.	Obligated Balance, Net - Beginning of Period	602,473,438.65	(20,406,559.26)		582,066,879.39
14.	Obligated Balance Transferred, Net	0.00	0.00		0.00
15.	Less: Obligated Balance, Net - End of Period	(472,412,630.79)	45,034,348.45		(427,378,282.34)
16.	Total Outlays	145,993,658.60	711,259.87	0.00	146,704,918.47

Additional Information included in Note 18.

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Working Capital Fund, Defense Finance and Accounting Service
COMBINED STATEMENT OF FINANCING
For the period ending September 1998

	Fin Oper	FSO	Elimination's	Grand Total
1 OBLIGATIONS AND NONBUDGETARY RESOURCES:				
A Obligations Incurred	1,579,397,922.43	205,091,357.35		1,784,489,279.78
B Less: Spending Authority for Offsetting Collections and Adjustments	(1,563,465,071.69)	(229,007,886.67)		(1,792,472,958.36)
C Donations Not in the Entity's Budget	0.00	0.00		0.00
D Financing Imputed for Cost Subsidies	0.00	0.00	61,694,830.00	61,694,830.00
E Transfers-In (Out)	(74,438,690.22)	(1,000,836.71)		(75,439,526.93)
F Exchange Revenue Not in the Entity's Budget	0.00	0.00		0.00
G Other	0.00	0.00		0.00
H Total Obligations as Adjusted and Nonbudgetary Resources	(58,505,839.48)	(24,917,366.03)	61,694,830.00	(21,728,375.21)
2 RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:				
A Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided (Net Increases) Net Decreases	(15,195,008.53)	145,196.78		(15,049,811.75)
B Costs Capitalized on the Balance Sheet (Increases) Decreases	(62,807,939.10)	12,163,673.55		(50,644,265.55)
C Financing Sources That Fund Costs of Prior Periods	105,314,256.93	(46,032.79)		105,268,224.14
D Other	0.00	0.00	6,100,409.71	6,100,409.71
E Total Resources That Do Not Fund Net Costs of Operations	27,311,309.30	12,262,837.54	6,100,409.71	45,674,556.55
3 COSTS THAT DO NOT REQUIRE RESOURCES:				
A Depreciation and Amortization	169,470,368.24	8,609,244.79		178,079,613.03
B Revaluation of Assets and Liabilities	0.00	0.00		0.00
C Other	4,291,122.87	8,452.50		4,299,575.37
D Total Costs That Do Not Require Resources	173,761,491.11	8,617,697.29	0.00	182,379,188.40
4 Financing Sources Yet to be Provided	(120,726,356.56)	11,968.30		(120,714,388.26)
5 Net Cost of Operations	21,840,604.37	(4,024,862.90)	67,795,239.71	85,610,981.18

Additional information included in Note 20.

The accompanying notes are an integral part of these statements

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

***FOOTNOTES
TO THE
OPERATIONS
PRINCIPAL STATEMENTS***

**DEPARTMENT OF DEFENSE
DEFENSE FINANCE AND ACCOUNTING SERVICE
DEFENSE WORKING CAPITAL FUND
CONSOLIDATED OPERATIONS
NOTES TO THE PRINCIPAL STATEMENTS
AS OF SEPTEMBER 30, 1998**

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 Department of Defense (DoD), as required by the Chief Financial Officers (CFO) Act expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The report has also been prepared to provide information with which Congress, agency managers, the public, and other interested parties can assess management performance and stewardship. The financial statements have been prepared from the books and records of the Department in accordance with "Department of Defense Financial Management Regulation" "DoDFMR" Volume 6B, as adopted from Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements." These statements, therefore, are different from the financial reports, also prepared by the DoD pursuant to OMB directives that are used to monitor and control DoD's use of budgetary resources.

B. Reporting Entity. The Department was created on September 18, 1947, by the National Security Act of 1947. The overall mission of the Department is to organize, train, and equip forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies. Fiscal year 1998 represents the third year that the Department will prepare and have audited, DoD Agency-wide financial statements as required by the CFO Act and the GMRA.

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

The accompanying audited financial statements account for all resources for which the Department 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.

C. Budgets and Budgetary Accounting. The Department's major activities consist of general, working capital (revolving funds), trust, special, and deposit funds.

1. General funds are used to record financial transactions arising under congressional appropriations.

2. The Department expanded the use of businesslike financial management practices through the establishment of the Defense Business Operations Fund (DBOF) on October 1, 1991. On December 11, 1996, the DBOF became the Defense Working Capital Funds (DWCFs). The DWCFs ("the Funds") operate with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The Funds build on revolving fund principles previously used for industrial and commercial-type activities. The Department's working capital funds include industrial and commercial type transactions. i.e.: Supply Management and Distribution Depot funds are composed of four divisions administered by the Departments of the Army, Navy, Air Force and the Defense Logistics Agency (DLA). These activities provide supplies and inventories to Department organizations on a commercial basis. Receipts derived from resale operations are normally available in their entirety for use without further congressional action.

3. Special funds account for receipts of the government that are earmarked for a specific purpose.

4. Deposit fund accounts are generally used to (1) hold assets for which the Department is acting as agent or custodian or whose distribution awaits legal determination or (2) account for unidentified remittances.

5. Trust fund accounts are used to record the receipt and expenditure of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

D. Basis of Accounting. Transactions are generally 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. Budgetary accounting is accomplished through unique general ledger accounts to facilitate compliance with legal and internal control requirements associated with the use of federal funds. All known intrafund balances have been eliminated.

E. Revenues and Other Financing Sources. Financing sources for general funds are provided through congressional appropriations that are received on both an annual and a multi-year basis. Revenue for business fund activities is recognized at the point the rendered service is completed and billed or at the point inventory items are sold.

1. For financial reporting purposes under accrual accounting, operating expenses for general fund activities are recognized in the period incurred. Expenditures for capital and other long-term assets are not recognized as expenses until consumed in the Department's operations. Unexpended appropriations are recorded as equity of the U.S. Government.

2. Certain expenses, such as annual and military leave earned but not taken, are not funded when accrued. Such expenses are financed in the period in which payment is required.

F. Accounting for Intragovernmental Activities. The Department, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department as though the agency was a stand-alone entity.

1. The Department's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related interests costs are not apportioned to federal agencies. The Department's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues. Material disclosures are provided at Note 10.

2. Financing for the construction of DoD facilities is obtained through budget appropriations. To the extent this financing may have been ultimately obtained through the issuance of public debt, interest costs have not been capitalized since the Treasury Department does not allocate interest costs to the benefiting agencies.

3. The Department's civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The Department funds a portion of the civilian and military pensions. Reporting civilian pension benefits under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The Department recognizes an imputed expense for civilian employee pensions and other retirement benefits in the statement of net cost; and recognizes imputed revenue for the civilian employee pensions and other retirement benefits in the statement of changes in net position. The Department reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Trust Fund financial statements report. The Department recognizes the actuarial liability for the military retirement health benefits in the DoD Agency-wide statements.

4. Most legal actions, other than contract claims, to which the Department may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Either because payments under these statutes are limited to, amounts well below the threshold of materiality for claims payable from the Department's appropriations or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the Department's operations or financial condition.

5. In fiscal year 19**, the Department or its Components sold assets to foreign governments under the provisions of the Arms Export Control Act of

1976. Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance to a trust fund maintained by the Department of the Treasury from which the Military Services are reimbursed for the cost of administering and executing the sales. In fiscal year 19**, the Department received reimbursements of \$xxx thousands for assets and services sold under the Foreign Military Sales program.

G. Funds with the U.S. Treasury and Cash. The Department's fund resources are maintained in U.S. Treasury accounts. Its cash receipts and disbursements are processed by the Treasury Department, and the balance with the U.S. Treasury represents the aggregate of all unexpended balances. Material disclosures are provided at Note 2.

H. Foreign Currency. The Department conducts a significant portion of its operations overseas. Gains and losses from foreign currency transactions for four general fund appropriations (operation and maintenance, military personnel, military construction, family housing operation and maintenance, and family housing construction) are recognized and reported in the net cost statement. The gains or losses are computed as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of the fiscal year. Similar gains and losses for other appropriations are not recognized in the net cost statement. They are absorbed by budgetary transactions in which obligations are increased or decreased to reflect foreign currency fluctuations. Material disclosures are provided at Note 3.

I. Accounts Receivable. As presented in the balance sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other entities. Allowances for uncollectable accounts are based upon analysis of collection experience by fund type. Material disclosures are provided at Note 5.

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

K. Inventories and Related Property. Inventories, are valued at Latest Acquisition Cost (LAC) which approximates historical cost as required by DoD accounting policies. LAC is determined by subtracting appropriate surcharges from the Standard Cost to arrive at the price most recently paid for a carried item. Gains and losses that result from valuation changes for inventory items are recognized and reported in the net cost statement and included in the calculation of the cost of goods sold. No gains or losses are recognized in the net cost statement as a result of changes in valuation for general fund operating supplies and materials. Such changes are reflected in the asset valuations and

related invested capital as reported in the balance sheet statement. The related property portion of the amount reported includes operating materials and supplies, stockpile materials, seized property and forfeited property. Operating materials and supplies are valued at historical cost. Ammunition and munitions that are not held for sale are treated as operating materials and supplies. For FY 1998, the Department has elected to use the purchase method of recognizing operating materials and supplies, as provided in Statement of Federal Financial Accounting Standard (SFFAS) No. 3. Therefore, operating materials and supplies are expensed when purchased. Other material disclosures related to inventory and related property are provided at Note 8.

L. Investments in U.S. Government Securities.

Investments in U.S. Government securities are reported at cost, net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment. The reporting entity's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. No provision is made for unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity. Material disclosures are provided at Note 4.

M. General Property, Plant and Equipment.

1. The costs of Stewardship Assets (National Defense Property, Plant and Equipment, Heritage Assets and Stewardship Land) shall not be reported on the balance sheet beginning in FY 1998. Any such previously reported costs shall be charged to the Net Position of the Entity, and the adjustment shall be shown as a "prior period adjustment." Other information on Stewardship Assets shall be reported in Supplemental Stewardship Reports. See Chapter 11 for Stewardship Asset reporting requirements and instructions.

2. General Property, Plant and Equipment (PP&E) are valued at historical acquisition cost. All General PP&E, other than land, shall be depreciated in accordance with the Under Secretary of Defense (Comptroller) (USD(C)) policy memorandum dated March 26, 1998. DoD Components shall recognize and report General PP&E in accordance with the USD(C) policy memorandum dated May 22, 1998. These policy memorandums are available at: http://www.dtic.mil/comptroller/fmr/04/04_recent.html on the Internet.

3. Multi-use Heritage Assets are treated as General PP&E for reporting and accounting purposes. Therefore, the acquisition costs of Multi-use Heritage Assets, and any capitalized renovations or improvements, shall be reported on the balance sheet and depreciated. Multi-use Heritage Assets are Heritage Assets that are used predominantly for government operations (i.e., The Pentagon).

When records are not available to support the original acquisition cost of General PP&E, estimates shall be used. Such estimates shall be based on either (1) the cost of similar assets at the time of acquisition or (2) the current cost of similar assets discounted for inflation since the time of acquisition. If the original acquisition costs are not known for a significant amount of assets in a major class of General PP&E, the Notes

to the principal statements shall disclose the method of valuation and the reason for it use. Material disclosures are provided at Note 9.

N. Prepaid and Deferred Charges. Payments in advance of the receipt of goods and services are recorded as prepaid and deferred charges at the time of prepayment and reported as an asset on the Balance Sheet. Prepaid charges are recognized as expenditures and expenses when the related goods and services are received.

O. Leases. Generally, these leases and agreements were for rental equipment, space, and operating facilities. The Department owns substantially all of the facilities and real property used in its domestic operations. Capital assets overseas are purchased with appropriated funds, however; title is retained by the host country.

P. Contingencies. At any given time, the Department may be a party to various legal and administrative actions and claims brought against it. These relate primarily to tort claims resulting from aircraft, ship, and vehicle accidents, medical malpractice, property and environmental damages resulting from Departmental activities, and contract disputes.

Most legal actions, other than contract claims, to which the Department may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Either because payments under these statutes are limited to, amounts well below the threshold of materiality for claims payable from the Department's appropriations or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the Department's operations or financial condition. Contingencies related to the Judgment Fund are reflected as current period imputed cost offset by a corresponding imputed financing entry.

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

R. Equity. Equity consists of unexpended appropriations and cumulative result of operations. Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which neither legal liabilities for payments have been incurred nor actual payments made.

Cumulative results of operations represents the difference since inception of the activity between expenses and losses, and financing sources including appropriations, revenue, and gains. Beginning in FY 1998, this will include the cumulative amount of donations and transfers of assets in and out without reimbursement. In addition,

there will no longer be a segregation of cumulative amounts related to investments in capitalized assets, such as PP&E, or pre-credit reform loans, or a separate negative amount shown for future funding requirements. Cumulative results of operations for working capital funds represents the excess of revenues over expenses since fund inception, less refunds to customers and returns to the U.S. Treasury.

S. Treaties for Use of Foreign Bases. The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. Capital investments in buildings and other facilities (for example, runways) located on the overseas bases are capitalized as stipulated in Note 1-M. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Department. Therefore, in the event treaties or other agreements are terminated whereby use of foreign bases is no longer allowed, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the United States and the host country have been concluded to determine the amount due the United States for such capital investments.

T. Comparative Data

Not Applicable

U. Undelivered Orders. The Department is obligated for goods and services which have been ordered but not yet received (undelivered orders) as of September 30, 1998. The Department has Undelivered Orders of \$253,092 thousands.

Note 2. Fund Balances with Treasury:

	<u>Trust Funds</u>	<u>Revolving Funds</u>	<u>Appropriated Funds</u>	<u>Other Fund Types</u>	<u>Total</u>
A. Entity Fund and Account Balances:					
Unobligated Balance Available:					
Available	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Restricted	0	0	0	0	0
Reserve For Anticipated Resources	0	0	0	0	0
Obligated (but not expensed)	0	0	0	0	0
Unfunded Contract Authority	0	0	0	0	0
Unused Borrowing Authority	0	0	0	0	0
Total Entity Treasury Balance	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
B. Non-Entity Fund and Account Balance	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

C. The Fund Balance with Treasury does not include any amounts for which The Department of the Treasury is willing to accept corrections to cancelled appropriation accounts, in accordance with SFFAS Number 1.

D. Other Information:

Working Capital Fund Activities Below (USD(C)) Level:

	<u>Appropriated Funds</u>	<u>Entity Assets</u>	
		<u>Funds Collected</u>	<u>Funds Disbursed</u>
Beginning Balance		2,008,231,000.00	(1,954,836,000.00)
Transfer of Cash to Others		(2,008,231,000.00)	
Transfer of Cash from Others			1,954,836,000.00
Funds Collected		1,733,490,487.15	
Funds Disbursed			(1,880,088,075.74)
1998 Treasury Warrant			
Reprogramming Action			
Ending Balance		1,733,490,487.15	(1,880,088,075.74)

Cash collections and disbursements data for the financial statements is obtained from the finance network/Cash Outlay System Report and Service listings. The difference between cash collections in the finance network/Cash Outlay System Report and the general ledger amounted to \$1,878K. This amount is reported as an increase in accounts receivable. The difference between

cash disbursements in the finance network/Cash Outlay System Report and the general ledger amounted to \$71,527K. This amount is reported as an increase in accounts payable.

Note 3. Cash, and Other Monetary Assets:

Not Applicable

Note 4. Investments, Net :

Not Applicable

Note 5. Accounts Receivable, Net :

	(1)	(2)	(3)
	<u>Gross Amount Due</u>	<u>Allowance for Estimated Uncollectibles</u>	<u>Net Amount Due</u>
A. Entity Receivables:			
Intragovernmental	\$ 103,351,708.16	\$ (3,924.79)	\$ 103,535,632.95
With the Public	32,524.34		32,524.34
Total	103,384,232.50	(3,924.79)	103,568,157.29
B. Non-Entity Receivables:			
Intragovernmental	0	0	0
With the Public	\$ 0	\$ 0	\$ 0

C. Allowance Method Used:

D. Other Information:

1. Accounts Receivable Intragovernmental was adjusted by \$(1,876,987.33) due to undistributed collections. The allowance for Accounts Receivables is for Refunds Receivable.
2. Accounts Receivable eliminations of (\$3,523,257.54) occurred between Financial Operations and Financial Systems Organization.

Note 6. Other Assets :

A. Other Entity Assets	
1. Intragovernmental	
(a) Assets Returned for Credit	\$ 0
(b) Other	0
Total Intragovernmental	\$ 0
2. Other	
(a) Refunds Receivable	\$ 305,522.85
(b) Travel Advances	333,900.48
(c) Equipment Not in Use	24,925,855.06
Total Other	\$ 25,565,278.39
B. Other Information related to entity assets.	
C. Other Non-entity Assets	
1. Intragovernmental	
(a)	\$ 0
Total Intragovernmental	\$ 0
2. Other	
(a)	\$ 0
Total Other	\$ 0
D. Other Information related to non-entity assets.	

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

Not Applicable

Note 8. Inventory and Related Property:

Not Applicable

Note 9. General Property, Plant, and Equipment (PP&E), Net:

	(1)	(2)	(3)	(4)	(5)
	<u>Depreciation Method</u>	<u>Service Life</u>	<u>Acquisition Value</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Major Classes of Assets					
A. Land	N/A	N/A	\$ 0	N/A	\$ 0
B. Structures, Facilities, and Leasehold Improvements	S/L	11-20	7,902,810.16	4,232,672.93	3,670,137.23
C. ADP Software	S/L	1-5	934,023,187.24	538,417,398.51	395,605,788.73
D. Equipment	S/L	1-5	212,601,021.81	120,679,357.12	91,921,664.69
E. Assets Under Capital Lease			0	0	0
F. Construction-in-Progress			187,568,981.10	N/A	187,568,981.10
G. Other			25,559,644.93	23,979,483.35	1,580,161.58
Total			<u>1,367,655,645.24</u>	<u>687,308,911.91</u>	<u>680,346,733.33</u>

I. Other Information:**Legends:**

Column (1) Above
Depreciation Methods

SL = Straight Line
O = Other (explain)

Note 10. Debt:

Not Applicable

Note 11. Other Liabilities:**Note 11A. Environmental Cleanup**

Not Applicable

Note 11.B. OTHER LIABILITIES:

1. Other Liabilities Covered by Budgetary: Resources			
	<u>Noncurrent Liability</u>	<u>Current Liability</u>	<u>Total</u>
(a) Intragovernmental			
(1) Advances from Others	\$ 0	\$ 0	\$ 0
(2) Contingent Liabilities	0	0	0
(3) Deferred Credits	0	0	0
(4) Deposit Funds and Suspense Account Liabilities	0	0	0
(5) Liability for Borrowings to be Received	0	0	0
(6) Liability for Subsidy Related to Undisbursed Loans	0	0	0
(7) Other Liabilities	0	0	0
(8) Resources Payable to Treasury	0	0	0
Total	\$ 0	\$ 0	\$ 0
(b). With the Public			
(1) Accrued Funded Payroll and Benefits	0	12,816,994.38	12,816,994.38
(2) Advances from Others	0	0	0
(3) Contingent Liabilities	0	0	0
(4) Deferred Credits	0	0	0
(5) Deposit Funds and Suspense Accounts	0	0	0
(6) Other Liabilities	0	656,881.27	656,881.27
Total	\$ 0	\$13,473,875.65	\$13,473,875.65
2. Other Liabilities Not Covered by Budgetary Resources:			
(a) Intragovernmental			
(1) Accrued Annual Leave		51,420,430.47	51,420,430.47
(2) Futures Workers Compensation		89,085,409.71	89,085,409.71
Total		140,505,840.18	140,505,840.18

(1) Accrued Annual Leave		0.00	0.00
(2) Futures Workers Compensation		0.00	0.00
Total		0.00	0.00

2. Other Information:

- A. Other Liabilities include the Funded Portion of Accrued Annual Leave
 An Adjustment appears in the Eliminations Column of (\$89,085,409.71). This represents the Future Workers Compensation Benefits.

Note 12. Leases:

Not Applicable

Note 13. Pensions and Other Actuarial Liabilities:

Not Applicable

Note 14. Unexpended Appropriations:

Not Applicable

Note 15. Contingencies:

Not Applicable

Note 16. Footnote Disclosures Related to the Statement of Net Cost:

On the Statement of Net Cost, Line 5, Net Cost of Operations, there is a \$3,507,142.76 difference between what is reported on the Accounting Report (AR1307) and what is reported on the CFO Statement. This difference is due to the change in Accrued Annual Leave for Fiscal Year 1998.

Note 17. Deferred Maintenance on Property, Plant and Equipment

Not Applicable

Note 18. Prior Period Adjustments:

A. Prior Period Adjustments:		
1. Changes in Accounting Standards	\$ 0	
2. Errors and Omission in Prior Year Accounting Reports	107,836,522.22	
3. Error in Prior Year Recordeing of Annual Leave	(2,476,531.19)	
Total	<u>\$ 105,359,991.03</u>	
B. Other Information:		

Note 18.B. Other Disclosures to the Statement of Changes in Net Position:

A. Other Information: _____

**Note 19. Disclosures Related to the Statement of
Budgetary Resources:**

- 253,097,690.47
1. Net amount of Budgetary Resources Obligated for Undelivered Orders at the End of Period
 2. Available Borrowing and Contract Authority at the End of Period 656,526,518.18
 3. The statement does not include any amounts for which The Department of the Treasury is willing to accept corrections to cancelled appropriation accounts, in accordance with SFFAS Number 1.

4. Other Information: _____

Note 20. Disclosures Related to the Statement of Financing: _____

Note 21. Disclosures Related to the Statement of Custodial Activity: _____

Note 22. Inter-Agency Eliminations:

		Balance Sheet	Net Cost	Balance Sheet
Level 1 Schedule, Part A. – Government-wide, Seller Activity	Treasury Index or Appropriation	Accounts Receivable By DoD Entity:	Revenue by DoD Entity:	Unearned Revenue by DoD Entity:
Defense Finance and Accounting Service, WCF	97X4930.05xx	\$5,000,602.20	\$407,263.78	\$26,601,552.98
Total		\$5,000,602.20	\$407,263.78	\$26,601,552.98

Part B. Department of Defense Eliminations of Seller Activity With Other Federal Agencies Arrayed by Other Federal Agencies	Treasury Index	DoD Accounts Receivable Arrayed by Customer:	DoD Revenue Arrayed by Customer:	DoD Unearned Revenue by Customer:
Executive Office of the President, Defense Security Assistance Agency	11			
Department of Agriculture*	12			
Department of Commerce*	13			
Department of the Interior*	14			
Department of Justice*	15			
Department of Labor*	16			
Department of State*	19			
Department of the Treasury*	20			
Office of Personnel Management*	24			
Nuclear Regulatory Commission*	31			
Department of Veterans Affairs*	36			
General Service Administration*	47	97,941.88	149,493.96	103,436.56
National Science Foundation*	49			
Federal Emergency Management Agency*	58			
Environmental Protection Agency*	68	589.64	900.00	622.72
Department of Transportation*	69	52,435.22	80,034.70	55,376.91
Agency for International Development*	72			
Small Business Administration*	73			
Department of Health and Human Services*	75			
National Aeronautics and Space Administration*	80			
Department of Housing and Urban Development*	86			
Department of Energy*	89			
Department of Education*	91			
Social Security Administration*	28			
Unidentifiable Federal Agency Entity	00	4,733,780.84		26,319,762.56
Miscellaneous Identifiable Federal Agencies Not Required to Prepare CFO Audited Financial Statements	00	115,854.61	176,835.12	122,354.22
Total		\$ 5,000,602.20	\$ 407,263.78	\$ 26,601,552.98

Note 23. Other Disclosures:

Not Applicable

***DEFENSE FINANCE
AND
ACCOUNTING SERVICE***

***WORKING CAPITAL
FUND***

***SUPPLEMENTAL FINANCIAL
AND MANAGEMENT
INFORMATION***

Program Performance Measures

Financial Attributes

Operating Costs Attributes (In Millions of Dollars)

	FY 1998
Total Costs and Expenses	\$192.4
Revenues and Reimbursements	177.2
Net Operating Costs	\$1.5
Percentage of Revenue	.9%

Operating Costs Attributes (In Millions of Dollars)

	FY 1998
Revenues	
Federal Sources	\$1.77
Public Sources	
Other	0
Total Revenue	\$1.77
Expenses and Losses	\$1.92
Net Operating Income (Deficit)	(\$0.15)
Additional Apprriations	0
Operating Surplus (Deficit)	(\$0.15)

**Financial Condition Attribute
(In Thousands of Dollars)**

	FY 1998
Available Sources of Cash	66,288.0
Future Requirements for Cash	51,857.0
Cash Surplus (Shortfall)	
Total Assets	66,288.0
Total Liabilities	51,857.0
Asset to Debt Ratio	1: .78

Performance Measures Indicators FY 98

On August 1, 1995, the Director of DFAS approved 36 significant Performance Measures / Indicators (PMI) which serve as a repository for information that can be reported externally, when needed, or utilized by various levels of the organization to determine how effectively DFAS satisfies its operational requirements. The accumulation of data has provided to be an excellent management tool in the decision making process. The following two PMIs: Negative Unliquidated Obligations (NULOs); and Cross Disbursements; have been tracked to provide an insight as to how well DFAS has performed. The following graphs provide a graphic picture of DFAS' favorable performance during FY 1998:

DFAS NULOs

By Center And Age As of September 30, 1998

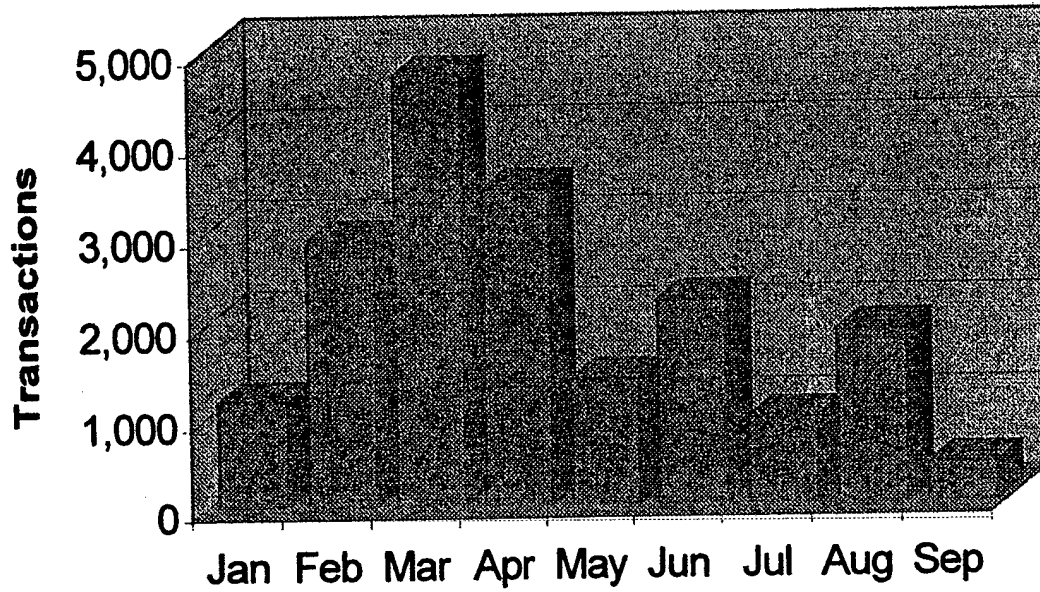
CENTER	0-30 Days	31-60 Days	61-90 Days	91-120 Days	Over 120 Days	Total Net NULO
Cleveland	\$68,096.00	\$0.00	\$0.00	\$0.00	\$0.00	\$68,096.00
Columbus	\$11,485.84	\$0.00	\$0.00	\$0.00	\$0.00	\$11,485.84
Denver	\$60,103.70	\$0.00	\$0.00	\$0.00	\$0.00	\$60,103.70
Headquarters	\$0.00	\$0.01	\$0.00	\$0.00	\$0.00	\$0.01
Indianapolis	\$29,424.10	\$30,404.54	\$48,611.37	\$0.00	\$0.00	\$108,440.01
Kansas City	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Pensacola	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Total DFAS	\$169,109.64	\$30,404.55	\$48,611.37	\$0.00	\$0.00	\$248,125.56

Cross Disbursements Center Summary As of September 30, 1998

DFAS Center

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
DFAS-FSO	157	158	259	262	137	133	160	110	54
DFAS-HQ	100	115	348	239	122	181	117	156	91
DFAS-DE	212	831	1,311	882	234	471	118	503	44
DFAS-IN	288	353	1,056	887	496	546	248	494	127
DFAS-CL	334	1,267	1,511	1,071	316	805	263	559	81
DFAS-CO	52	157	197	70	43	71	24	55	11
DFAS-KC	12	26	26	43	23	10	7	5	11
Total	1,155	2,907	4,708	3,454	1,371	2,217	937	1,882	419

DFAS Cross Disbursements As of 30 September 1998



FY 1998



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

March 1, 1999

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

SUBJECT Independent Auditor's Report on the Defense Finance and Accounting Service
Working Capital Fund Financial Statements for FY 1998 (Project No 8FI-2028)

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 auditors for financial statements, internal controls, and compliance with laws and regulations. We attempted to audit the Defense Finance and Accounting Service (DFAS) Working Capital Fund Financial Statements for FY 1998. As the fund manager of the DFAS Working Capital Fund, the Director, DFAS, is responsible for establishing and maintaining adequate internal controls and for complying with laws and regulations applicable to financial reporting. The Office of Management and Budget (OMB) designated the DFAS Working Capital Fund as one of the DoD organizations required to prepare audited financial statements

Disclaimer of Opinion. DFAS was not able to correct material deficiencies reported in prior years. DFAS also had weaknesses in its internal control process and did not fully comply with the laws and regulations governing preparation of financial statements. These problems materially affected the information in the DFAS Working Capital Fund Financial Statements for FY 1998. Although DFAS was working to correct the problems, corrective actions were not completed in FY 1998. Therefore, we performed work sufficient only to ensure that problems remained uncorrected. We also performed limited tests of the internal controls and compliance with laws and regulations. Those tests identified additional details about some of the significant problems that prevented DFAS from preparing reliable financial statements. As a result, we do not express an opinion on the DFAS Working Capital Fund Financial Statements for FY 1998. The information provided contains our reasons for disclaimer and is based on our audit of previous versions of these financial statements. Some numbers may have changed; however, the concerns expressed also relate to the version of the financial statements contained herein.

Internal Controls. We performed a limited review of internal controls to determine whether the controls were effective. Internal controls consist of five components: the control environment, risk assessment, control activities, information and communication, and monitoring. Effective implementation of these controls provides reasonable assurance that accounting data are accumulated, recorded, and reported properly by management and that assets are safeguarded. Our review of internal controls did not disclose all internal control weaknesses that may exist.

The DFAS Working Capital Fund needed to strengthen internal controls over accounting for fixed assets and revenue. Specifically, fixed assets recorded in the general ledgers were not recorded in the subsidiary ledgers, and revenue was overstated. Reported revenue was also recognized in an incorrect accounting period, and revenue exchanged between the two DFAS Working Capital Fund business areas was not eliminated. In addition, significant portions of the Fund Balance With Treasury account, Accounts Payable, and Accounts Receivable were unverifiable. As a result, we were unable to attest to the reliability of the financial statements.

Further, procedures and controls did not ensure that the financial statements were prepared accurately. The account balances in the general ledgers were adjusted by unsupported amounts, financial information was not presented consistently, and the consolidating financial statements were not always properly adjusted for amounts shown as eliminations between the two business areas

Compliance With Laws and Regulations. We performed a limited assessment of compliance with laws and regulations related to the DFAS Working Capital Fund Financial Statements for FY 1998. Noncompliance with laws and regulations is a reportable condition if the noncompliance could result in material misstatements in the financial statements or if the sensitivity of the matter would cause anyone to perceive the noncompliance as significant. Financial management systems and internal controls did not completely or accurately disclose the financial condition of the DFAS Working Capital Fund as required by Title 31, United States Code. When accounting for and disclosing information in the financial statements, DFAS did not always comply with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1998, as amended on November 20, 1998. DFAS also did not follow DoD guidance when it performed work without funded customer orders and failed to promptly follow up with those customers

Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended on January 25, 1999, DFAS disclosed that the accounting and nonaccounting systems used to produce the financial statements did not meet OMB and DoD requirements. Our work confirmed that systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The DFAS Annual Statement of Assurance for FY 1998 identified as repeat material weaknesses many of the reportable conditions we found in the DFAS Working Capital Fund, such as inadequate financial accounting processes and deficiencies in systems

Additional Reports. This is one of two reports related to the DFAS Working Capital Fund Financial Statements for FY 1998. This report briefly summarizes the major deficiencies affecting the DFAS Working Capital Fund. A separate report will discuss internal controls and compliance with laws and regulations in more detail

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Audit Team Members

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

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