

AUDIT OPINION

DEPARTMENT OF DEFENSE

***AGENCY-WIDE
FINANCIAL STATEMENTS***

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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 Department of Defense Agency-wide Financial
Statements for FY 1998 (Project No. 8FI-2024.01)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. We attempted to audit the FY 1998 DoD Agency-wide Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Financing, Statement of Budgetary Resources, and Statement of Custodial Activity. As the Chief Financial Officer of DoD, the Under Secretary of Defense (Comptroller) is responsible for these financial statements, for establishing and maintaining internal controls, and for complying with laws and regulations applicable to DoD financial accounting and reporting. We did not audit the Army, Navy, and Air Force financial statements for FY 1998. The Military Department audit agencies attempted to audit those financial statements and issued disclaimers of opinion.

Disclaimer of Opinion. DoD did not provide us with the FY 1998 Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Financing, Statement of Budgetary Resources, and Statement of Custodial Activity in time for us to perform all of the necessary audit work. Therefore, we did not verify the reported amounts. However, we identified deficiencies in internal controls and accounting systems related to General Property, Plant, and Equipment; Inventory; Environmental Liabilities; Military Retirement Health Benefits Liability; and material lines within the Statement of Budgetary Resources. Those deficiencies would have precluded an audit opinion. We also identified \$1.57 trillion in adjustments to financial data used to prepare financial statements for the Army General Fund, Army Working Capital Fund, Navy General Fund, Defense Logistics Agency, and Other Defense Organizations. Those adjustments were not supported by adequate audit trails or by sufficient evidence to determine their validity.

The financial data reported on the FY 1998 Financial Statements for the Army, Navy, and Air Force General Funds; the Army, Navy, and Air Force Working Capital Funds; the U.S. Army Corps of Engineers, Civil Works Program; the Defense Logistics Agency; and the Defense Finance and Accounting Service were unauditible and comprise a significant portion of the financial data reported on the DoD Agency-wide Financial Statements for FY 1998.

Because the financial statements were not provided in a timely manner and internal control weaknesses, compilation problems, and financial management system deficiencies continued to exist, we were not able to perform adequate audit tests of the various line item amounts reported on the financial statements. As a result, we do not express an opinion on the DoD Agency-wide Financial Statements for FY 1998.

Required Supplementary Stewardship Information. The Stewardship Statement includes National Defense Property, Plant, and Equipment; Heritage Assets; and Stewardship Land. Based on initial versions of the DoD Components' financial statements, DoD will remove approximately \$618.4 billion of assets from its Balance Sheet and reclassify it as stewardship assets because of a change in accounting standards effective in FY 1998. This information is not required to be audited.

However, we applied certain limited procedures prescribed by professional standards that raised doubts that we were unable to resolve regarding whether material modifications should be made to the information for it to conform with Federal accounting standards.

Internal Controls. The internal controls consist of the following components: 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. Management is responsible for internal controls. We performed applicable tests of the internal controls to determine whether the controls were effective and working as designed. However, these tests did not provide sufficient evidence to support an opinion on internal controls; therefore, we do not express an opinion on the DoD internal controls.

DoD internal controls were not adequate to ensure that resources were properly managed and accounted for, that DoD complied with applicable laws and regulations, and that the financial statements were free of material misstatements. DoD internal controls did not ensure that adjustments to financial data were fully supported and that assets and liabilities were properly accounted for and valued. The material weaknesses and reportable conditions we identified were also reported in the management representation letter for the DoD Agency-wide Financial Statements for FY 1998, the DoD Annual Statement of Assurance for FY 1998, and the DoD Biennial Financial Management Improvement Plan. A separate report discusses internal control weaknesses in further detail.

Compliance With Laws and Regulations. Our objective was to assess compliance with laws and regulations related to the DoD Agency-wide Financial Statements for FY 1998 and not to express an opinion. The scope of our work was limited because DoD did not provide us with the financial statements in a timely manner, as required by the Chief Financial Officers Act of 1990, as amended. Therefore, we do not express an opinion on compliance with laws and regulations

DoD did not fully comply with laws and regulations that had a direct and material affect on its ability to determine financial statement amounts. In the Biennial Financial Management Improvement Plan, we identified several areas where DoD could improve its reporting of financial management system problems, as required by the Federal Managers' Financial Integrity Act of 1982. For example, the Biennial Financial Management Improvement Plan did not identify the deficiencies for each financial management system and did not disclose the remedies, resources, and milestones necessary to improve DoD financial management systems. In addition, DoD financial management systems and methodology for valuing inventory were not consistent with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," October 27, 1993.

The results of our tests also disclosed instances where DoD financial management systems did not substantially comply with the three requirements of the Federal Financial Management Improvement Act of 1996. For example, DoD financial management systems were not integrated; did not maintain adequate audit trails; did not value and depreciate property, plant, and equipment in accordance with Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," November 30, 1995; and did not incorporate the U.S. Government Standard General Ledger at the transaction level. Our work would not necessarily disclose all material weaknesses. A separate report discusses compliance issues in further detail.



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for Auditing