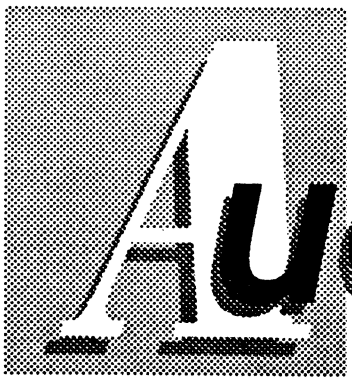

OFFICE OF THE INSPECTOR GENERAL

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE ARMY AUDIT AGENCY EXAMINATION OF THE ARMY'S FINANCIAL STATEMENTS FOR FISCAL YEARS 1995 AND 1994

Report No. 96-094 April 10, 1996

Department of Defense

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

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

April 10, 1996

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

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Army Audit Agency Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994 (Report No. 96-094)

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Army Audit Agency (AAA) disclaimer of opinion on the Army's financial statements for FYs 1995 and 1994, along with the AAA audit report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994." An audit of the Army's financial statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Since this report contains no recommendations, comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (317) 542-3859 (DSN 699-3859), or Mr. John J. Vietor, Audit Project Manager, at (317) 542-3855 (DSN 699-3855). See Appendix E for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 96-094 **April 10, 1996**
(Project No. 5FI-2023.01)

Inspector General, DoD, Oversight of the Army Audit Agency Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an audit of the Army's financial statements. We delegated the audit of the FY 1995 Army financial statements to the Army Audit Agency on May 16, 1995. This report provides our endorsement of the Army Audit Agency disclaimer of opinion on the Army's financial statements for FYs 1995 and 1994, along with the Army Audit Agency's report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994."

Audit Objective. The audit objective was to determine the accuracy and completeness of the audit of the FYs 1995 and 1994 Army financial statements conducted by the Army Audit Agency.

Audit Results. The Army Audit Agency examination of the FYs 1995 and 1994 Army financial statements, dated March 15, 1996, stated that the Army Audit Agency was unable to express an opinion on the financial statements. We concur with the Army Audit Agency's disclaimer of opinion; our endorsement of that disclaimer is in Appendix A. The Army Audit Agency's report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994," is in Appendix B.

Summary of Recommendations and Management Comments. This report contains no recommendations that are subject to resolution in accordance with DoD Directive 7650.3. Accordingly, comments are not required.

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Appendix A. IG, DoD, Endorsement Memorandum

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

MAR 1 9 1996

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

SUBJECT: Endorsement of the Disclaimer of Opinion on the FYs 1995 and 1994 Army Principal Financial Statements (Project No. 5FI-2023)

The Chief Financial Officers Act of 1990, as amended, requires financial statement audits by the statutory Inspectors General. On May 16, 1995, we delegated to the Army Audit Agency (AAA) the audit of the FY 1995 Army principal financial statements. Summarized below are the AAA opinion letter on the FYs 1995 and 1994 Army principal financial statements and the results of our review of the audit conducted by AAA. We endorse the disclaimer of opinion expressed by AAA (Enclosure) in its audit of the FYs 1995 and 1994 Army principal financial statements.

Disclaimer of Opinion

The AAA examination of the FYs 1995 and 1994 Army principal financial statements, dated March 15, 1996, stated that AAA was unable to express an opinion on the FYs 1995 and 1994 Army principal financial statements. We concur with the AAA disclaimer of opinion.

The primary reason that prevented the AAA from performing the audit was the inadequate accounting systems used to compile the Army's principal financial statements. The accounting systems do not:

- have integrated, transaction-driven general ledgers;
- have audit trails;
- support amounts for several types of assets, liabilities, and expenses;
- adequately capture the value of Government property furnished to contractors;
- capture the values of equipment and real property owned by field units and installations; and
- have complete or accurate data for wholesale assets.

While inadequate accounting systems were the primary reason for the AAA disclaimer of opinion, procedural and compliance problems also contributed to the lack of reliable balances on the FYs 1995 and 1994 Army principal financial statements. Procedural and compliance problems included the following.

- The reported value for unserviceable equipment awaiting repair was overstated because Army procedures were not followed and these assets were not reported at full standard price, less the required reduction for repair costs.

o The DFAS Indianapolis Center did not adequately address or could not explain large variances from one fiscal year to the next in several account balances.

o The Under Secretary of Defense (Comptroller) has issued guidance conflicting with that issued by the Office of Management and Budget (OMB). For example, DoD policy prevents the Army from following OMB reporting requirements for probable contingent liabilities.

Inadequate accounting systems resulted in disclaimers of opinion for the FYs 1991, 1992, 1993 and 1994 Army principal financial statements. Inadequate accounting systems still existed in relation to the FY 1995 financial statements and were the major reason that the audit could not be performed and an audit opinion issued.

Internal Controls and Compliance With Laws and Regulations

Internal controls did not fully protect the Army's assets, ensure compliance with laws and regulations, and ensure that the fincial statements contained no material misstatements. Procedural and compliance problems contributed to the lack of reliable amounts on the Army's financial statements. As a result, the risk of material financial misstatements is high. The Army and the Defense Finance and Accounting Service have recognized these weaknesses and reported them in their FY 1995 Annual Statements of Assurance on management controls.

Review of Army Audit Agency Work

To fulfill our responsibilities under the Chief Financial Officers Act for determining the accuracy and completeness of the independent audit conducted by the AAA, we:

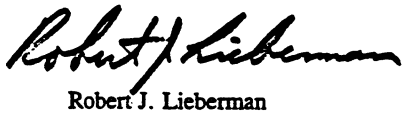
o evaluated qualifications and independence of AAA auditors,

o reviewed the AAA approach and planning of the audit, and

o monitored progress of the audit at key points.

In addition to the above oversight procedures, we also performed other procedures deemed necessary to determine the fairness and accuracy of the audit approach and conclusions.

We conducted our review of the AAA audit of the FYs 1995 and 1994 Army principal financial statements in accordance with generally accepted Government auditing standards from May 16, 1995, through March 15, 1996. We found no indication that we could not rely on the AAA opinion on the Army principal financial statements and its related evaluations of internal controls and compliance with laws and regulations.



Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosure

DEPARTMENT OF THE ARMY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

Secretary of the Army

In accordance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the Army prepared the accompanying Principal Financial Statements for the fiscal years ended 30 September 1995 and 1994. As delegated by, and in coordination with, the Inspector General, DOD, we were engaged to audit the statements, including an evaluation of related internal controls and compliance with laws and regulations.

We were unable to express an opinion on the Army's Financial Statements for the fiscal years ended 30 September 1995 and 1994. The main reasons for our disclaimer were inadequate accounting systems, lack of audit trails, and unsupported amounts for several types of assets, liabilities, and expenses. Procedural and compliance problems also contributed to the lack of reliable amounts on the Army's financial statements. We present details on our disclaimer reasons in the Significant Matters section below.

Internal controls weren't fully effective to protect the Army's assets, ensure compliance with laws and regulations, and ensure there were no material misstatements in the financial statements. As a result, the risk of material financial misstatements is high. The Army and the Defense Finance and Accounting Service have recognized these weaknesses and reported them in their FY 95 annual assurance statements on management controls. We present details in our separate report on internal controls and compliance with laws and regulations.

Financial data in the Overview and the Supplemental Financial and Management Information sections of the Army's FY 95 Annual Financial Report was derived from the same sources as the financial statements and, therefore, may not be reliable.

The Defense Finance and Accounting Service is primarily responsible for correcting the Army's accounting system deficiencies. However, the Inspector General, DOD challenged the Accounting Service's existing strategy for overcoming these deficiencies in a draft report issued on 29 December 1995 to the Under Secretary of Defense (Comptroller). Action taken as a result of the Inspector General's report will have a direct effect on how and when the Army will have auditable accounting data.

SIGNIFICANT MATTERS

Our work showed that the Army continues to experience major financial reporting problems. The most significant of these problems severely limited our audit scope and caused us to issue a disclaimer of opinion on the financial statements. However, we also noted specific areas of progress. We summarize the main reasons for disclaimer and the progress areas in the following paragraphs. More detailed discussions on these subjects, including specific recommendations, are in the supporting audit reports issued separately.

Main Reasons for Disclaimer

The following accounting system and procedural problems disclosed by our audits (both current and prior) are the main reasons we couldn't issue an opinion.

Accounting Systems

Deficiencies in the Army's accounting systems constitute the major reason for our inability to render an audit opinion. The accounting systems don't have integrated, transaction-driven general ledgers. Consequently, data for physical assets in the Army's financial statements are compiled using "work-around" procedures and data from management systems not intended and not suitable for financial reporting.

The accounting systems also don't produce account-oriented transaction files (subsidiary ledgers). Therefore, the audit trails needed to verify the values reported for cash-based accounts on the Army's financial statements don't exist, and these statement balances aren't auditable. (Cash-based accounts reported on the Army's statements for FY 95 included about $3.9 billion in accounts receivable and accounts payable, and about $60.8 billion in expenses.)

Government Furnished Property. The Army's accounting systems don't adequately capture the value of government property furnished to contractors. In prior audits, we recommended that the Army use contractor reports as an alternate source for reporting the value of government furnished property. Because the data in these reports was prepared from the accountable records, which the contractor maintains, we concluded that it was more representative than the figures available from the Army's accounting systems. The Army agreed to use the contractors' reports, but for FY 95 it didn't enter the value of property related to Army-administered contracts into the DOD database for government furnished property. As a result, the database contained

contractor-reported amounts only for the Army's DOD-administered contracts, and the total value reported for government furnished property on the Army's FY 95 financial statements was misstated. We couldn't determine the exact amount of the misstatement, but a comparison of the amounts reported in FY 94 and FY 95 provided an indication. In FY 94, using all of the contractors' reports, the Army reported about $15.5 billion for government furnished property. The reported amount for FY 95 was about $8.3 billion.

Unit and Installation Property. The Army's accounting systems didn't capture the values of equipment and real property owned by field units and installations. Instead, the values reported in the Army's financial statements for unit and installation-owned assets were derived from asset management and physical accountability systems. However, the data in these systems wasn't complete or accurate. As a result, we couldn't verify the values reported on the Army's FY 95 financial statements for equipment in the possession of units (about $82.6 billion), real property (about $34.6 billion), and unit assets in transit (about $500 million).

Wholesale Assets. The data in the accounting systems for wholesale assets wasn't complete or accurate. Not counting munitions, wholesale assets reported on the Army's FY 95 financial statements (assets in storage at depots; assets in transit between contractors, depots and using units; and assets on loan to other governmental entities) totaled about $23.7 billion. The accounting system data for these assets either wasn't used for financial reporting, or was used to report asset values but wasn't auditable or consistent. The accounting system data wasn't reliable or auditable because inventory transactions sometimes weren't properly processed, and transactions rejected by the accounting systems often weren't properly resolved. This occurred in part, because logistics and financial personnel weren't sufficiently knowledgeable on how their respective processes and systems interact.

Equipment Awaiting Repair

The reported value for unserviceable equipment awaiting repair was overstated. These assets were reported at full standard price (about $14.3 billion) in the Commodity Command Standard System, but their value should have been reduced by the estimated costs to repair them. We reported this problem last year for the FY 94 statements, and the Army agreed to reduce the equipment balance by the estimated repair costs. However, sufficient corrective action wasn't taken. Defense accounting offices were told about the need to revalue the assets, but Army commodity commands weren't told to calculate estimated repair costs. As a result, the

unserviceable assets were still valued at full standard prices. We couldn't determine the amount of the understatement, but two of the commands we audited projected maintenance costs at about $729 million over 5 years. The full price value of the unserviceable reparables at these two commands was about $3.9 billion.

Statement Preparation

The process the Defense Finance and Accounting Service used for preparing the financial statements had improved. Existing controls were generally enforced, and additional automated procedures were employed to analyze and evaluate the data. Moreover, some detailed reviews were conducted to identify and explain unexpected balances for some accounts--especially the physical asset accounts. However, the Accounting Service didn't adequately address or couldn't explain differences in several cash-based account balances. Consequently, unexplained differences exist between some account balances reported on the Army's Statements of Financial Position for FY 94 and FY 95. For example, advances and prepayments to Federal agencies decreased from $641 million to $90 million; accounts payable to non-Federal agencies increased from $64 million to $1.3 billion. We didn't audit these differences in detail, but their existence is a potential problem indicator.

Basis of Accounting

Office of Management and Budget Bulletin 94-01 (Form and Content of Agency Financial Statements) specifies the form and content for financial statements prepared pursuant to the requirements of the Chief Financial Officers Act. This bulletin incorporates a hierarchy of accounting principles to be used until a comprehensive set of accounting standards are issued by the Director of the Office of Management and Budget and the Comptroller General. In conflict with this policy, the Under Secretary of Defense (Comptroller) requires the Army to prepare its financial statements according to a hierarchy that begins with DOD Guidance on Form and Content of Financial Statements. The DOD guidance and the Office of Management and Budget guidance differ in several areas, such as accounting terminology, the presentation of fund balances with Treasury, the presentation of war reserves, and the recording of contingent liabilities. Because the other conditions discussed above necessitated a disclaimer, we didn't perform detailed audit work to quantify the effect of the DOD guidance.

Contingent Liabilities

DOD policy prevents the Army from following Office of Management and Budget reporting requirements for probable contingent liabilities. Consequently, the Army has a significant amount of liabilities which aren't recorded on its Statement of Financial Position. As of 30 September 1995, the Army estimated its probable contingent liabilities to be $14.6 billion, and this amount is disclosed in the footnotes. However, the Army has not yet developed and implemented procedures to ensure that all such liabilities are identified, and it has acknowledged that additional liabilities likely exist. In addition, for the past 2 years the Army has estimated its probable contingent liabilities to be about $25 billion. Although the footnotes don't provide specific information to explain the $10 billion reduction for FY 95, we were told that it occurred because DOD funds would be used for one of the major cost categories and because revised cost estimates were lower for some other categories. Due to the DOD policy prohibiting the recording of contingent liabilities, we didn't conduct detailed audit tests to fully verify the reasonableness of the Army's estimates or its conclusions on funding responsibility. Nevertheless, the liabilities on the Statement of Financial Position will continue to be misstated until DOD changes its policy.

Progress Areas

Army leaders have acknowledged the existence of significant problems and have taken actions to address them. The Defense Finance and Accounting Service has also taken some specific action to improve the Army's financial statements.

The Army Chief of Staff, in his July 1995 "State of the Army" message, emphasized the need for all Army managers to ensure that the resources entrusted to them are closely safeguarded and used efficiently. The Under Secretary of the Army, in a June 1995 message to Army managers, stressed the importance of ensuring that the Army's management controls are adhered to. Additionally, by continuing to emphasize the Army's Joint Reconciliation Program, the Assistant Secretary of the Army (Financial Management and Comptroller) has achieved significant progress in reducing unmatched disbursements, negative unliquidated obligations, and outstanding travel advances.

We also found that management controls were sufficient to ensure accurate reporting of wholesale munitions, valued at about $27.9 billion. Inventory transactions processed by the Commodity Command Standard System were accurate, prices in the standard system used to value munitions items were generally accurate, and storage activities reported accurate

balances on hand. In addition, the Army made progress in resolving its military pay control weaknesses, and the U.S. Army Corps of Engineers improved its control over construction in progress and engineering and design costs to the extent that these areas are no longer considered to be material weaknesses. The Army's annual assurance statement continues to report Armywide control problems to bring attention to needed corrective actions.

The Defense Finance and Accounting Service has performed comparative analyses for all property account balances and for Army National Guard accrued annual leave balances. These analyses disclosed potential reporting errors. In February 1996, the Accounting Service alerted the National Guard about potential errors in its property and annual leave data and the need for a corrective action plan. This action by the Accounting Service should improve the reliability of data included on the Army's future financial statements.

One of the more important actions that the Army began prior to FY 95 was establishing the Senior Level Steering Group to oversee action taken in response to audits conducted pursuant to the Chief Financial Officers Act. This group chartered an effort to develop the Stewardship Improvement Plan, which was to be the Army's plan to enable it to better safeguard the Army's resources and also facilitate compliance with requirements of the Act. Implementation of this initiative is still in its formative stages.

AUDIT SCOPE AND METHODOLOGY

Army management, with support provided by the Defense Finance and Accounting Service, is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles.
- Establishing and maintaining management controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met.
- Complying with applicable laws and regulations.

We were responsible for auditing the financial statements and evaluating related internal controls and compliance with laws and regulations. In carrying out these responsibilities, we:

- Evaluated and, as necessary, tested relevant internal controls encompassing:
  - Financial statement preparation procedures.
  - Wholesale munitions.
  - Equipment in transit.
  - Wholesale equipment.
- Conducted followup reviews on previous recommendations addressing:
  - Retail equipment.
  - Accounting systems.
  - Problem disbursements.
  - Travel advances.
  - Payroll.
  - Real property.
  - Government furnished property.
  - Contingent liabilities.
- Tested compliance with selected laws and regulations.
- Assessed data contained in the Overview section of the annual financial report for consistency with data reported in the financial statements.

We didn't conduct audit work on programs that are classified for national security.

To the extent possible, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 93-06 (Audit Requirements for Federal Financial Statements). However, as noted above, there were significant limitations to the scope of our work.

Francis E. Reardon

FRANCIS E. REARDON, CPA
The Auditor General

15 March 1996

Appendix B. AAA Report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994"

Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994

Auditor's Report

U.S. Army Audit Agency

15 March 1996
Audit Report: AA 96-152

DEPARTMENT OF THE ARMY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

15 March 1996

Secretary of the Army

This is the auditor's report which summarizes the results of our efforts to audit the Army's Principal Financial Statements for the fiscal years ended 30 September 1995 and 1994. We performed our work pursuant to the Chief Financial Officers Act of 1990 (Public Law 101-576) as amended.

We were unable express an opinion on the financial statements primarily because of inadequate accounting systems and incomplete or unauditable supporting records. We were unable to apply other auditing procedures in these areas to satisfy ourselves as to the fairness of the data presented.

Brief discussions of our results and conclusions are in the Significant Matters section of this report. More detailed discussions are in the supporting audit reports listed in Annex B.

I appreciate the courtesies and cooperation extended to us during the audit.

FRANCIS E. REARDON, CPA
The Auditor General

Appendix B. AAA Report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994"

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AUDITOR'S REPORT

Appendix B. AAA Report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994"

DEPARTMENT OF THE ARMY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

Secretary of the Army

In accordance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the Army prepared the accompanying Principal Financial Statements for the fiscal years ended 30 September 1995 and 1994. As delegated by, and in coordination with, the Inspector General, DOD, we were engaged to audit the statements, including an evaluation of related internal controls and compliance with laws and regulations.

We were unable to express an opinion on the Army's Financial Statements for the fiscal years ended 30 September 1995 and 1994. The main reasons for our disclaimer were inadequate accounting systems, lack of audit trails, and unsupported amounts for several types of assets, liabilities, and expenses. Procedural and compliance problems also contributed to the lack of reliable amounts on the Army's financial statements. We present details on our disclaimer reasons in the Significant Matters section below.

Internal controls weren't fully effective to protect the Army's assets, ensure compliance with laws and regulations, and ensure there were no material misstatements in the financial statements. As a result, the risk of material financial misstatements is high. The Army and the Defense Finance and Accounting Service have recognized these weaknesses and reported them in their FY 95 annual assurance statements on management controls. We present details in our separate report on internal controls and compliance with laws and regulations.

Financial data in the Overview and the Supplemental Financial and Management Information sections of the Army's FY 95 Annual Financial Report was derived from the same sources as the financial statements and, therefore, may not be reliable.

The Defense Finance and Accounting Service is primarily responsible for correcting the Army's accounting system deficiencies. However, the Inspector General, DOD challenged the Accounting Service's existing strategy for overcoming these deficiencies in a draft report issued on 29 December 1995 to the Under Secretary of Defense (Comptroller). Action taken as a result of the Inspector General's report will have a direct effect on how and when the Army will have auditable accounting data.

SIGNIFICANT MATTERS

Our work showed that the Army continues to experience major financial reporting problems. The most significant of these problems severely limited our audit scope and caused us to issue a disclaimer of opinion on the financial statements. However, we also noted specific areas of progress. We summarize the main reasons for disclaimer and the progress areas in the following paragraphs. More detailed discussions on these subjects, including specific recommendations, are in the supporting audit reports issued separately.

Main Reasons for Disclaimer

The following accounting system and procedural problems disclosed by our audits (both current and prior) are the main reasons we couldn't issue an opinion.

Accounting Systems

Deficiencies in the Army's accounting systems constitute the major reason for our inability to render an audit opinion. The accounting systems don't have integrated, transaction-driven general ledgers. Consequently, data for physical assets in the Army's financial statements are compiled using "work-around" procedures and data from management systems not intended and not suitable for financial reporting.

The accounting systems also don't produce account-oriented transaction files (subsidiary ledgers). Therefore, the audit trails needed to verify the values reported for cash-based accounts on the Army's financial statements don't exist, and these statement balances aren't auditable. (Cash-based accounts reported on the Army's statements for FY 95 included about $3.9 billion in accounts receivable and accounts payable, and about $60.8 billion in expenses.)

Government Furnished Property. The Army's accounting systems don't adequately capture the value of government property furnished to contractors. In prior audits, we recommended that the Army use contractor reports as an alternate source for reporting the value of government furnished property. Because the data in these reports was prepared from the accountable records, which the contractor maintains, we concluded that it was more representative than the figures available from the Army's accounting systems. The Army agreed to use the contractors' reports, but for FY 95 it didn't enter the value of property related to Army-administered contracts into the DOD database for government furnished property. As a result, the database contained

contractor-reported amounts only for the Army's DOD-administered contracts, and the total value reported for government furnished property on the Army's FY 95 financial statements was misstated. We couldn't determine the exact amount of the misstatement, but a comparison of the amounts reported in FY 94 and FY 95 provided an indication. In FY 94, using all of the contractors' reports, the Army reported about $15.5 billion for government furnished property. The reported amount for FY 95 was about $8.3 billion.

Unit and Installation Property. The Army's accounting systems didn't capture the values of equipment and real property owned by field units and installations. Instead, the values reported in the Army's financial statements for unit and installation-owned assets were derived from asset management and physical accountability systems. However, the data in these systems wasn't complete or accurate. As a result, we couldn't verify the values reported on the Army's FY 95 financial statements for equipment in the possession of units (about $82.6 billion), real property (about $34.6 billion), and unit assets in transit (about $500 million).

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Equipment Awaiting Repair

The reported value for unserviceable equipment awaiting repair was overstated. These assets were reported at full standard price (about $14.3 billion) in the Commodity Command Standard System, but their value should have been reduced by the estimated costs to repair them. We reported this problem last year for the FY 94 statements, and the Army agreed to reduce the equipment balance by the estimated repair costs. However, sufficient corrective action wasn't taken. Defense accounting offices were told about the need to revalue the assets, but Army commodity commands weren't told to calculate estimated repair costs. As a result, the

unserviceable assets were still valued at full standard prices. We couldn't determine the amount of the understatement, but two of the commands we audited projected maintenance costs at about $729 million over 5 years. The full price value of the unserviceable reparables at these two commands was about $3.9 billion.

Statement Preparation

The process the Defense Finance and Accounting Service used for preparing the financial statements had improved. Existing controls were generally enforced, and additional automated procedures were employed to analyze and evaluate the data. Moreover, some detailed reviews were conducted to identify and explain unexpected balances for some accounts--especially the physical asset accounts. However, the Accounting Service didn't adequately address or couldn't explain differences in several cash-based account balances. Consequently, unexplained differences exist between some account balances reported on the Army's Statements of Financial Position for FY 94 and FY 95. For example, advances and prepayments to Federal agencies decreased from $641 million to $90 million; accounts payable to non-Federal agencies increased from $64 million to $1.3 billion. We didn't audit these differences in detail, but their existence is a potential problem indicator.

Basis of Accounting

Office of Management and Budget Bulletin 94-01 (Form and Content of Agency Financial Statements) specifies the form and content for financial statements prepared pursuant to the requirements of the Chief Financial Officers Act. This bulletin incorporates a hierarchy of accounting principles to be used until a comprehensive set of accounting standards are issued by the Director of the Office of Management and Budget and the Comptroller General. In conflict with this policy, the Under Secretary of Defense (Comptroller) requires the Army to prepare its financial statements according to a hierarchy that begins with DOD Guidance on Form and Content of Financial Statements. The DOD guidance and the Office of Management and Budget guidance differ in several areas, such as accounting terminology, the presentation of fund balances with Treasury, the presentation of war reserves, and the recording of contingent liabilities. Because the other conditions discussed above necessitated a disclaimer, we didn't perform detailed audit work to quantify the effect of the DOD guidance.

Contingent Liabilities

DOD policy prevents the Army from following Office of Management and Budget reporting requirements for probable contingent liabilities. Consequently, the Army has a significant amount of liabilities which aren't recorded on its Statement of Financial Position. As of 30 September 1995, the Army estimated its probable contingent liabilities to be $14.6 billion, and this amount is disclosed in the footnotes. However, the Army has not yet developed and implemented procedures to ensure that all such liabilities are identified, and it has acknowledged that additional liabilities likely exist. In addition, for the past 2 years the Army has estimated its probable contingent liabilities to be about $25 billion. Although the footnotes don't provide specific information to explain the $10 billion reduction for FY 95, we were told that it occurred because DOD funds would be used for one of the major cost categories and because revised cost estimates were lower for some other categories. Due to the DOD policy prohibiting the recording of contingent liabilities, we didn't conduct detailed audit tests to fully verify the reasonableness of the Army's estimates or its conclusions on funding responsibility. Nevertheless, the liabilities on the Statement of Financial Position will continue to be misstated until DOD changes its policy.

Progress Areas

Army leaders have acknowledged the existence of significant problems and have taken actions to address them. The Defense Finance and Accounting Service has also taken some specific action to improve the Army's financial statements.

The Army Chief of Staff, in his July 1995 "State of the Army" message, emphasized the need for all Army managers to ensure that the resources entrusted to them are closely safeguarded and used efficiently. The Under Secretary of the Army, in a June 1995 message to Army managers, stressed the importance of ensuring that the Army's management controls are adhered to. Additionally, by continuing to emphasize the Army's Joint Reconciliation Program, the Assistant Secretary of the Army (Financial Management and Comptroller) has achieved significant progress in reducing unmatched disbursements, negative unliquidated obligations, and outstanding travel advances.

We also found that management controls were sufficient to ensure accurate reporting of wholesale munitions, valued at about $27.9 billion. Inventory transactions processed by the Commodity Command Standard System were accurate, prices in the standard system used to value munitions items were generally accurate, and storage activities reported accurate

balances on hand. In addition, the Army made progress in resolving its military pay control weaknesses, and the U.S. Army Corps of Engineers improved its control over construction in progress and engineering and design costs to the extent that these areas are no longer considered to be material weaknesses. The Army's annual assurance statement continues to report Armywide control problems to bring attention to needed corrective actions.

The Defense Finance and Accounting Service has performed comparative analyses for all property account balances and for Army National Guard accrued annual leave balances. These analyses disclosed potential reporting errors. In February 1996, the Accounting Service alerted the National Guard about potential errors in its property and annual leave data and the need for a corrective action plan. This action by the Accounting Service should improve the reliability of data included on the Army's future financial statements.

One of the more important actions that the Army began prior to FY 95 was establishing the Senior Level Steering Group to oversee action taken in response to audits conducted pursuant to the Chief Financial Officers Act. This group chartered an effort to develop the Stewardship Improvement Plan, which was to be the Army's plan to enable it to better safeguard the Army's resources and also facilitate compliance with requirements of the Act. Implementation of this initiative is still in its formative stages.

AUDIT SCOPE AND METHODOLOGY

Army management, with support provided by the Defense Finance and Accounting Service, is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles.
- Establishing and maintaining management controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met.
- Complying with applicable laws and regulations.

We were responsible for auditing the financial statements and evaluating related internal controls and compliance with laws and regulations. In carrying out these responsibilities, we:

- Evaluated and, as necessary, tested relevant internal controls encompassing:
  - Financial statement preparation procedures.
  - Wholesale munitions.
  - Equipment in transit.
  - Wholesale equipment.
- Conducted followup reviews on previous recommendations addressing:
  - Retail equipment.
  - Accounting systems.
  - Problem disbursements.
  - Travel advances.
  - Payroll.
  - Real property.
  - Government furnished property.
  - Contingent liabilities.
- Tested compliance with selected laws and regulations.
- Assessed data contained in the Overview section of the annual financial report for consistency with data reported in the financial statements.

We didn't conduct audit work on programs that are classified for national security.

To the extent possible, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 93-06 (Audit Requirements for Federal Financial Statements). However, as noted above, there were significant limitations to the scope of our work.

Francis E. Reardon

FRANCIS E. REARDON, CPA
The Auditor General

15 March 1996

ANNEXES

ANNEX A

PRINCIPAL STATEMENTS

The Army's FY 95 Principal Statements are presented in the format prescribed by the Office of Management and Budget (OMB) and the Department of Defense (DoD). The statements present the overall financial position and operating results of the Army for the fiscal years ending September 30, 1995 and 1994.

The following statements are included as Army's Principal Statements.

- Statement of Financial Position
- Statement of Operations (and Changes in Net Position)

The principal statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of the Chief Financial Officers Act of 1990 as amended by the Government Management Reform Act. The footnotes should be considered an integral part of the principal statements.

Limitations of the Financial Statements:

While the statements have been prepared from the books and records of the entity in accordance with the format prescribed by OMB and DoD, the statements are different from the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

Prior year balances have been restated in some cases. Additional information is contained at Note 1 (Q).

ANNEX A

Department of the Army
Statement of Financial Position
as of September 30, 1995 and 1994
(Thousands)

ASSETS	1995	1994
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1). Fund Balances with Treasury (Note 1G and 2)	$29,660,945	$29,938,483
(a). Funds Collected	5,734,069	6,293,110
(b). Funds Disbursed	(69,039,211)	(71,239,741)
(c). Funds with Treasury	92,966,087	94,885,114
(2). Investments, Net (Note 4)	1,003	899
(3). Accounts Receivable, Net (Note 5)	977,322	799,061
(4). Interest Receivable		
(5). Advances and Prepayments (Note 1J)	89,800	640,809
(6). Other Federal (Intragovernmental)		
b. Transactions with Non-Federal (Governmental) Entities:		
(1). Investments (Note 4)		
(2). Accounts Receivable, Net (Note 1I and 5)	179,552	272,195
(3). Credit Program Receivables/ Related Foreclosed Property, Net		
(4). Interest Receivable, Net		
(5). Advances and Prepayments (Note 1J)	920,048	867,101
(6). Other Non-Federal (Governmental)		
c. Cash and Other Monetary Assets (Note 1H and 3)	270,250	192,863
d. Inventory, Net (Note 1K and 8)	1,896,011	2,009,680
e. Work in Process		
f. Operating Materials/Supplies, Net		
g. Stockpile Materials, Net (Note 11)	31,264,747	30,461,203
h. Seized Property		
I. Forfeited Property, Net		
j. Goods Held Under Price Support and Stabilization Programs, Net		
k. Property, Plant and Equipment, Net (Note 1L and 15)	155,943,247	160,372,538
l. Other Entity Asset (Note 1M)	153,000	7,196,186
m. Total Entity Assets	$221,355,925	$232,751,018
2. Non-Entity Assets:		
a. Transactions With Federal (Intragovernmental) Entities:		
(1). Fund Balance with Treasury (Note1G and 2)	354,656	924,017
(2). Accounts Receivable, Net (Note 5)		
(3). Interest Receivable, Net		
(4). Other		
b. Transactions With Non-Federal (Governmental) Entities:		
(1). Accounts Receivable, Net (Note 1I and 5)	$7,549	$23,322
(2). Interest Receivable, Net	1,348	
(3). Other		
c. Cash and Other Monetary Assets (Note 3)		
d. Other Non-Entity Assets		
e. Total Non-Entity Assets	$363,553	$947,339
3. Total Assets	$221,719,478	$233,698,357

Appendix B. AAA Report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994"

ANNEX A

Department of the Army
Statement of Financial Position
as of September 30, 1995 and 1994
(Thousands)

LIABILITIES	1995	1994
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1). Accounts Payable (Note 1N)	$1,070,454	$2,318,943
(2). Interest Payable		
(3). Debt		
(4). Other Federal (Intragovernmental) Liabilities (Note 1P and 17)	1,421,524	1,555,719
b. Transactions with Non-Federal (Governmental) Entities:		
(1). Accounts Payable (Note 1N)	1,307,626	64,311
(2). Accrued Payroll and Benefits (Note 1O)		
(a). Salaries and Wages	1,117,479	1,236,092
(b). Annual Accrued Leave		
(c). Severance Pay and Separation Allowance	508,223	190,829
(3). Interest Payable		
(4). Liabilities for Loan Guarantees		
(5). Lease Liabilities		
(6). Pensions and Other Actuarial Liabilities (Note 19)		
(7). Other Non-Federal (Governmental) Liabilities (Note 1P and 17)	190,720	364,297
c. Total Liabilities Covered by Budgetary Resources:	$5,616,026	$5,730,191
5. Liabilities Not Covered By Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1). Accounts Payable (Note 1N)	$351,862	$351,761
(2). Debt		
(3). Other Federal (Intragovernmental) Liabilities (Note 17)		
b. Transactions with Non-Federal (Governmental) Entities:		
(1). Accounts Payable (Note 1N)		
(2). Debt		
(3). Lease Liabilities	216	
(4). Pensions and Other Actuarial Liabilities (Note 19)		
(5). Other Non-Federal (Governmental) Liabilities (Note 17)	1,910,432	1,807,796
c. Total Liabilities Not Covered By Budgetary Resources	$2,262,510	$2,159,557
6. Total Liabilities	$7,878,536	$7,889,748
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$27,966,112	$28,854,520
b. Invested Capital	190,559,173	197,561,952
c. Cumulative Results of Operations	(2,421,833)	1,147,161
d. Other	0	404,533
e. Future Funding Requirements	(2,262,510)	(2,159,557)
f. Total Net Position	$213,840,942	$225,808,609
8. Total Liabilities and Net Position	$221,719,478	$233,698,357

ANNEX A

Department of the Army
Statement of Operations (and Changes in Net Position)
For the Fiscal Years Ended September 30, 1995 and 1994
(Thousands)

	1995	1994
REVENUES AND FINANCING SOURCES (Note 1E)		
1. Appropriated Capital Used	$53,273,311	$55,610,306
2. Revenues from Sales of Goods and Services		
a. To the Public	495,222	1,111,633
b. Intragovernmental	5,466,516	5,177,302
3. Interest and Penalties, Non-Federal		
4. Interest, Federal		
5. Taxes		
6. Other Revenues and Financing Sources (Note 22)	912,178	888,412
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	(321,412)	(381,152)
8. Total Revenues and Financing Sources	$59,825,815	$62,406,501
EXPENSES		
9. Program or Operating Expenses (Note 23)	$54,475,979	$56,135,865
10. Cost of Goods Sold (Note 24)		
a. To the Public	495,222	1,022,831
b. Intragovernmental	5,466,516	5,266,104
11. Depreciation and Amortization		
12. Bad Debts and Write-offs	37,000	54,807
13. Interest		
a. Federal Financing Bank/Treasury Borrowing		
b. Federal Securities		
c. Other	1,342	1,694
14. Other Expenses (Note 1Q and 25)	357,780	307,009
15. Total Expenses	$60,833,839	$62,788,310
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($1,008,024)	($381,809)
17. Plus (Minus) Extraordinary Items		
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($1,008,024)	($381,809)
19. Net Position, Beginning Balance, as Previously Stated	$225,808,609	$231,027,071
20. Adjustments (Note 27)	2,545	72,490
21. Net Position, Beginning Balance, as Restated	$225,811,154	$231,099,561
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(1,008,024)	(381,809)
23. Plus (Minus) Non Operating Changes (Note 28)	(10,962,188)	(4,909,143)
24. Net Position, Ending Balance	$213,840,942	$225,808,609

Appendix B. AAA Report, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994"

ANNEX A

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies:

A. Basis of Accounting and Presentation:

Pending issuance of final accounting standards as approved by the Federal Accounting Standards Advisory Board, the following hierarchy of accounting principles and standards have been used in preparation of these financial statements:

- DoD "Guidance on Form and Content of Financial Statements for FY 94 and FY 95 Financial Activity";
- Form and Content Requirements included in Office of Management and Budget Bulletin 94-01;

To the extent that accounting issues are not fully covered by the preceding, the Army follows guidance promulgated by the Joint Financial Management Improvement Program (JFMIP) principals – the Office of Management and Budget, the General Accounting Office, and the Department of the Treasury.

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

B. Reporting Entity:

Fiscal year 1995 represents the fifth year that the Army and DFAS-Indianapolis Center have prepared financial statements as required by the Chief Financial Officers Act of 1990.

The accounts used to prepare the principal statements are classified as entity/non-entity and by type of fund. Entity accounts consists 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.

Designators with X, F, and R indicate availability for an indefinite period of time. Appropriations with a designator "" are for a specific period of time.

Entity Accounts:

Revolving Funds
21X4528 - Working Capital Fund, Army Conventional Ammunition

Trust Funds
21X8063 - Bequest of MG Fred C. Ainsworth, Library, Walter Reed Army Medical Center
21X8927 - General Gift Fund

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Note 1B Continued

General Funds
21*7020 - Military Construction, Family Housing
21*7025 - Operation & Maintenance, Family Housing
21*1705 - National Board for the Promotion of Rifle Practice, Army
21*1805 - Cemeterial Expenses, Army
21*2010 - Military Personnel, Army
21*2020 - Operation & Maintenance, Army
21*2031 - Aircraft Procurement, Army
21*2032 - Missile Procurement, Army
21*2033 - Procurement of Weapons and Tracked Combat Vehicles, Army
21*2034 - Procurement of Ammunition, Army
21*2035 - Other Procurement, Army
21*2040 - Research, Development, Test & Evaluation, Army
21*2050 - Military Construction, Army
21*2060 - National Guard Personnel, Army
21*2065 - Operation & Maintenance, Army National Guard
21*2070 - Reserve Personnel, Army
21*2080 - Operation & Maintenance, Army Reserve
21*2085 - Military Construction, Army National Guard
21*2086 - Military Construction, Army Reserve

Special Funds
21X5095 - Wildlife Conservation, etc., Military Reservations, Army
21X5098 - Restoration, Rocky Mountain Arsenal
21X5194 - DoD 50th Anniversary of World War II Commemoration Account
21X5285 - Forest and Wildlife Conservation, Military Reservations
21X5286 - National Science Center, Army

Non-Entity Accounts:

Deposit Funds
21X6001 - Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property-Army
21X6002 - Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Army
21X6010 - Army Member Savings Deposit-Desert Shield/Desert Storm Savings Program
21X6031 - Effects of Mentally Incompetent Soldiers - United States Army
21X6050 - Employees' Payroll Allotment Account, United States Savings Bonds
21*6060 - Estates of Deceased Soldiers, Regular Army
21X6075 - Withheld Allotment of Compensation for Payment of Employees Organization Dues
21X6083 - Withheld Allotment of Compensation for Charitable Contributions
21X6105 - Withheld Employee Contributions, State or Territorial Retirement
21X6108 - Employer Contributions, State or Territorial Retirement
21X6112 - Withheld Employee Contributions, State or Territorial Disability Benefits
21X6113 - Withheld Employee Contributions, State or Territorial Death Benefits
21X6129 - Foreign Taxes Withheld
21X6131 - Employee and Employer Contributions, Private Insurance Plans, Dept of the Army
21X6134 - Amounts Withheld for Civilian Pay Allotments

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Note 1B Continued

21X6208 - Amounts Withheld for Group Life Insurance, National Guard Members
21X6275 - Withheld Income Taxes (State, County, City)
21X6434 - Servicemen's Group Life Insurance Funds, Suspense, Dept of the Army
21*6763 - Gains and Deficiencies on Exchange Transactions-Army
21X6875 - Budget Clearing Account (Misc.)
21X6999 - Accounts Payable, Check Issue Underdrafts

Special Funds (Receipt Accounts)

21R0891 - Miscellaneous Fees for Regulatory and Judicial Services not Otherwise Classified
21R1020 - Fines, Penalties, and Forfeitures, Economic Stabilization Laws
21R1030 - Fines, Penalties, and Forfeitures, Immigration and Labor Laws
21R1060 - Forfeitures of Unclaimed Money and Property
21R1099 - Miscellaneous Fines, Penalties and Forfeitures
21R1125 - Recoveries Under Military Occupation
21R1210 - Contributions to Conscience Fund
21R1292 - Residue of Funds of Quasi-Governmental Organizations
21R1299 - Gifts--To the United States not otherwise classified
21R1840 - Rental of Equipment and other Personal Property
21R2462 - Deposits for Survivor Annuity Benefits
21R3019 - Recoveries for Government Property Lost or Damaged, Not Otherwise Classified
21R3041 - Recoveries Under Foreign Aid Programs -- Foreign Military Sales
21R3102 - Recoveries From Federal Agencies Resulting for Reductions in Civilian Salaries of Military Retirees
21R3200 - Collections of Receivables from Cancelled Accounts
21R3210 - General Fund Miscellaneous Income and Recoveries not Otherwise Classified
21R3220 - General Fund Proprietorship Receipts
21R5095 - Sale of Hunting and Fishing Permits, Military Reservations
21R5098 - Restoration, Rocky Mountain Arsenal, Army-Reimbursements from Private Industry
21R5286 - National Science Center - Facilities
21R5194 - Royalties for Use of DoD-Military Insignia and Trademarks
21R8063 - Bequest of MG Fred Ainsworth to Walter Reed Army Medical Center
21R8927 - Trust Fund Receipt Accounts for Department of the Army General Gift Fund

Special Funds

21F0109 - Federal Tax withheld from payments to nonresident aliens
21F3845 - Proceeds of Sales, Personal Property
21F3875 - Budget Clearing Account (Misc.)
21F3878 - Budget Clearing Account (Chargebacks)
21F3879 - Undistributed & Letter of Credit Differences (Suspense)
21F3880 - Unavailable Check Cancellations
21F3885 - Undistributed Intra-government Payments
21F3886 - Federal Employee Retirement System (FERS) - Thrift Savings Plan Account

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C. **Basis of Consolidation:**

The Army's financial statements are prepared from a consolidation of accounting information reported from multiple field level accounting systems as well as departmental level data input by the DFAS-Indianapolis Center. This consolidated accounting data is maintained in the Headquarters Accounting and Reporting System (HQARS) departmental general ledger located at DFAS-IN.

General ledger account balances have been verified to the year-end departmental budget execution and expenditure reports. Budget execution reports are prepared from installation reports that are certified for accuracy and completeness by installation commanders. Other methods, to include feeder reports, must be used to verify the accuracy of general ledger balances in those instances where budget execution and expenditure reports don't contain the particular information - for example, "Government Furnished Property." Information on classified operations has been aggregated and reported in such a manner that it is no longer classified.

The previous year requirements for including a Statement of Cash Flows and Statement of Budget and Actual Expenses have been waived by the Office of Management and Budget for Department of Defense agencies and, accordingly, are not included.

D. **Budgets and Budgetary Accounting:**

The Assistant Secretary of the Army (Financial Management and Comptroller) is responsible for directing the Army's budget and monitoring its execution against funds appropriated by Congress. Funds are distributed by appropriation directors through major commands to installations responsible for accomplishing the diverse missions for which the Army is responsible. As missions are performed, installations report obligations and disbursements against the applicable appropriations.

The Army's appropriations are divided into the general, revolving, trust, special and deposit funds. These accounts are used to fund and report how the resources have been used in the course of executing the Army's missions.

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

The Conventional Ammunition Working Capital Fund, a revolving fund, accounts for the procurement, production, storage, distribution, maintenance, and demilitarization of conventional ammunition for all services.

Trust funds are used to record the receipt of funds held in trust for the government. Special funds are comprised of receipt and expenditure accounts that can be used only in accordance with specific provisions of law. Deposit funds generally are used to hold assets that are awaiting legal determination or for which the Army acts as agent or custodian. These accounts may also be used for unidentified remittances.

ANNEX A

E. Revenues and Other Financing Sources:

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

Appropriations are, when authorized, supplemented by revenues generated by sales of goods or services through a reimbursable order process. Revenue is recognized to the extent the revenue is payable to the Army from other federal agencies and the public as a result of costs incurred or services performed on their behalf. Revenue is recognized when earned under the reimbursable process. The Conventional Ammunition Working Capital Fund recognizes revenues at the point of delivery.

Other revenues and financing sources include donated revenue and inventory and other gains. Donations to the Army are recognized as a financial source upon acceptance of the donated asset. Revenue is recorded for the value of the increase to the asset account.

F. Accounting for Intragovernmental Activities:

The Army, 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 were a stand alone entity.

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

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

In FY 1995 the Army sold assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Customers are required to make payments in advance to a Treasury trust fund. The trust fund is used to reimburse DoD for the cost of administering and executing sales. In FY 1995, the Army processed $3 billion in gross obligations citing DoD funds or reimbursing Army funds under the Foreign Military Sales Program.

G. Fund Balances with Treasury:

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

ANNEX A

Fund Balance with Treasury is adjusted for the amount of undistributed disbursements and collections reported in the departmental expenditure system. A corresponding adjustment is also processed to both accounts payable and accounts receivable respectively. These transactions represent Army's in-float (undistributed) disbursements/collections for transactions that have not been recorded by the charged funded station in the same month the disbursements/collections were processed. See Note 2, "Fund Balance with Treasury."

H. Cash and Other Monetary Assets:

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

I. Accounts Receivable, Net:

Accounts Receivable is adjusted for the amount of undistributed collections reported in the departmental expenditure system. A corresponding adjustment is also processed to Fund Balance With Treasury. These transactions represent the Army's in-float (undistributed) collections for transactions that were not recorded by the charged funded station in the same month as the collection was processed. See Note. 5, "Accounts Receivable, Net."

J. Advances and Prepayments:

Payments to public entities in advance of the receipt of goods and services are recorded as non-federal prepaid advances at the time of prepayment. Prepayments amounting to $533.5 million were recorded in the Statement of Financial Position. They are recognized as expenses when the related goods and services are received.

Advances included $89.8 million to government agencies and funds; $109 million to contractors; $214.5 million to other non-federal entities; and $63 million to travelers.

K. Inventory, Net:

The inventory balances are made up of the Army's Conventional Ammunition Working Capital Fund (CAWCF) inventory, and are controlled by the Army Materiel Command. Inventories are primarily comprised of industrial stock components and some finished end items awaiting transfer of ownership to a customer.

Currently, inventory is not recorded in the financial statements at the approximate historical cost in accordance with Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property." Instead, inventory is valued at a standard price (sale price) which includes the purchase price plus cost recovery factors (commonly called surcharges) necessary to recover operating costs and anticipated inflation rate changes.

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Gains or losses that result from valuation changes for inventory are not recognized and reported in the Statement of Operations. Such gains or losses are, however, reflected in the inventory asset valuation and related invested capital account in the Statement of Financial Position. See Note 8, "Inventory, Net."

L. Property, Plant and Equipment, Net:

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

Current DoD financial capitalization policy requires that assets previously capitalized at lower thresholds -- $5,000 prior to FY 91; $15,000 from FY 91-93; $25,000 in 1994; and $50,000 in 1995 -- remain in the PP&E accounts subsequent to the raising of capitalization thresholds. Unfortunately, most of the Army's property accountability systems can't comply with financial capitalization and historical cost reporting requirements. Consequently, these systems are using the current $50,000 capitalization criteria, for items having an estimated useful life of two or more years regardless of when acquired.

No gains or losses were recognized in the Statement of Operations for revaluation changes and/or loss of equipment. However, the assets and related investment accounts reflect both pricing and value changes based on a periodic update to the general ledger. Depreciation is not recorded for assets financed by general fund appropriations. Routine maintenance and repair costs are expensed when incurred.

Real property comprising land, buildings, and other facilities is valued using historical costs. The $50,000 asset capitalization threshold was generally applied to the total costs (acquisition and capital improvements) of each facility supported by the Army's primary real property accountability system, the Integrated Facilities System. The other real property system generally reported asset costs in excess of $25,000.

Personal property (military equipment) is generally valued using latest acquisition costs or standard prices.

Natural resources comprise the estimated value of standing timber reserves. Construction-in-progress (CIP) is updated based on costs incurred. In accordance with guidance from DoD Comptroller, CIP includes $4.3 billion of work-in-process inventory and progress payments made to others for procurement and RDT&E construction in progress funded efforts which are not complete.

New buildings are capitalized upon acceptance by the installation. Gains or losses from transfer of assets or liabilities between agencies are not recognized, except when assets are transferred to the Base Realignment and Closure Account. This account is not allowed to accumulate gains or losses on disposal. Any gain or loss must be transferred back to the original/losing command.

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As of September 30, 1995, the Army was committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for the rental of equipment, space, right of ways, and operating facilities.

Real property assets at overseas locations were reclassified during FY 1995 as a result of implementing the DoD accounting policy. The policy requires that real property assets recorded under foreign government agreements permitting DoD occupancy of facilities - which require maintenance to be provided by DoD - be recorded as a capital lease. Consequently, over $5 billion dollars of assets previously recorded as other than capital leases have been reclassified in FY 95.

Government furnished material and property (GFM/GFP) are reported monthly in the departmental general ledger. Contractors are required to maintain accountable records for GFM/GFP. The contractor data is used to supplement the general ledger balances. Land and buildings also include amounts for real property in the hands of contractors. See Note 15, "Property, Plant and Equipment."

M. Other Entity Assets:

Other Entity Assets includes items classified as sensitive equipment.

N. Accounts Payable:

Accounts payable for goods and services are generally recognized upon receipt of a receiving report providing notification of acceptance of goods or services. The account is adjusted for the amount of undistributed disbursements reported in the departmental expenditure system. A corresponding adjustment is also processed to Fund Balance with Treasury. These transactions represent the Army's in-float (undistributed) disbursements for transactions that have not been recorded by the charged funded station in the same month the disbursement was processed.

O. Accrued Payroll and Benefits:

Accrued payroll and benefits represents civilian and military payroll and benefits earned but not paid as of the end of the accounting month. The amount is accrued in the financial statements as a non-federal liability. FY 95 amounts accrued for civilian and military personnel were $644 million and $982 million respectively. Accrued Payroll and Benefits includes severance pay and separation allowances in the amount of $508 million.

P. Other Liabilities:

Payments received by Army from entities in advance of the delivery of goods or performance of services are treated as unearned revenue and recorded as a liability. Accrued merged year cancelled budget authority (accounts payable) amounted to $45 million.

Military and civilian annual leave are accrued as earned and reduced as leave is taken. The military pay and civilian pay systems compute the account balance based on current pay rates. Sick and other types of leave are expensed as taken. Accrued liabilities for annual leave are recorded as unfunded "Other Non-Federal (Government) Liabilities" and "Future Funding Requirements" in the Statement of Financial Position. The expense is financed in the period in which payment is required. See Note 17, "Other Liabilities."

ANNEX A

Q. **Restatements:**

Army's financial statements will continue to reflect restatements and reclassifications due to the evolving nature of federal accounting standards and the development of new reporting financial systems. Restatements to the FY 94 Statement of Financial Position have been made due to an understatement of the liability for reimbursements made by Department of Labor to "Army" claimants under the Federal Employees Compensation Act. Payment on these bills is deferred two years to allow for funding through the budget process. Additional changes resulted from a reconciliation of Cumulative Results of Operations and Invested Capital and are reflected in the schedule that follows.

Changes to the Statement of Operations and Changes in net Position result from procedural guidance cited in DoD Financial Management Regulation 7000.14-R which states that inventory gain or loss accounts be used only by activities within the Supply Management Business Area of the Defense Business Operations Fund and the Defense Commissary Agency.

FY 94 Statement of Financial Position Changes
(Thousands)

FY 94 Line	FY 94 Balance	Change	FY 94 Restated
5.a. 1	$198,219	$153,542	$351,761
7.b	$199,761,388	($2,199,436)	$197,561,952
7.c	($1,052,275)	2,199,436	$1,147,161
7.e	($2,006,015)	($153,542)	($2,159,557)

FY 94 Statement of Operations and Changes in Net Position
(Thousands)

FY 94 Line	FY 94 Balance	Change	FY 94 Restated
14.	$2,973,418	($2,666,409)	$307,009
23.	($2,089,193)	($2,819,950)	($4,909,143)

R. **Undelivered Orders:**

The Army was obligated to pay for aggregate undelivered orders (goods and services that have been ordered but not yet received) amounting to $27.3 billion at fiscal year-end. Unexpended appropriations in the financial statements were reduced by $4.7 billion for unfilled orders where Army has not performed or earned the reimbursement (reimbursable orders received for which supplies or services have not been delivered to the ordering agency).

Note 2. Fund Balances with Treasury:

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

ANNEX A

(Thousands)

	Trust Funds	Revol-ving Funds	Approp-riated Funds	Other Fund Types	FY 95 Total	FY 94 Total
Entity Asset Fund Balance						
Unobligated Balance Avail.						
Available	$454	$159,678	$3,585,250	$73,585	$3,818,967	$4,492,394
Restricted			1,673,758		1,673,758	1,679,904
Reserve, For						
Anticipated Resources					0	0
Obligated (But Not						
Not Expensed) Bal.	94		24,156,823	11,303	24,168,220	23,766,185
Unfunded Contract Auth.					0	0
Unused Borrowing Auth.					0	0
Total Entity Asset	$548	$159,678	$29,415,831	$84,888	$29,660,945	$29,938,483
Non-Entity Asset Fund Balance						
Funds Collected	$0	$0	$0	$10,975,029	$10,975,029	$8,590,002
Funds Disbursed	0	0	0	(10,620,373)	(10,620,373)	(7,665,985)
Fund Balance with Treasury	$0	$0	$0	$354,656	$354,656	$924,017
Grand Total	$548	$159,678	$29,415,831	$439,544	$30,015,601	$30,862,500

Note 3. Cash, Foreign Currency, and Other Monetary Assets:

(Thousands)

	Entity Assets		Non-Entity Assets	
A. Cash		$239,338		$0
B. Foreign Currency		30,912		0
C. Other Monetary Assets:				
(1) Gold	$0		$0	
(2) Special Drawing Rights	0		0	
(3) U.S. Reserves in the Inter-national Monetary Fund	0		0	
(4) Other	0		0	
(5) Total Other Monetary As	$0	$0	$0	$0
D. Total FY 95		$270,250		$0
Total FY 94		$192,863		$0

ANNEX A

Note 4. Investments:

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. Army reported $1 million in the Trust Fund appropriations. The investments will be held to maturity, so no provision is made for unrealized gains or losses.

Note 5. Accounts Receivable, Net:

Accounts Receivable include all receivables due from federal and non-federal sources, net of allowance for estimated uncollectible accounts. The allowance for uncollectible accounts was based on an analysis of collection experience by fund type for current and noncurrent receivables. During FY 95 the Army wrote off $37 million in uncollectible receivables, including principal and interest.

Accounts Receivable Balance

(Thousands)

	Gross Due	Allowance	Net Due
A. Entity Receivables:			
Intragovt.	$977,322	$0	$977,322
Government	262,730	83,178	179,552
B. Non-Entity Receivables:			
Intragovt.	$0	$0	$0
Government	64,619	57,070	7,549
FY 95 Total	$1,304,671	$140,248	$1,164,423
FY 94 Total	$1,214,360	$119,782	$1,094,578

Note 8. Inventory, Net:

Inventory held for resale by the Army is contained in the revolving fund, Conventional Ammunition Working Capital Fund (CAWCF). During FY 1995, CAWCF inventory was adjusted $344 million for unserviceable, condemned and obsolete inventory. The components of the Army's inventory is shown in the table below.

(Thousands)

CAWCF INVENTORY

	FY 95	FY 94
Work in Process	$47,004	$79,379
In Transit	224,911	147,226
Agency Operations	1,624,096	1,783,075
Total	$1,896,011	$2,009,680

ANNEX A

Note 11. Stockpile Materials Net:

A. Stockpile Materials:

Stockpile materials are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. Army has $31.3 billion in stockpile materials representing ammunition and missiles. Army war reserve ammunition and missiles positioned at intermediate supply points and installations have been combined with war reserves stocked at wholesale supply activities to reflect total stockpile materials.

(Thousands)	Stockpile Materials Amount	Allowance for Losses	Stockpile Materials Net	Valuation Method
A. Stockpile Materials:				
(1) Held for Sale				
(2) Held in Reserve For Future Sale	$31,264,747		$31,264,747	N/A
FY 95 Total	$31,264,747	$0	$31,264,747	
FY 94 Total	$30,461,203	$0	$30,461,203	N/A

B. Restrictions on stockpile materials and supplies:

Stockpile materials are not held with the intent of selling in the ordinary course of business.

Note 15. Property, Plant and Equipment:

(THOUSANDS) CLASSES OF FIXED ASSETS	Acquisition Value	Accumulated Depreciation	Net Book Value FY 95	Net Book Value FY 94
A. LAND	$478,197		$478,197	$454,254
B. STRUCT, FACILITIES & LEASEHOLD IMPROVEMENTS	26,058,662	$0	26,058,662	29,655,851
C. MIL. EQUIP.	112,172,317	0	112,172,317	118,761,783
D. ADP SOFTWARE	14,967	0	14,967	22,337
E. EQUIPMENT	0	0	0	0
D. ASSETS UNDER CAPITAL LEASE	5,581,252	0	5,581,252	6,403
G. OTHER	135,019	0	135,019	0
H. NAT. RESOURCES	2,468,516	0	2,468,516	1,268,036
I. CONST. IN PROG.	9,034,317	0	9,034,317	10,203,874
TOTAL	$155,943,247	$0	$155,943,247	$160,372,538

ANNEX A

Government furnished material and property (GFM/GFP) are reported monthly in the departmental general ledger. Contractors are also required to maintain accountable records for GFM/GFP. The contractor data is used to supplement the general ledger balances.

GFM/GFP	(Thousands)
Work in Process GFM	$1,565,949
Construction in Proc-GFM	$1,434,738
Equipment with Contractors	$5,322,759

Note 17. Other Liabilities:

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

A. Other Liabilities Covered by Budgetary Resources:	(Thousands) Non-Current Liabilities	Current Liabilities	FY 95 Total	FY 94 Total
1. Intragovernmental				
(1) Unearned Revenue from Fed. Agencies		$794,965	$794,965	$816,983
(2) Deposit Fund		354,656	354,656	544,462
(3) Cash Advances		271,587	271,587	194,274
(4) Progress Billings to Others		316	316	0
Total	$0	$1,421,524	$1,421,524	$1,555,719
2. Governmental				
(1) Unearned Revenue Adv.		$181,822	$181,822	$364,297
(2) Non-Entity Liabilities		8,898	8,898	
Total	$0	$190,720	$190,720	$364,297

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B. Other Liabilities Not Covered by Budgetary Resources:	(Thousands) Non-Current Liabilities	Current Liabilities	FY 95 Total	FY 94 Total
1. Intragovernmental				
(1) Cancelled Budget Authority				
(2) Accrued Annual Leave-Civ				
(3) Accrued Annual Leave-Mil				
(4) Other				
Total	$0	$0	$0	$0
2. Governmental				
(1) Cancelled Budget Authority		$44,996	$44,996	$48,989
(2) Accrued Annual Leave-Civ		713,513	713,513	590,148
(3) Accrued Annual Leave-Mil		1,151,790	1,151,790	1,168,469
(4) Other		133	133	190
Total	$0	$1,910,432	$1,910,432	$1,807,796

Note 19. Pensions and Other Actuarial Liabilities:

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

The Army funds a portion of the pension benefits under these retirement plans. No amounts are reported as assets or liabilities in the financial statements because the funds are maintained and reported by the Office of Personnel Management for CSRS and FERS; and DoD for MRS. Overseas commands obligate mission funds to pay separation and severance pay for Foreign Nationals in accordance with the Status of Forces Agreements.

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

FERS - Army contributes to FERS, Social Security and TSP for civilian employees hired after December 31, 1983, or CSRS employees that elected to be covered under FERS.

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

The Army also contributes to the FERS Thrift Savings Plan on behalf of its participating employees. The contributions listed on page 64 were made to the retirement plans and FERS Thrift Savings Plan (TSP).

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Retirement Contributions
(Thousands)

	FY 95	FY 94
CSRS	$295,718.0	$313,145.1
FERS	351,539.7	368,016.1
MRS	4,430,300.0	4,598,500.0
SS	326,496.0	319,220.4
Total	$5,404,053.7	$5,598,881.6
TSP	$110,322.0	$101,173.0

On-the-job injuries under the Federal Employees Compensation Act (FECA) are administered by the Department of Labor (DOL). DOL provides an actuarial estimate for the present value of future claims that Army would be expected to pay in future years.

Note 20. Net Position:

Net Position is comprised of the following components:

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

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

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

Other - represents other components of net position not specifically identified above. In prior years Army financial statements showed balances in this account relating to miscellaneous receipts. New guidance from the Department of the Treasury requires the miscellaneous receipt balances to be excluded from Army's "Net Position" since the receipts are considered withdrawn by Treasury immediately upon collection. Consequently, FY 95 will have a zero balance.

ANNEX A

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

Note 20. Net Position:

(Thousands)

Fund Balance	Trust Funds	Revolving Funds	Appropriated Funds	FY 95 Total	FY 94 Total
1. Unexpended-Appro					
- Unobligated					
- Available	$454		$3,658,835	$3,659,289	$4,296,351
-Unavailable	0		1,673,758	1,673,758	1,679,904
- Undelivered Orders	11		22,633,054	22,633,065	22,878,265
2. Invested Capital	1,002	$8,164	190,550,007	190,559,173	197,561,952
3. Cumulative Results of Operations		740,912	(3,162,745)	(2,421,833)	1,147,161
4. Other			0	0	404,533
5. Future Funding Requirements			(2,262,510)	(2,262,510)	(2,159,557)
FY 95 Total	$1,467	$749,076	$213,090,399	$213,840,942	$225,808,609

A breakout of line 5 from the schedule above follows:

FUTURE FUNDING REQUIREMENTS
(Thousands)

	FY 95	FY 94
Annual Leave	$1,865,303	$1,758,617
Workman's Comp. and Med. Claims	351,862	351,761
Canceled Budget Authority(A/P)	44,996	48,989
Other	349	190
Total	$2,262,510	$2,159,557

ANNEX A

Note 22. Other Revenue and Financing Sources:

(Thousands)

	FY 95	FY 94
A. Other Revenues and Financing Sources:		
(1) Miscellaneous Receipts	$0	$381,152
(2) Donated Revenue	0	0
(3) Other Gains	807	104
(4) Inventory Gains	443,976	343,609
(5) Miscellaneous Reimbursements	467,395	163,547
Total	$912,178	$888,412

B. Other Information:

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

Note 23. Program or Operating Expenses:

(Thousands)

	FY 95	FY 94
A. Operating Expenses by Object Classification:		
(1) Personnel Services and Benefits	$32,130,549	$32,584,724
(2) Travel and Transportation	1,576,052	1,724,311
(3) Rental, Communication and Utilities	1,300,887	1,441,874
(4) Printing and Reproducation	50,472	48,655
(5) Contractual Services	13,661,243	14,140,799
(6) Supplies and Materials	4,001,708	3,599,898
(7) Equipment not Capitalized	485,688	460,379
(8) Grants, Subsidies and Contributions	90,693	49,267
(9) Insurance Claims and Indemnities	447	988
(10) Other:	1,178,240	2,084,970
(11) Total Expenses by Object Class	$54,475,979	$56,135,865

ANNEX A

(Thousands)

	FY 95	FY 94
B. Operating Expenses by Activity:		
(1) Revolving Fund	$205,308	$369,373
(2) General Fund	54,270,400	55,766,333
(3) Trust Fund	271	159
(4) Unallocated Expenses	0	0
Total Expenses	$54,475,979	$56,135,865

Note 24. Cost of Goods Sold:

(Thousands)

Cost of Goods Sold	FY 95	FY 94
Public	$495,222	$1,022,831
Intragovernmental	5,466,516	5,266,104
Total	$5,961,738	$6,288,935

Note 25. Other Expenses:

Inventory Loss/Adjustments from the CAWCF revolving fund accounted for the majority of this Statement of Operations (and Changes in Net Position) line item.

(Thousands)

	FY 95	FY 94
A. Other Expenses:		
(1) Inventory Loss/Adjustments	$355,257	$305,159
(2) Other Losses	2,523	1,850
Total	$357,780	$307,009

ANNEX A

Note 27. Prior Period Adjustments:

(Thousands)	FY 95	FY 94
A. Prior Period Adjustments	$2,545	$72,490
Total	$2,545	$72,490

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

(Thousands)	FY 95	FY 94
A. Increases:		
(1) Transfers-In	($330,217,496)	$246,593,915
(2) Unexpended Appropriations	(3,225,403)	(3,103,977)
(3) Donations Received	0	0
(4) Other Increases	28,733,051	55,541,677
(5) Total Increases	($304,709,848)	$299,031,615
B. Decreases:		
(1) Transfers-Out	$323,214,204	($246,795,704)
(2) Donations	0	0
(3) Other Decreases	(29,466,544)	(57,145,054)
(4) Total Decreases	$293,747,660	($303,940,758)
C. Net Non-Operating Changes (Transfers):	($10,962,188)	($4,909,143)

ANNEX A

Note 29. Intrafund Eliminations:
(Thousands)

The following schedule shows the values of the transactions that were required to be eliminated from the Statement of Financial Position and Statement of Operations (and Changes in Net Position) since they were made to other DoD entities.

Army to Army

Schedule A (sales to)	Accts Rec/ Accts Pay	Revenue/ Expenses	Unearned Revenue/ Advances	Collections/ Disbursements
Department of Army	$762,758	$5,276,985	$1,023,351	$5,252,358
Total	$762,758	$5,276,985	$1,023,351	$5,252,358

Army to DBOF

Schedule B (sales to)	Accts Rec/ Accts Pay	Revenue/ Expenses	Unearned Revenue/ Advances	Collections/ Disbursements
Army	$25,122	$201,454		$188,647
Navy	2,193	9,397		8,111
Air Force	6,182	35,184		37,782
DLA	26,192	50,131	$2,226	29,663
U.S. TRANSCOM	11,941	37,156		27,619
DISA	2,465	12,566		11,628
DeCA	15,369	47,183		42,408
DFAS	91,309	164,447		93,639
JLSC	1,212	9,809		6,992
Other	9,330	56,260		56,299
Total	$191,315	$623,587	$2,226	$502,788

ANNEX A

Army to Components Schedule C (sales to)	Accts Rec/ Accts Pay	Revenue/ Expenses	Unearned Revenue/ Advances	Collections/ Disbursements
Department of Navy	$94,893	$763,714	$160,338	$692,812
Department of Air Force	78,780	652,996	457,706	575,562
Other	359,356	2,878,988	58,180	3,003,380
Total	$533,029	$4,295,698	$676,224	$4,271,754

Note 30. Contingencies:

The Army canceled all merged year and expiring account appropriations. The Army may still be responsible for an estimated $371 million in obligations that related to the canceled appropriations. Additionally, variances between budgeted rates and accrued variances for obligations to be paid in foreign currencies amounted to $82.5 million.

The Army is subject to various asserted claims for over $100 million. These claims are in various phases ranging from investigation to appeal. While no opinion has been expressed regarding specific claims' likely outcome or possible associated loss, experience indicates that many such claims are settled for less than claimed, dismissed altogether, or the possibility of the contingency materializing is remote. The following disclosures are made in accordance with DoD Guidance on Form and Content of Financial Statements for FY 94 and FY 95 Financial Activity.

Environmental Compliance - Probable liabilities for the Army's Environmental Program are primarily comprised of estimates to cleanup contamination at Army installations, such as Rocky Mountain Arsenal. Other contingent liabilities were established as a result of changes in conservation program requirements relating to the Endangered Species Act, Clean Water Act, Resource Conservation & Recovery Act, and the Sikes Act.

Rightsizing - Contingent liabilities were created as a result of rightsizing the military and civilian workforce. These contingent liabilities primarily relate to Congressionally authorized programs designed to provide transition benefits and incentives for military and civilians leaving the workforce.

Workman's Compensation - On-the-job injuries under the Federal Employees Compensation Act (FECA) are administered by the Department of Labor (DOL).

Base Realignment - These anticipated costs relate to the movement of troops, material and equipment in connection with consolidation of missions and the turnover of facilities.

ANNEX A

Radio-active Waste - Improper handling and disposal of low level radioactive waste in the past has resulted in a number of sites being listed as having the potential of being contaminated with radioactivity.

Re-enlistment Bonuses - Enlisted military personnel in certain military occupation specialties (MOS) receive a bonus over a period of six years upon re-enlistment. There are additional MOSs for initial entry bonuses which are partially paid upon completion of basic training with the balance being paid over the remaining enlistment period. Officers do not re-enlist but take an oath of office. However, officers in the medical field do receive a bonus.

(Millions)

Environmental Compliance	$10,513
Rightsizing	1,522
Workman's' Compensation	1,353
Base Realignment	478
Radio-active Waste	417
Re-enlistment Bonuses	300

The Army is also the Executive Agent for the Chemical Demilitarization Program. A majority of the Chemical Stockpile Disposal Program will be funded by Defense appropriations, $8.6 billion in the Chemical Agents and Munitions Destruction Defense (CAMD,D) appropriation and $1 billion in the Military Construction Defense-Wide account

A rough order of magnitude cost estimate for the Non-Stockpile Chemical Materiel Program is $17.7 billion. Of this amount, $1.2 billion is included in the CAMD,D appropriation for FY 1992-2005 requirements relating to the Chemical Weapons Convention and remediation of buried chemical weapons munitions. The remaining possible liability for the NSCMP should be funded by the Defense Environmental Restoration Appropriation.

Footnotes 6,7,9,10,12,13,14,16,18,21, and 26 are not applicable to the Certified Financial Statements for Department of the Army.

ANNEX B

SUPPORTING AUDIT REPORTS

1. Proposed Adjustments and Comments Regarding Army's FY 95 Annual Financial Report (AA 96-139)

2. Conditions Found in Previous Financial Statement Audits, Civil Works, U.S. Army Corps of Engineers (AA 96-137)

3. Report on Internal Controls and Compliance With Laws and Regulations (AA 96-154)

4. Financial Reporting of Wholesale Munitions, U.S. Army Industrial Operations Command, U.S. Army Missile Command (AA 96-155)

5. Financial Reporting of Wholesale Equipment (AA 96-160)

6. Financial Reporting of Equipment In Transit (AA 96-156)

7. Travel Advances, Defense Accounting Office, U.S. Army Missile Command (AA 96-157)

8. Standard Operations and Maintenance, Army Research and Development System--Status of Prior Audit Recommendations, Defense Accounting Office, U.S. Army Missile Command (AA 96-158)

9. Wholesale Equipment, Tobyhanna Defense Distribution Depot (AA 96-159)

10. Audit of the Compilation of the Army's FY 95 Financial Statements at the Defense Finance and Accounting Service - Indianapolis Center (Inspector General, DOD, Project #5FI-2012)

We issued the Proposed Adjustments report on 21 February 1996, and the Civil Works report on 26 February 1996. The other reports will be issued after the date of this report.

ANNEX C

OTHERS RECEIVING COPIES OF THE REPORT

Chief of Staff, Army
Under Secretary of the Army
Vice Chief of Staff
Assistant Secretary of the Army (Civil Works)
Assistant Secretary of the Army (Financial Management and Comptroller)
Assistant Secretary of the Army (Installations, Logistics and Environment)
Assistant Secretary of the Army (Manpower and Reserve Affairs)
Assistant Secretary of the Army (Research, Development and Acquisition)
General Counsel
Director of the Army Staff
The Inspector General
Chief of Legislative Liaison
Chief of Public Affairs
Chairman, Army Reserve Forces Policy Committee
Deputy Chief of Staff for Logistics
Deputy Chief of Staff for Operations and Plans
Deputy Chief of Staff for Personnel
Assistant Chief of Staff for Installation Management
Chief, National Guard Bureau
Deputy Assistant Secretary of the Army for Budget
Director, Program Analysis and Evaluation
Commander in Chief, U.S. Army, Europe and Seventh Army
Commanders
  U.S. Army Forces Command
  U.S. Army Training and Doctrine Command
  U.S. Army Materiel Command
  U.S. Army Military District of Washington
  U.S. Army Corps of Engineers
  U.S. Army Criminal Investigation Command
  U.S. Total Army Personnel Command
  U.S. Army Aviation and Troop Command
  U.S. Army Communications-Electronics Command
  U.S. Army Industrial Operations Command
  U.S. Army Missile Command
  U.S. Army Tank-automotive and Armaments Command
  XVIII Airborne Corps and Fort Bragg
  I Corps and Fort Lewis
  Anniston Army Depot
  Red River Army Depot
  3d Military Police Group, U.S. Army Criminal Investigation Command
Directors
  U.S. Army Research Laboratory
  U.S. Army Center for Public Works
Commandant, U.S. Army Logistics Management College
Director, Center for Army Lessons Learned

ANNEX C

Inspector General, Department of Defense
Directors
  Defense Finance and Accounting Service
  Defense Finance and Accounting Service-Indianapolis Center
  Defense Intelligence Agency
  Defense Logistics Studies Information Exchange
Commander, Tobyhanna Defense Distribution Depot
Defense Accounting Officer
  U.S. Army Aviation and Troop Command
  U.S. Army Communications-Electronics Command
  U.S. Industrial Operations Command
  U.S. Army Missile Command
  U.S. Army Tank-automotive and Armaments Command
  XVIII Airborne Corps and Fort Bragg
  I Corps and Fort Lewis
  Anniston Army Depot
  Red River Army Depot
  Tobyhanna Defense Distribution Depot
  U.S. Army Research Laboratory
Auditors General
  Air Force Audit Agency
  Naval Audit Service

Appendix C. Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management of 1994, for determining the accuracy and completeness of the independent audit conducted by the AAA, we evaluated AAA's qualifications and independence, reviewed AAA's audit approach, and monitored audit progress at key points.

Evaluation of AAA's Qualifications and Independence. Our determination of AAA's qualifications and independence was based on a lengthy and continuous association between the IG, DoD, and the AAA. We also relied on a June 1992 determination by the General Accounting Office that the various DoD audit organizations were independent and capable. Also, the GAO had no objections to the IG, DoD, using the work of these audit agencies in discharging its responsibilities for the audit of the financial statements of the various Military Departments.

To determine AAA's independence, we reviewed the Government Auditing Standards, the AICPA Codification of Statements on Auditing Standards, and the AICPA Code of Professional Conduct for independence criteria. We also reviewed testimony given by the Assistant Comptroller General, Accounting and Information Division, General Accounting Office (GAO), before the House Subcommittee on Government Management, Information and Technology, Committee on Government Reform and Oversight. In addition, we reviewed IG, DoD, Report No. APO 95-010, "Report on the Oversight Review of the Organization and Staffing of the DoD Audit Organizations for Audits of Financial Statements," dated July 19, 1995.

Review of AAA's Audit Approach. We used the President's Council on Integrity and Efficiency "Federal Financial Statement Audit Manual" as criteria for reviewing AAA's audit approach. Specifically, we reviewed the following: the notification letter, opening conference documentation, strategy formulation, the entity profile, the general risk analysis, the account risk analysis, audit programs, and cycle memorandums.

We reviewed any additional planning documentation we deemed necessary to accomplish the audit objective. We also attended and participated in numerous audit planning workshops throughout the course of the audit.

Monitoring of Audit Progress at Key Points. Through the IG, DoD, Integrated Audit Process Team and the Executive Steering Committee, we provided a forum for a centrally managed exchange of guidance and information leading to a focused DoD-wide effort to audit the DoD consolidated financial statements, to include the supporting financial statements of DoD's major components. The AAA audit of the Army financial statements constituted a significant portion of this DoD-wide audit effort. Audit initiatives for monitoring progress of the audit at key points also involved attending and participating in numerous AAA in-process reviews and workshops. We also

reviewed and commented on each AAA draft audit report, including the audit opinion report, that was issued in relation to the audit of the Army's financial statements for FYs 1995 and 1994.

In addition to the above oversight procedures, we performed other procedures deemed necessary to determine the fairness and accuracy of AAA's audit approach and conclusions.

Audit Period, Standards, and Locations. We performed this financial audit from May 16, 1995, through March 15, 1996. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit. Appendix D lists the organizations we visited or contacted.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Department of the Army

Army Audit Agency, Alexandria, VA

Other Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN

Appendix E. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, U.S. Army Corps of Engineers

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 Investigative Service
Director, Defense Logistics Agency
Director, National Security Agency

Non-Defense Federal Organizations

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

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

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

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
Richard B. Bird
John J. Vietor
Craig W. Michaels
Cheri D. Givan
Susanne B. Allen