Audit Report

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE ARMY AUDIT AGENCY AUDIT OF THE FY 1998 ARMY GENERAL FUND FINANCIAL STATEMENTS

Report Number 99-091 March 1, 1999

Office of the Inspector General
Department of Defense

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Acronyms

AAA	Army Audit Agency
GAO	General Accounting Office

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

March 1, 1999

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

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 1998 Army General Fund Financial Statements (Report No. 99-091)

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 FY 1998 Army General Fund Financial Statements, along with the AAA report, "Army's Principal Financial Statements for Fiscal Year 1998: Summary Audit Report." An audit of the Army General Fund 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 findings or recommendations, written 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 (703) 604-9175 (DSN 664-9175) (rbird@dodig.osd.mil) or Mr. John J. Vietor, Audit Project Manager, at (317) 510-3855 (DSN 699-3855) (jvietor@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-091 March 1, 1999
(Project No. 8FI-2025)

Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 1998 Army General Fund Financial Statements

Executive Summary

Introduction. An audit of the Army General Fund Financial Statements is required by Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. We delegated the audit of the FY 1998 Army General Fund Financial Statements to the Army Audit Agency. This report provides our endorsement of the Army Audit Agency disclaimer of opinion on the FY 1998 Army General Fund Financial Statements, along with the Army Audit Agency report, "Army's Principal Financial Statements for Fiscal Year 1998: Summary Audit Report."

Audit Objective. Our objective was to determine the accuracy and completeness of the Army Audit Agency audit of the FY 1998 Army General Fund Financial Statements. See Appendix A for a discussion of the audit process.

Audit Results. The Army Audit Agency Report, "Army's Principal Financial Statements for Fiscal Year 1998: Summary Audit Report," February 9, 1999, stated that the Army Audit Agency could not express an opinion on the FY 1998 Army General Fund Financial Statements. We concur with the Army Audit Agency disclaimer of opinion; our endorsement of that disclaimer is at Exhibit 1. The Army Audit Agency report is at Exhibit 2.

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Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the "Chief Financial Officers Act of 1990," as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," we performed oversight of the independent audit conducted by the Army Audit Agency (AAA) of the FY 1998 Army General Fund Financial Statements. Our purpose was to determine whether we could rely on the AAA audit. We reviewed the AAA audit approach and planning and monitored audit progress at the key points.

Reviewing the AAA Audit Approach. We used the "Federal Financial Statements Audit Manual," January 1993, issued by the President's Council on Integrity and Efficiency, and the "Financial Audit Manual," December 12, 1997, issued by the General Accounting Office (GAO), as the criteria for reviewing the AAA audit approach. Specifically, we reviewed the engagement letter, participated in the entrance conference, assisted in formulating the audit strategy, and commented on audit plans and programs. We also participated in audit planning and auditor working group meetings coordinated by the GAO; Inspector General, DoD; and the AAA.

Monitoring Audit Progress. Through the DoD Financial Statement Audit Executive Steering Committee, we provided a forum for a centrally managed exchange of guidance and information leading to a focused DoD-wide audit of the DoD Consolidated Financial Statements, including the supporting financial statements of major DoD Components. We participated in audit working groups on significant topics in financial reporting relating to the Army General Fund. For example, we participated in the Audit Working Groups for DoD-Wide Real Property, Fund Balance With Treasury, Statement of Budgetary Resources, and Eliminating Entries. We also participated in the Audit Working Groups for the Army Defense Joint Accounting System and General and Mission Equipment. We reviewed and commented on related draft audit reports issued by the AAA, including the audit opinion report and the report on the evaluation of internal controls and compliance with laws and regulations.

In addition to the above oversight procedures, we performed other procedures necessary to determine the fairness and accuracy of the AAA audit approach and conclusions. For example, we co-performed audit work with the AAA to verify the existence and completeness of real property assets.

Audit Period and Standards. We performed this financial statement audit from February 24, 1998, to March 1, 1999, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit.

Contacts During the Audit. We visited individuals and organizations in the DoD audit and accounting community. Further details are available upon request.

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

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

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

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

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

Summary of Prior Audit Coverage

The GAO and the Inspector General, DoD, have conducted multiple reviews related to oversight of financial statement audits. GAO reports can be accessed on the Internet at http://www.gao.gov. Inspector General, DoD, reports can be accessed on the Internet at http://www.dodig.osd.mil.

Appendix B. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

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

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Indianapolis Center

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office
  National Security and International Affairs Division,
    Technical Information Office

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

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

Exhibit 1. Inspector General, DoD, Endorsement Memorandum

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

March 1, 1999

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

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1998 Army General Fund Financial Statements (Project No. 8FI-2025)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Army Audit Agency (AAA) the audit of the FY 1998 Army General Fund Financial Statements. Summarized below is the AAA disclaimer of opinion on the FY 1998 Army General Fund financial statements and the results of our review of the AAA audit. We endorse the disclaimer of opinion expressed by the AAA (Enclosure).

Disclaimer of Opinion. The AAA disclaimer of opinion on the FY 1998 Army General Fund Financial Statements, February 18, 1999, states that the AAA was unable to express an opinion on the financial statements. We concur with the AAA disclaimer of opinion. The AAA could not express an opinion on the financial statements for the reasons summarized below.

- Continual problems with inadequate accounting systems, insufficient audit trails, and procedural problems prevented AAA from using any practical methods to conduct audit work of sufficient scope to enable it to express an opinion on the FY 1998 Army General Fund Financial Statements. Inadequate accounting systems required the Defense Finance and Accounting Service Indianapolis Center to make unsupported adjustments of $512 billion to force the general ledger to match the status of funds data.

- The FY 1998 Army General Fund Financial Statements were late and incomplete. The Defense Finance and Accounting Service Indianapolis Center did not provide financial statements to the auditors until January 8, 1999. Then the Defense Finance and Accounting Service Indianapolis Center made 183 adjustments to the financial statements totaling $225 billion, of which only 14 adjustments for $44 billion were auditor recommended adjustments. The revised financial statements were not provided to the auditors until February 16, 1999.

Internal Controls. The AAA determined that internal controls did not ensure that the FY 1998 Army General Fund Financial Statements contained no material misstatements. There are significant internal control weaknesses associated with the processes, procedures, and accounting systems used to prepare the financial statements. For example, the Army did not have adequate procedures and controls to ensure that amounts reported for general equipment were accurate and complete. Also, the reliability and completeness of program requirements and estimated costs for environmental liabilities were questionable because of financial reporting weaknesses. The Army and the Defense Finance and Accounting Service

have recognized many of the financial reporting weaknesses and reported them in their FY 1998 Annual Statements of Assurance. Details on these matters are discussed in the internal controls section of the AAA audit report.

Compliance With Laws and Regulations. The AAA also identified areas of noncompliance with laws and regulations, which are discussed in more detail in the compliance with laws and regulations section of the AAA audit report. For example, under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, the AAA work disclosed that financial management systems did not comply with Federal financial management system requirements; applicable Federal accounting standards; and the U.S. Government Standard General Ledger at the transaction level. Also, the Defense Finance and Accounting Service Indianapolis Center's compilation of financial data from field activities and other sources into the Army FY 1998 General Fund Financial Statements was not in compliance with applicable laws and regulations. The Defense Finance and Accounting Service Indianapolis Center's use of status and expenditure data is an unacceptable method of compiling the Army General Fund Financial Statements.

Review of Army Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent work conducted by the AAA, we reviewed the audit approach and planning and monitored progress at key points. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the AAA work on the FY 1998 Army General Fund Financial Statements from February 24, 1998, to March 1, 1999, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the AAA disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosure *

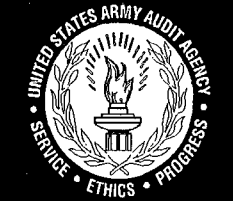
* The Enclosure is included in Exhibit 2, pages 11-12.

Exhibit 2. AAA Audit Report, "Army's Principal Financial Statements for Fiscal Year 1998: Summary Audit Report"

U.S. Army Audit Agency

Army's Principal Financial Statements for Fiscal Year 1998

Summary Audit Report



18 February 1999
Audit Report: AA 99-158

DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of the Auditor General
3101 Park Center Drive
Alexandria, VA 22302-1596

18 February 1999

Secretary of the Army

This report summarizes the results of our efforts to audit the Army's Principal Financial Statements for the fiscal year ended 30 September 1998. We performed our work pursuant to the Chief Financial Officers Act of 1990 as amended by the Government Management Reform Act of 1994.

We could not 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 to satisfy ourselves as to the fairness of the data presented.

This report doesn't contain recommendations, but it does include brief discussions of our results and conclusions. More detailed discussions of our results and conclusions are in various supporting audit reports (see Annex C).

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

FRANCIS E. REARDON, CPA
The Auditor General

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BACKGROUND

Financial Statements

Federal agencies are required to submit a set of financial statements, overview and notes that were standardized by the Federal Accounting Standards Advisory Board. The Army is required to prepare these financial statements:

- Balance Sheet.
- Statement of Net Cost.
- Statement of Changes in Net Position.
- Statement of Budgetary Resources.
- Statement of Financing.

In addition, the Army must report required supplemental stewardship information. The major component of this is National Defense Property, Plant and Equipment, which is composed of weapon systems and support property, plant and equipment used in the performance of military missions.

Accounting Services

The Defense Finance and Accounting Service has a primary role in the Army's financial operations. It performs much of the Army's accounting services and prepares the Army's annual financial statements. The Accounting Service—subordinate to the Under Secretary of Defense (Comptroller)—owns and operates most of the accounting systems used to account for the Army's resources and, since its establishment in 1991, has capitalized most of the Army's accounting offices in CONUS. The Army has retained ownership and operational control of accounting offices supporting the Army National Guard and U.S. Army Corps of Engineers, all overseas accounting offices, and some of the associated accounting systems.

All offices that account for Army resources—both those offices belonging to the Accounting Service and those belonging to the Army—report accounting data to the Defense Finance and Accounting Service-Indianapolis Center, which uses the data to prepare summary financial reports. Additional information about the financial systems and

the associated reporting structure is in the Overview portion of the Army's Annual Financial Report.

Audit Services

For the Army's FY 98 financial statements, the Inspector General, DOD delegated audit responsibility, including rendering the audit opinion, to U.S. Army Audit Agency. The Inspector General, DOD assisted us by performing required audit work at the Indianapolis Center. The work consisted of examining the processes that the Indianapolis Center used to compile and summarize accounting data and to prepare the Army's financial statements. Accordingly, we reviewed and evaluated applicable audit programs and summary memos that we relied on. In addition, our audit work on existence and completeness testing of the Army's real property databases was a coordinated effort with the Inspector General, DOD and the U.S. General Accounting Office.

Federal Accounting Standards

Office of Management and Budget Bulletin 97-01 (Form and Content of Agency Financial Statements) identifies eight Statements of Federal Financial Accounting Standards (SFFAS) that Federal agencies are to follow. In the event that agencies engage in transactions that are not addressed by these standards, agencies are to adhere to the following hierarchy for providing sources of generally accepted accounting principles for the Federal Government:

1. Individual standards agreed to by the Director of the Office of Management and Budget, the Comptroller General and the Secretary of the Treasury and published by Office of Management and Budget and the General Accounting Office.

2. Interpretations related to the standards issued by the Office of Management and Budget in accordance with procedures outlined in its Circular A-134 (Financial Accounting Principles and Standards).

3. Requirements contained in Office of Management and Budget's Form and Content Bulletin in effect for the period covered by the financial statements.

4. Accounting principles published by other authoritative standard-setting bodies and other authoritative sources (a) in the absence of other guidance in the first three parts of this hierarchy, and

(b) if the use of such accounting principles improves the meaningfulness of the financial statements.

The DOD Financial Management Regulation extends this hierarchy downward by specifying three additional sources:

5. United States Government Standard General Ledger, published by the Department of the Treasury, Financial Management Service, through its Treasury Financial Manual.

6. Policies and guidance published in the DOD Financial Management Regulation.

7. Interim policies and guidance issued by the Office of the Under Secretary of Defense (Comptroller) through various memorandums.

Internal Controls

Internal controls over financial reporting should provide management with reasonable (but not absolute) assurance that:

- Assets are safeguarded against loss and unauthorized use or disposition.

- Transactions are executed in accordance with budgetary authority and laws and regulations.

- Transactions are recorded properly to permit the preparation of financial statements in accordance with guidance issued by the Office of Management and Budget.

Because of inherent limitations in any internal control, errors or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

AUDITOR'S REPORT

DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of the Auditor General
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Alexandria, VA 22302-1596

Secretary of the Army

As required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the U.S. Army prepared the accompanying General Fund financial statements for fiscal year 1998. As delegated by, and in coordination with, the Inspector General, DOD, we were engaged to audit these statements. The financial statements are the responsibility of Army management. Our responsibility is to express an opinion on these statements based on our audit.

We were unable to express an opinion on these financial statements because:

- Inadequate accounting systems, insufficient audit trails, and procedural problems prevented us from using any practical methods to conduct audit work of sufficient scope to enable us to express an opinion on these financial statements.

- The financial statements weren't prepared in time for us to perform necessary audit work prior to the reporting deadlines established by the Office of Management and Budget.

Therefore, we caution users that the information presented in the financial statements may not be reliable.

Internal controls weren't fully effective to ensure that the financial statements contained no material misstatements. The Army and the Defense Finance and Accounting Service have recognized many financial reporting weaknesses and included them in their FY 98 annual assurance statements.

Our limited audit work didn't identify any instances of unreported failures to comply with laws and regulations related to the Army's financial statements. However, the systems that support the Army's financial statements didn't meet the requirements of the Federal Financial Management Improvement Act of 1996. Specifically, these systems didn't substantially comply with established Federal financial management systems requirements, applicable Federal accounting

management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

As a result of these conditions, we consider the risk of material misstatement in the financial statements to be high.

We performed a limited review of the information in the Overview section of the report and concluded that the financial data in that section may not be reliable since it was derived from the same sources as the financial statements. In addition, we noted some problems in the reporting of performance measures.

We also concluded that the reporting process for Required Supplementary Stewardship Information didn't provide reasonable assurance that the information was accurate and complete. This process related to the Army's change in reporting policies for FY 98 to comply with Statements of Federal Financial Accounting Standards. The change resulted in removing national defense equipment from the Balance Sheet and reporting it as Required Supplementary Stewardship Information.

We performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 98-08 (Audit Requirement for Federal Financial Statements).

FRANCIS E. REARDON, CPA
The Auditor General

18 February 1999

REPORT ON INTERNAL CONTROLS

REPORT ON INTERNAL CONTROLS

Internal controls weren't fully effective to make sure the financial statements didn't contain any material misstatements. As a result, there is a high risk of material misstatements in the financial statements. The Army and Defense Finance and Accounting Service have recognized many material weaknesses and reported them in their FY 98 annual assurance statement on internal management controls. (We discuss this issue in the Report on Compliance With Laws and Regulations beginning on page 33.)

We evaluated and tested relevant financial internal controls related to the reporting of budgetary resources, centralized disbursing procedures, material asset and liability balances, and the compilation process for financial statements at the Defense Finance and Accounting Service-Indianapolis Center. We also evaluated the process for stewardship reporting and followed up on previously identified internal control deficiencies. Because of accounting system deficiencies, we didn't attempt to audit the expenses reported in the Army's statements.

We noted progress in several areas to correct previously identified problems. However, we also identified additional internal control problems and instances where previously agreed-to corrective actions had not been adequately implemented. We consider these problems reportable conditions under standards established by the American Institute of Certified Public Accountants and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements). Reportable conditions represent significant deficiencies in the design or operation of the internal control structure. Material weaknesses are reportable conditions involving deficiencies in the design or operation of internal controls leading to an unacceptable high risk that losses, noncompliance or material misstatements in the financial statements could occur and not be promptly detected.

The Army has recognized that significant problems exist with the processes, procedures, and accounting systems used to prepare its financial statements. To address these problems, the Deputy Assistant Secretary of the Army for Financial Operations, in conjunction with functional experts within and outside the Army, has developed a 5-year strategic plan covering FYs 99-03. The goal of this plan is to achieve an unqualified audit opinion on the Army's financial statements for FY 03.

We summarize the reporting problems in three sections:

- Systems and Procedures.
- Financial Accounts.
- Property Accounts.

Additional information is in our separate supporting reports listed in Annex C.

SYSTEMS AND PROCEDURES

This section addresses three areas:

- Accounting systems.
- Compilation process for financial statements.
- Performance Information.

Accounting Systems

Deficiencies in the accounting and finance systems that account for Army resources constitute the major reason for our inability to render a favorable audit opinion on the Army's financial statements. The accounting systems lack a single standard transaction-driven general ledger—an essential element of control for sound, reliable financial reporting. In addition, the accounting systems don't produce account-oriented transaction files (subsidiary ledgers), and data for physical assets are compiled using "work-around" procedures and data from management systems not intended and not suitable for financial reporting. Consequently, the audit trails necessary to verify and reconcile account balances aren't adequate, and the statement balances aren't auditable by any practical means.

Because of system deficiencies, the Army uses a consolidation of accounting data from source documents, budgetary accounting systems, and multiple field-and department-level entries to produce the financial statements. Army management couldn't provide reasonable assurance that the accounting and non-accounting systems used to record and

report Army financial data were reliable. It also acknowledged the possible existence of material transactions that weren't properly recorded in the accounting records and included in the financial statements.

The Defense Finance and Accounting Service, as functional proponent for the Army's accounting and financial management systems, has reported inadequate general ledger control as a material weakness in its annual statement of assurance since FY 91. The FY 98 statement of assurance cites FY 03 as the estimated target date for correction.

The Accounting Service is working on a new accounting system—the Defense Joint Accounting System—that it believes will resolve many of the problems with existing systems. A test of the Accounting System's support of financial operations is currently being conducted at the Ballistic Missile Defense Organization. The test began in October 1998 and is scheduled to continue through September 1999. A prototype system is to be deployed at Fort Benning in March 2000. Additional testing is planned for other organizations. The results of these tests should indicate the extent to which the system will resolve current reporting problems. However, even if the tests are successful the new system will not be fully fielded for several years. In the interim, the Army will continue to depend on inadequate accounting systems.

Compilation Process for Financial Statements

The Defense Finance and Accounting Service-Indianapolis Center's compilation of financial data from field entities and other sources into the Army's FY 1998 General Fund financial statements wasn't in full compliance with applicable laws and regulations. Improved procedures and internal controls were needed in several areas.

The Indianapolis Center's use of status and expenditure data is an unacceptable method for compiling the financial statements. Taken as a whole, the Army General Fund financial statements will not be auditable until a transaction-driven, integrated accounting system based on general ledger accounting is implemented Armywide.

The Indianapolis Center didn't compile the Army's statements in a timely manner. By prior mutual agreement, the Accounting Service is to provide a working copy of the financial statements and notes to the auditors by 11 December of each year. However, the Indianapolis Center didn't provide the statements until 8 January 1999. The delay in preparing the statements occurred because the Center didn't have a working financial system in place as of 30 September 1998 to prepare the statements. Because of this delay, auditors didn't have adequate

time to audit the financial statements before the deadline set by the Office of Management and Budget.

Footnote disclosure in the statements needed improvement—especially for Fund Balance With Treasury. The Indianapolis Center didn't disclose that the correct balance of a major component of Non-Entity Fund Balance With Treasury couldn't be determined.

The Indianapolis Center made numerous adjustments to the general ledger while preparing the Army's FY 98 financial statements. Two of these adjustments, valued at about $512 billion, were used to force the general ledger to match the status of funds data. The Indianapolis Center posted many equity adjustments to Transfers In and Transfers Out instead of directly to equity. As a result, transfer balances on the Statements of Financing and Net Cost were understated by about $17 billion, and the results of operations was misrepresented.

Performance Information

We did a limited review of performance results information presented in the Overview section. In addition, with respect to internal controls related to performance results determined by management to be key and reported in the Overview and Supplemental Financial and Management Information, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by Office of Management Bulletin 98-08. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such control.

Although our review was limited, we noted certain matters that, in our judgment, could adversely affect the Army's ability to collect, process, record, and summarize performance information and report performance results in accordance with management's criteria. The Army stated in the Overview that one of its goals is to improve readiness. An essential element of this goal is to maintain a certain level of major weapon systems availability relating to mission-capable readiness. During FY 98, U.S. Army Audit Agency completed an audit of the Unit-Level Logistics

System-Ground (Audit Report: AA98-170, 29 April 1998). The audit determined that the Army didn't collect accurate data on equipment readiness. Consequently, the performance results relating to mission-capable readiness were misstated. The proponents for the reporting systems agreed with our recommendations and expect to have the problems resolved by the second quarter of FY 99.

FINANCIAL ACCOUNTS

This section addresses these areas:

- Reporting of budgetary resources.
- Fund Balance With Treasury.
- Accounts receivable.
- Liabilities.
- Progress payments.
- Problem disbursements.
- Military payroll issues.

Reporting of Budgetary Resources

Internal controls over the accounting, processing and reporting of fund balances, obligations and disbursements that we tested at the local level were generally adequate to ensure the reasonableness of the individual transactions submitted for the Statement of Budgetary Resources. However, the statement hadn't been prepared when we completed the audit, couldn't be based on a standard general ledger as required, and would be substantially unusable because the effect of intra-Army transactions wasn't going to be eliminated. In addition, unresolved material weaknesses dealing with military pay could affect the accuracy of the statement.

The accounting systems, key accounting procedures and accounting practices used for preparing the Statement of Budgetary Resources didn't comply with legal and regulatory requirements. The Federal Financial Management Improvement Act of 1996 requires each agency to

implement and maintain financial management systems that comply with Federal financial management systems requirements, applicable Federal accounting standards and the U.S. Standard General Ledger.

Because the systems don't comply with the Act, Indianapolis Center personnel had to rely on fund control data for part of the data reported in the Statement of Budgetary Resources instead of on accounting data from a general ledger as required. Center personnel had to develop crosswalks and complicated formulas to convert the data for the statement. The lack of financial management systems and the use of alternative procedures for preparing financial statements meant that adequate audit trails weren't available to trace summary transactions or balances to source documentation.

Fund Balance with Treasury

We weren't able to attest to the reasonableness of the reported total for Fund Balance With Treasury (about $29.5 billion as of 30 September 1998). Treasury reports showed a net amount of about $704.3 million of unresolved discrepancies between Treasury records and disbursing officer statements of accountability for checks issued. (The total amount of the discrepancies was about $1.8 billion.) Although a large discrepancy existed as of 30 September 1998, significant improvement occurred during the year. As of 30 September 1997, the net discrepancy between Treasury records and disbursing officer statements of accountability for checks issued was about $1.4 billion, and the total amount of the discrepancies was about $4.4 billion. Also, of the unresolved discrepancies of about $704.3 million at 30 September 1998, only about $56.8 million was more that 6 months old—an indication that the major cause of the discrepancies was timing differences between the two sets of records.

During the year the Accounting Service continued the consolidation of its disbursing functions from Defense Accounting Offices and Defense Finance and Accounting Service Operating Locations to a Centralized Disbursing Directorate at the Indianapolis Center. We found that the internal control procedures used by the Centralized Disbursing Directorate provided reasonable assurance that monthly collection and disbursement activity was recognized, recorded, and reported at the appropriate time to the U.S. Treasury Financial Management Service.

During FY 98 the Centralized Disbursing Directorate disbursed about $34.7 billion in support of worldwide Army and other customer operations. But the procedures used to research and correct discrepancies between the directorate's records of collections and

disbursements and Treasury's records of the same transactions needed management attention. As of 30 September 1998, the net unresolved imbalance between the two sets of records totaled about $101.9 million.

As a percentage of monies the directorate handled on a monthly basis, the imbalance was small and many factors—including the timing of transactions—contributed to the difference. But management needed to examine the differences to make sure they weren't indicators of potentially serious problems. A check cashed and not reported as issued could be caused by checks written on pilfered check stock. In addition, if discrepancies aren't researched and corrected quickly, the research effort becomes progressively more difficult because information needed for the research isn't readily available, and the unresolved imbalance continues to grow.

Accounts Receivable

During FY 98 we focused on following up on two recommendations that the Inspector General, DOD made to the Defense Finance and Accounting Service-Columbus Center to improve the reporting of accounts receivable. The recommendations had not been implemented, and we made additional recommendations to improve the reporting of delinquent accounts receivable. Accounts receivable balances at accountable stations were incomplete because the Columbus Center had not established procedures for reconciling its records to station records. As a result, we estimated that stations understated the delinquent accounts receivable balances by as much as $147 million.

As of 30 September 1998, the Debt Management Office at the Columbus Center reported about $2.8 billion of delinquent accounts receivable. However, only about $26 million of this amount was due to the Army General Fund, and much of it probably wasn't collectable. Therefore, the net effect on the Army's General Fund statements was not material.

Liabilities

In most instances, the liabilities that managers estimated appeared complete. Specifically, there were projects and estimates for all eligible installations, activities and sites. However, continued problems with the various cost estimating systems still affected the value of the approximately $33.6 billion of reported liabilities. We found that:

- Environmental liabilities were generally complete. However, the estimates still lacked documentation, and deficiencies with the cost estimating systems made the reported value questionable.

- Legal liabilities weren't complete due to reporting thresholds, and the reported liability was understated by an unknown amount.

- Liabilities for accounts payable non-Federal were understated by about $400 million due to unrecorded contract holdbacks.

- Panama Treaty implementation liabilities for moving troops and equipment were declining as expected, but the environmental cleanup costs were understated by an unknown amount.

The Army did take corrective actions on our prior audit recommendation to improve the process of reporting environmental restoration liabilities for Army National Guard and Army Reserve Regional Support Command activities. During FY 98, the U.S. Army Environmental Center made sure that installation action plans contained the required information and generally were approved. The approval process helped to ensure that environmental cleanup projects were identified, reported and approved. The process also provided additional assurance about the existence of reported environmental liabilities.

Progress Payments

The Accounting Service had not implemented changes to correct problems we identified during FY 96 with recording holdbacks related to progress payments. In our report on progress payments for the FY 96 financial statements, we recommended that the Accounting Service:

- Modify Army accounting systems to provide for recording of contract holdbacks and use the systems to record holdbacks related to progress payments.

- Make sure actual progress payment rates are used when calculating contract holdback amounts.

- Review trial balances submitted by operating locations and accounting offices to make sure that stations reporting account balances for contract holdbacks also report an account balance for the corresponding asset account.

The Accounting Service agreed to test the recommendation to review trial balances, but didn't agree to modify systems to provide for recording of

contract holdbacks or to make sure actual progress payment rates were used when calculating contract holdback amounts.

On 2 October 1998, the Office of Management and Budget made an adjudication decision that supported our position. We didn't conduct detail audit work in this area for FY 98, but we estimate the following effect:

- Property, Plant and Equipment (Construction-in-Progress) would be understated by about $2.4 billion for the amount of progress payments and holdbacks that should have been recorded in general ledger accounting code 1582, Work in Process-Contractor.

- Advances would be overstated by about $2 billion for the progress payments recorded in general ledger accounting code 1453, Progress Payments Made to Others.

- Accounts Payable Non-Federal would be understated by about $400 million for the unrecorded contract holdbacks.

Because of the limited scope of our assessment, we didn't recommend adjustments to the financial statements. However, the Army should have included a footnote to the statements explaining that the 2 October policy decision, if implemented for the FY 98 statements, would likely result in a $400 million increase in accounts payable and the related asset account; and shifting about $2 billion between asset accounts.

Problem Disbursements

The Army reported significant amounts of problem disbursements at the end of FY 98. There are three categories of problem disbursements: in-transit (disbursements paid by a disbursing office but not yet received by the funded station); unmatched disbursements (specific obligation previously recorded in the accounting records); and negative unliquidated obligations (disbursements applied against specific obligations that exceed the recorded obligation amounts).

We noticed some success in reducing problem disbursements balances, but the totals were short of FY 98 goals. As of 30 September 1998, the Army reported in-transit disbursements of about $876 million, unmatched disbursements of about $2.053 billion and negative unliquidated obligations of about $490 million. These totals represent a decrease in in-transit and unmatched disbursements from FY 97.

However, the negative unliquidated obligation balances increased from the previous year.

The Accounting Service has reported disbursements as a material weakness in its annual assurance statement since FY 96. Primary causes for the problem disbursements were identified as a lack of integration between the entitlement and accounting systems, and errors and delays in posting disbursements to accounting records. The FY 98 assurance statement cites FY 99 as the estimated target date for correction.

The problems identified with disbursements cast doubt on the reliability of the amounts reported in the Army's financial accounts. In response to this situation, the Army and the Accounting Service previously established a Joint Reconciliation Program to increase their combined efforts. These efforts are continuing during FY 99.

Military Payroll Issues

The Army and the Accounting Service continued to make progress in resolving previously reported military payroll issues related to mismatches between the personnel and payroll systems and to soldiers leaving the Army without clearing their debts to the Army.

Military Personnel and Payroll

The Army and the Accounting Service are continuing their efforts to integrate the personnel and pay systems to ensure that only personnel entitled to be paid are actually paid. The primary focus of the integration process is for various pay events (such as base pay, special pay or other entitlements) to be transmitted from personnel systems to finance. The fielding of software upgrades to enhance the interface between personnel and pay systems was scheduled to begin during FY 98. However, initial fielding has been delayed because of on-going problems with the Standard Installation Division Personnel System-3 and the need to improve the baseline system before adding enhancements.

Current projections are to field more than 80 pay events in 4 increments. The first increment will consist of 10 pay events and is projected for fielding during the second quarter FY 00. The remaining three releases of pay events will be fielded at a rate of one grouping each fiscal year through FY 03. The end result will be an integrated system that gives commanders and soldiers more accurate and timely information, reduces fraud and potential overpayments, and improves database integrity between personnel and pay system.

Out-of-Service Debt

The Army has made significant progress in reducing out-of-service debt. During FY98 the Army established a debt management task force headed by the Assistant Secretary of the Army (Financial Management and Comptroller) to identify causes of valid and invalid out-of-service debt. The task force successfully completed its mission and suggested corrective actions. We have also completed a follow-on review of the Army's out-of-service debt for FY 98. These audits and reviews resulted in recommendations to improve the Army's policies and procedures to decrease out-of-service debt. The reports noted some debts were unavoidable and some weren't valid. These efforts have reduced the out-of-service debt from about $43 million during FY 97 to about $26 million during FY 98. In addition, during a separate audit, we validated an annual cost avoidance of about $14 million a year as a result of the Army's efforts to reduce out-of-service debt.

PROPERTY ACCOUNTS

This section addresses these areas:

- Equipment.
- Real property.
- Capital leases.
- Operating materials and supplies.

Equipment

Over the years we have cited several problems with the reported values for military equipment and war reserves. These problems involved equipment in transit, standard unit price updates, and the valuation of equipment at standard price regardless of condition. The Army categorizes most of its equipment as national defense equipment. To comply with Statements of Federal Financial Accounting Standards, the Army removed this equipment from the Balance Sheet and reported it as Required Supplementary Stewardship Information for FY 98. Therefore the problems related to the value of this equipment no longer affected the

Balance Sheet. However, because these problems weren't completely solved, the value removed from the Balance Sheet and reported as a prior period adjustment in the Statement of Changes in Net Position may be misstated.

Our review of the revised reporting process for equipment identified weaknesses in the reporting of quantities of national defense equipment. In addition, significant reporting problems related to general equipment continued.

Stewardship Reporting of National Defense Equipment

The procedures and systems used to identify and report quantities of national defense equipment in the Army's FY 98 financial statements didn't provide reasonable assurance that the data was accurate and complete. The Army took action to identify and report the quantities of its national defense equipment in its Supplemental Stewardship Report. However, there were significant proposed changes to the reporting requirements and numerous attempts to define national defense equipment throughout the reporting period. As a result, the Army didn't have an official approved list of its national defense equipment at the time of our audit and didn't complete the initial version of the Supplemental Stewardship Report until a month after the initial primary financial statements were completed. In addition, the Army's centralized logistics system didn't include all national defense equipment and didn't provide a method to track equipment additions and deletions.

General Equipment

The Army didn't have adequate procedures and controls to ensure that amounts reported for general equipment were accurate and complete. This condition has been addressed in previous audit reports, and the Army has taken some action to establish the necessary procedures and controls. However, additional actions need to be taken.

Before FY 98 the Army established a value for general equipment through certifications from individual property book officers throughout the Army. These certifications were submitted, without supporting documentation, through Defense Accounting Offices to the Defense Finance and Accounting Service-Indianapolis Center. The process didn't provide a sufficient audit trail or a central database of all general equipment. The Army plans to field the Defense Property Accountability System for future reporting, and an initial implementation plan was finalized in January 1999.

Because adequate procedures and controls weren't in place and an automated system to report general equipment wasn't fielded, Army management used a new approach to establish a value for general equipment for the FY 98 financial statements. Army management formed an equipment task force at U.S. Army Materiel Command's Logistics Support Activity and directed it to perform an Army-wide data call to establish a database of Army general equipment.

The task force was successful in fulfilling many of its objectives related to gathering and reporting general equipment data, but it wasn't able to complete the data call by October 1998 as originally planned. Consequently, we weren't able to conduct sufficient audit tests to verify the accuracy of the database. However, based on our limited review of the database and other support for the $8.9 billion reported for general equipment in the draft financial statements, we identified an overstatement of about $7.3 billion.

This was the first time the Army tried to collect detailed information related to general equipment from every unit in the Army and to build a central database that would provide a sufficient audit trail. At the time of our audit, guidance defining national defense and general equipment was still being finalized. Also, about 20 percent of the Army's units still had not responded to the data call. However, we believe the Army is demonstrating a real commitment to obtaining accurate and complete financial statement information related to the value of the Army's general equipment.

Real Property

The Army continued to make progress in areas dealing with rights and obligations, and presentation and disclosure of real property assets. The Army's real property assets included land, buildings, other structures and facilities, and improvements to these assets. Our Armywide testing showed that the Army's real property inventories taken as a whole were reliable as to the existence of recorded assets. Also, by focusing on current reporting requirements, the Army designed and successfully implemented its FY 98 business rules to comply with the reporting of stewardship assets, and the depreciation and recognition of real property assets.

However, the Army's progress was limited by the lack of supporting documentation for the values recorded in its real property databases. This is a DOD-wide problem. In addition, the Army had not corrected some of the guidance and operating problems that prevented us from attesting to the reliability of the real property asset values reported in the FY 96 and FY 97 financial statements. As a result, the real property

values in the FY 98 statements are probably misstated, but the amount of the misstatement is unknown.

To overcome the valuation problem, early in FY 99 DOD contracted with an accounting firm to develop an alternative method to validate the recorded real property costs or to provide estimates for real property costs determined to be inaccurate.

Capital Leases

The Army corrected the most significant reporting problems we previously reported. As a result of revised DOD guidance, the Army reclassified about $5.6 billion (acquisition value) of overseas real property assets from Assets Under Capital Lease to the real property accounts. Also, the Army correctly adjusted and reported its Section 801 family housing leases in its FY 98 financial statements and related footnotes.

In addition, the Indianapolis Center included capital lease information in its annual guidance, as recommended. However, not all the installations identified in our FY 97 review of CONUS capital leases were corrected or correctly reclassified. Four of the seven lease amounts we previously identified as errors or misclassifications, were correctly reclassified as operating leases or Army-owned real property. But two of the remaining leases were incorrectly reclassified as leasehold improvements, and one lease was still incorrectly classified as a capital lease.

Operating Materials and Supplies

Based on guidance from DOD, the Army expenses the inventories of repair parts owned by its combat divisions and separate brigades. We previously reported that we believe the inventories of these units met the definition of operating materials and supplies and that expensing them understated the Army's total assets. This is a DOD issue being reviewed by the Office of the Under Secretary of Defense (Comptroller).

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

The Army isn't yet able to fully comply with the Chief Financial Officers Act of 1990 and related requirements. However, during our review of compliance with laws and regulations, we found no material instances of unreported legal or regulatory infractions.

We tested the Army's compliance with selected provisions of laws and regulations throughout the audit. Instances of noncompliance are reportable if they could result in material misstatements to the financial statements, or if the sensitivity of the matter would cause others to perceive it as significant.

Most of the noncompliance problems we identified were directly or indirectly tied to internal control weaknesses and the Army's inability to fully comply with the Chief Financial Officers Act (and related implementing guidance). We discuss these problems in the Report on Internal Controls.

We also tested and reviewed certain key laws that affected the Army's ability to produce reliable financial statements. We discuss four pertinent laws in the following paragraphs. However, the objective of our audit wasn't to provide an opinion on the Army's overall compliance with laws and regulations, and we do not express such an opinion.

Chief Financial Officers Act

We evaluated the Army's compliance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, and various implementing regulations issued by the Office of Management and Budget and DOD, as they relate to presentation of information in financial statements. The Army and the Accounting Service have made a concerted effort to meet the act's requirements. But current management and accounting systems weren't designed for financial statement reporting, and they can't produce reliable and auditable financial statements. Until system deficiencies are resolved, the Army and the Accounting Service will be unable to produce statements that conform to prescribed accounting guidance. Nevertheless, we have identified areas in which the Army and the Accounting Service can achieve financial reporting improvements over the short term. We discuss these areas and the necessary corrective actions in the Report on Internal Controls, and in the audit reports listed in Annex C.

Anti-Deficiency Act

We evaluated the Army's compliance with the Anti-Deficiency Act as part of our review of the compilation of the financial statements at the Indianapolis Center. Our review at that level didn't identify any potential violations of the act.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act of 1982 requires the Army and the Accounting Service to report annually to the Secretary of Defense about whether their management controls comply with the act's requirements. In their respective FY 98 annual assurance statements, the Army and the Accounting Service reported several management control weaknesses involving noncompliance with prescribed accounting principles, standards and related requirements. The specific weaknesses most directly related to the Army's financial statements follow. Summaries of these weaknesses are in Annex B.

Army Assurance Statement

The Army reported 15 uncorrected material weaknesses for FY 98. The following weaknesses most directly affect the accuracy and reliability of the Army's financial statements:

- Control of National Guard Personnel, Army (NGPA) Federal Funds.
- Unreliable Payroll Data—Reserve Personnel, Army (RPA).
- Equipment In-Transit Visibility.
- Information Systems Security.
- Year 2000 (Y2K) Computer Problem.
- Processing of Reported Potential Violations of the Anti-Deficiency Act.

Defense Finance and Accounting Service Assurance Statement

The Accounting Service reported 47 uncorrected material weaknesses for FY 98. Here are examples of weaknesses that directly affect the accounting data the Indianapolis Center uses to prepare the Army's principal financial statements.

- Inadequate General Ledger Control and Unreliable Financial Reporting.
- Unreliable Financial Reporting of Personal and Real Property.
- Interface Between Contract Payment and Accounting Systems (Negative Unliquidated Obligations (NULO) and Unmatched Disbursements).
- Check Issue Reporting Discrepancies.
- Conformity of Defense Finance and Accounting Service Systems to the Year 2000 Requirements.
- Inadequate Systems Interface Between Computerized Accounts Payable System (CAPS) and Standard Army Finance Systems Redesign (SRD-1).
- Inadequate Military Payroll Reconciliation of Data Elements in the Military Payroll - Reserve Component (DJMS-RC) and Personnel Data System, Central Site Control.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards and the U.S. Government Standard General Ledger at the transaction level. The act also requires that we report on agency compliance with these requirements.

The financial management systems didn't meet all aspects of the Federal Financial Management Improvement Act of 1996. The lack of a single integrated general ledger and the differences between status of appropriation data and the general ledger data caused the financial statement compilation process at the Indianapolis Center to be

complicated and lengthy. The Center made material adjustments to the general ledger data to make it match the status of appropriation data without knowing the reasons for the differences.

The Assistant Secretary of the Army (Financial Management and Comptroller) has stated that the Army cannot provide reasonable assurance that the accounting and non-accounting systems used to record and report Army financial data are reliable because they don't meet the standards set by the Office of Management and Budget. Therefore the Army uses a consolidation of accounting data from source documents, budgetary accounting systems and multiple field- and department-level data inputs to produce the financial statements. The Assistant Secretary noted that solutions to the accounting system deficiencies would take years to correct.

DOD has also acknowledged the existence of problems with the financial systems. In its Annual Statement of Assurance for FY 98, the Accounting Service stated:

> Financial data in DOD is not always adequately compiled and maintained within accounting and other financial management systems, is not fully compliant with regulatory an statutory requirements, and is unable to produce fully auditable financial statements.

In addition, in September 1998 DOD published the first DOD Biennial Financial Management Improvement Plan that identifies many impediments to achieving auditable financial statements, including financial management system deficiencies. The Biennial Plan is intended to be a strategic financial improvement plan that addresses financial management systems. However, it doesn't identify specific remedial actions for financial management system deficiencies nor time frames to implement such actions.

Federal Accounting Standards

As noted in the Report on Internal Controls, the Army's financial statements weren't prepared in full accordance with Federal accounting standards. This is primarily due to the lack of adequate accounting systems.

In addition, the combined Statement of Budgetary Resources and related required supplementary information for the FY 98 financial statements wasn't prepared in accordance with Federal accounting standards. These standards require a principal combining Statement of Budgetary Resources and related required supplementary information by individual

budget accounts. Though not material, this departure from Federal accounting standards was due to DOD's improper implementation of the standards.

AUDIT SCOPE AND METHODOLOGY

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 internal 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 related to:

    - Reporting of Budgetary Resources.
    - Centralized Disbursing.
    - National Defense Equipment.
    - General Equipment.
    - Real Property.
    - Liabilities.
    - The overall process for compiling the financial statements.

- Conducted limited followup reviews on previously reported problems and recommendations related to:

    - Accounting systems.
    - Payroll.
    - Progress payments.
    - Problem disbursements.

- Operating materials and supplies.

- Evaluated compliance with selected laws and regulations.

- Reviewed the Overview section of the Annual Financial Report for consistency with data reported in the financial statements and to test the existence and completeness assertions over performance information.

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

We performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements).

ANNEXES

FINANCIAL STATEMENTS AND NOTES

Department of the Army
CONSOLIDATED BALANCE SHEET
As of September 30, 1998
($ in thousands)

	FY 1998
ASSETS	
1 Entity Assets:	
A. Intragovernmental	
1. Fund Balance with Treasury (Note 2)	$29,508,603
2. Investments, Net (Note 4)	1,074
3. Accounts Receivable, Net (Note 5)	1,288,550
4. Other Assets (Note 6)	0
B. Total Intragovernmental	$30,798,227
C. Investments, Net (Note 4)	0
D. Accounts Receivable, Net (Note 5)	195,297
E Loans Receivable and Related Foreclosed Property, Net (Note 7)	0
F Cash and Other Monetary Assets (Note 3)	0
G. Inventory and Related Property, Net (Note 8)	21,289,242
H. General Property, Plant and Equipment (Note 9)	14,209,766
I. Stewardship Assets (National Defense PP&E, etc.)	See Stewardship Statement
J. Other Assets (Note 6)	2,825,272
K. Total Entity Assets	$69,317,804
2. Non-Entity Assets:	
A Intragovernmental	
1. Fund Balance with Treasury (Note 2)	124,241
2. Accounts Receivable, Net (Note 5)	0
3. Other Assets (Note 6)	0
B. Total Intragovernmental	$124,241
C. Accounts Receivable, Net (Note 5)	38,960
D. Cash and Other Monetary Assets (Note 3)	151,399
E. Other Assets (Note 6)	0
F. Total Non-Entity Assets	$314,600
3 Total Assets	$69,632,404

The accompanying notes are an integral part of these statements.

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FINANCIAL STATEMENTS AND NOTES

Department of the Army
CONSOLIDATED BALANCE SHEET
As of September 30, 1998
($ in thousands)

	FY 1998
LIABILITIES	
4. Liabilities Covered by Budgetary Resources:	
A Intragovernmental	
1. Accounts Payable	$1,781,953
2. Environmental Cleanup (Note 11)	0
3. Debt (Note 10)	0
4. Other Liabilities (Notes 11, 12, and 15)	676,340
B Total Intragovernmental	$2,458,293
C. Accounts Payable	1,471,085
D. Liabilities for Loan Guarantees	0
E. Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 13)	0
F. Environmental Cleanup (Note 11)	0
G. Other Liabilities (Notes 11, 12, and 15)	2,783,574
H. Total Liabilities Covered by Budgetary Resources:	$6,712,952
5. Liabilities Not Covered by Budgetary Resources:	
A. Intragovernmental	
1 Accounts Payable	0
2 Debt (Note 10)	0
3. Environmental Cleanup (Note 11)	0
4 Other Liabilities (Notes 11, 12, and 15)	334,013
B. Total Intragovernmental	$334,013
C. Accounts Payable	0
D. Debt (Note10)	0
E. Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 13)	2,145,293
F. Environmental Cleanup (Note 11)	23,020,002
G. Other Liabilities (Notes 11, 12, and 15)	1,229,074
H. Total Liabilities Not Covered by Budgetary Resources:	$26,728,382
6. Total Liabilities	33,441,334
NET POSITION	
7. Unexpended Appropriations (Note 14)	$25,584,267
8. Cumulative Results of Operations	10,606,803
9. Total Net Position	$36,191,070
10. Total Liabilities and Net Position	$69,632,404

The accompanying notes are an integral part of these statements.

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FINANCIAL STATEMENTS AND NOTES

Department of the Army
CONSOLIDATED STATEMENT OF NET COST
For the period ending September 30, 1998
($ in thousands)

	FY 1998
1. Program Costs	
A. Intragovernmental	$17,099,580
B. With the Public	54,148,769
C. Total Program Cost	$71,248,349
D. Less: Earned Revenues	(7,869,295)
E Net Program Costs	$63,379,054
2 Costs Not Assigned to Programs	0
3. Less: Earned Revenues Not Attributable to Programs	0
4. Deferred Maintenance (Note 17)	
5. Net Cost of Operations	$63,379,054

Additional information included in Note 16.

The accompanying notes are an integral part of these statements.

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FINANCIAL STATEMENTS AND NOTES

Department of the Army
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the period ending September 30, 1998
($ in thousands)

		FY 1998
1	Net Cost of Operations	$63,379,054
2	Financing Sources (Other than Exchange Revenues):	
	A. Appropriations Used	64,157,828
	B. Taxes (and Other Non-exchange Revenue)	0
	C. Donations (Non-exchange Revenue)	0
	D. Imputed Financing	809,963
	E. Transfers-In	2,855,602
	F. Transfers-Out	(836,379)
3.	Net Results of Operations (Line 2 less Line 1)	$3,607,960
4.	Prior Period Adjustments (Note 18)	(144,536,432)
5.	Net Change in Cumulative Results of Operations	(140,928,472)
6	Increase (Decrease) in Unexpended Appropriations	(1,702,014)
7.	Change in Net Position	(142,630,486)
8.	Net Position-Beginning of Period	178,821,556
9.	**Net Position-End of Period**	$36,191,070

Additional information included in Note 18.

The accompanying notes are an integral part of these statements.

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FINANCIAL STATEMENTS AND NOTES

Department of the Army
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the period ending September 30, 1998
($ in thousands)

	FY 1998
BUDGETARY RESOURCES:	
1. Budget Authority	$63,270,813
2. Unobligated Balance - Beginning of Period	4,529,059
3. Net Transfers Prior-Year Balance, Actual (+/-)	(246,471)
4. Spending Authority from Offsetting Collections	10,923,337
5. Adjustments	5,599,944
6 Total Budgetary Resources	$84,076,682
STATUS OF BUDGETARY RESOURCES:	
7. Obligations Incurred	79,557,460
8 Unobligated Balances - Available	3,275,857
9. Unobligated Balances - Not Available	1,243,365
10. Total Status of Budgetary Resources	$84,076,682
OUTLAYS:	
11. Obligations Incurred	79,557,460
12 Less: Spending Authority From Offsetting Collections and Adjustments	(16,738,871)
13 Obligated Balance, Net - Beginning of Period	25,105,434
14. Obligated Balance Transferred, Net	0
15. Less: Obligated Balance, Net - End of Period	(24,984,253)
16. Total Outlays	$62,939,770

Additional information included in Note 19.

The accompanying notes are an integral part of these statements.

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FINANCIAL STATEMENTS AND NOTES

Department of the Army
COMBINED STATEMENT OF FINANCING
For the period ending September 30, 1998
($ in thousands)

	FY 1998
1. OBLIGATIONS AND NONBUDGETARY RESOURCES:	
A. Obligations Incurred	$79,557,460
B. Less: Spending Authority for Offsetting Collections and Adjustments	(16,738,871)
C. Donations Not in the Entity's Budget	0
D. Financing Imputed for Cost Subsidies	809,963
E. Transfers-In (Out)	2,019,223
F. Exchange Revenue Not in the Entity's Budget	368,909
G. Other	160,589
H. Total Obligations as Adjusted and Nonbudgetary Resources	$66,177,273
2. RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:	
A. Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided	1,361,581
B. Costs Capitalized on the Balance Sheet	3,268,281
C Financing Sources That Fund Costs of Prior Periods	3,725,247
D Other	(12,894,724)
E. Total Resources That Do Not Fund Net Costs of Operations	($4,539,615)
3. COSTS THAT DO NOT REQUIRE RESOURCES:	
A. Depreciation & Amortization	903,733
B. Revaluation of Assets & Liabilities	98,505
C. Other	1,121
D. Total Costs That Do Not Require Resources	$1,003,359
4. Financing Sources Yet to be Provided	738,037
5. Net Cost of Operations	$63,379,054

Additional information included in Note 20.

The accompanying notes are an integral part of these statements.

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DEPARTMENT OF THE ARMY

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies:

A. Basis of Presentation:

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

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 Defense Finance and Accounting Service (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. Department level budget execution reports are prepared from installation budget execution 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 required information.

B. Reporting Entity:

The Army's primary mission is to train and equip forces for the conduct of prompt and sustained combat operations on land. The accompanying audited financial statements account for all funds for which the Army is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The audited financial

statements are presented on the accrual basis of accounting as required by federal financial accounting standards.

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

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
21X4275 - Army Initiative Guaranteed Loan Financing Account

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

General Funds
21X0810 - Environmental Restoration
21*7020 - Military Construction, Family Housing
21*7025 - Operation & Maintenance, Family Housing
21*1705 - National Board for the Promotion of Rifle Practice, Army
21X1805 - Salaries and Expenses, Cemeterial Expenses, Army
21*2010 - Military Personnel, Army
21*2020 - Operations & 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 - Operations & 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, Army
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
21X6208 - Amounts Withheld for Group Life Insurance, National Guard Members
21X6275 - Withheld Income Taxes
21X6434 - Servicemen's Group Life Insurance Funds, Suspense, Army
21*6763 - Gains and Deficiencies on Exchange Transactions, Army
21X6875 - Budget Clearing Account
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
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 Canceled 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
21R5194 - Royalties for Use of DoD-Military Insignia and Trademarks
21R5285 - Forest and Wildlife Conservation, Military Reservations
21R5286 - National Science Center - Facilities
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

C. 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 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 only be used 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.

D. Basis of Accounting:

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

The principal statements provided for the Army were prepared as consolidated statements net of intra-entity transactions. However, the OMB has deferred the requirement for consolidating statements for the Statement of Budgetary Resources and the Statement of Financing. For FY 1998 and FY 1999 the Army will prepare combining statements for the Statement of Budgetary Resources and the Statement of Financing.

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. Certain expenses, such as annual and military leave earned but not taken, are not funded when accrued. Such expenses are financed in the period in which payment is required. Therefore, for the Army's general funds, an amount due from future financing sources (appropriations to be provided) is recognized as an offset to equity in the Statement of Financing.

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. However, it should be noted that 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.

The Army's 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. Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security.

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

FERS - Army contributes to FERS, Social Security (SS) and Thrift Savings Plan 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. Below is the Army's contributions to the retirement plans and FERS Thrift Savings Plan (TSP).

Retirement Contributions
(Thousands)

	FY 98
CSRS	$309,420
FERS	380,437
MRS	3,817,773
Social Security	349,985
	$4,857,615
TSP	$141,354

The Army funds a portion of the pension benefits under these retirement plans. No amounts are reported as assets or liabilities in the Balance Sheet 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.

The Army recognizes an imputed expense for civilian employee pensions and other retirement benefits in the statement of net cost; and recognizes imputed revenue for the civilian employee pensions and other retirement benefits in the statement of changes in net position.

The Army's Components sell assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, the Army has authority to sell defense articles and services to foreign countries. Customers are required to make payments in advance to a trust fund maintained by the Department of the Treasury from which the Military Services are reimbursed for the cost of administering and executing the sales. In fiscal year 1998, the Army received reimbursements of $337.1 thousand for assets and services sold under the Foreign Military Sales program.

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

The Army's financial resources are maintained in both the DFAS and the U.S. Treasury accounts. The account balances with Treasury and with DFAS represents the aggregate of all Army appropriations. The Army has traditionally reported on its

financial statements amounts reported by the Treasury instead of the balance reflected inits departmental general ledger. Frequently, the account balances at the Treasury do not agree with the account balances on the departments financial records. To comply with the OUSD(C) "Alternative Methodology" policy, the account balances reported in these financial statements represent the balances in the department's financial records instead of the balances reported by Treasury. Any differences resulting from this change in reporting have been disclosed. See Note 2, "Fund Balance with Treasury".

Fund Balance With Treasury, as reported, 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 adjustments represent Army's in-float (undistributed) disbursements/collections for transactions that have been reported by a disbursing station but not recorded by the appropriate accountable station. See Note 2, "Fund Balance with Treasury".

The Army is an agent for the Department of the Treasury for cash on hand. Cash in the accounts of Army officials was reported in the financial statements as "Cash and Other Monetary Assets". Other cash reported included imprest funds 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 and Other Monetary Assets".

H. Foreign Currency:

The Department conducts a significant portion of its operations overseas. Gains and losses from foreign currency fluctuations are computed as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of the fiscal year and are recognized and reported in the net cost statement. Similar material gains and losses for appropriations not recognized in the net cost statement are provided at Note 3.

I. Accounts Receivable:

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other entities. Allowances for uncollectible accounts are based on an analysis of collection experience by fund type. Accounts receivable are 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 reported by a disbursing station but not recorded by the appropriate accountable station. Accounts Receivable that were established under accounts that have been canceled are included in these financial statements. See Note 5, "Accounts Receivable, Net".

J. Loans Receivable: Not applicable

K. Inventories and Related Property:

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. Gains or losses that result from valuation changes for inventory are not recognized and reported in the Statement of Net Cost. Such gains or losses are, however, reflected in the inventory asset valuation and related cumulative results of operations account in the Balance Sheet. See Note 8, "Inventory and Related Property, Net" .

L. Investments in U.S. Government Securities:

Investments in U.S. Government securities are reported at cost, net of unamortized premiums or discounts Premiums or discounts are amortized into interest income over the term of the investment. The reporting entity's intent is to hold investments to maturity. Consequently, no provision is made for unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity. See Note 4, "Investments, Net".

M. General Property, Plant and Equipment:

The Department, as encouraged by the Federal Accounting Standards Advisory Board (FASAB), elected to implement the Statement of Federal Financial Accounting Standard No. 11, "Amendments to Accounting for Property, Plant and Equipment - Definitional Changes, in FY 1998. As a result of that decision, the costs of National Defense PP&E are not reported on the Balance Sheet beginning in FY 1998. Any such previously reported costs have been charged to the Net Position of the Entity, and the adjustment is shown as a prior period adjustment. Information on National Defense PP&E is reported in the Required Supplemental Stewardship Information section

Certain financial reporting requirements have changed and, consequently, four P&E categories have been established-- General PP&E, National Defense PP&E, Heritage Assets, and Stewardship Land. General PP&E is valued at historical acquisition cost plus capitalized renovations or improvements. General PP&E assets are capitalized when the cost equals or exceeds the DoD capitalization threshold (currently $100,000) and have a useful life of two or more years. All General PP&E, other than land, is depreciated consistent with the requirements in the Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant and Equipment." Heritage Assets defined as "multi-use" are treated as General PP&E in the financial statements and are also depreciated.

N. Prepaid and Deferred Charges:

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

O. Leases:

As of September 30, 1998, the Army was committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for the rental of equipment, space, rights of way, and operating facilities. The Army owns substantially all of the facilities and real property used in its domestic operations. Capital assets overseas are purchased with appropriated funds, however; title is retained by the host country.

Prior guidance concerning reporting property assets at overseas locations as assets under Capital Lease has been rescinded. Current DoD accounting policy prohibits reporting buildings and other structures and facilities as assets under capital lease unless a specific agreement with the host nation exists, and the agreement is the equivalent of an installment purchase and meets one of the criteria in Chapter 7 of Volume 4 of DODFMR 7000.14. Capital lease liabilities are recognized in the financial statements for Section 801 Family Housing. See Note 12.

P. Contingencies:

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

Q. Accrued Leave:

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

R. Equity:

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

Cumulative results of operation represents the difference, since fund inception of the activity, between expenses and losses and financing sources including appropriations, revenue, and gains. Beginning in FY 1998, this will include the cumulative amount of donations and transfers of assets in and out without reimbursement. In addition, there will no longer be a segregation of cumulative amounts related to investments in capitalized assets, such as PP&E, or a separate negative amount shown for future funding requirements.

S. Treaties for Use of Foreign Bases:

The Army has the use of land, buildings, and other facilities which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the Army continued use of these properties until the treaties expire. These assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Army In the event treaties or other agreements are terminated and use of foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets after negotiations between the United States and the host country have been concluded, to determine the amount due the United States for such capital investments. Operating expenses for overseas bases are included in the Statement of Net Cost.

T. Comparative Data:

Comparative data from FY 97 has not been included because this is the first year for which financial statements are prepared using the OMB 97-01 prescribed formats. In future years comparative data will be presented to provide an understanding of changes in the financial position and operations of the Army.

U. Undelivered Orders:

The Army was obligated to pay for undelivered orders (goods and services that have been ordered but not yet received) amounting to $21.2 Billion at fiscal year-end. No liability for payment has been established in the financial statements because goods/services have yet to be delivered.

Note 2. Fund Balances with Treasury:

This account balance represents the aggregate of all Army appropriations reflected in the departmental-level general ledger rather than the amounts reported by Treasury. The schedule below identifies, by fund type, the status of the resources maintained in the Army's 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".

A. Fund and Account Balances

($ in thousands)

	Trust Funds	Revolving Funds	Appropriated Funds	Other Fund Types	Total
A Entity Fund and Account Balances:					
Unobligated Balance Available:					
Available	$736	$185,763	$2,991,851	$97,507	$3,275,857
Restricted	0	0	1,243,365	0	1,243,365
Reserve For Anticipated Resources	0	0	0	0	0
Obligated Balance, Net	55	55,333	24,923,180	10,813	24,989,381
Unfunded Contract Authority	0	0	0	0	0
Unused Borrowing Authority	0	0	0	0	0
Total Entity Treasury Balance	$791	$241,096	$29,158,396	$108,320	$29,508,603
B Non-Entity Fund and Account Balance:	$0	$0	$0	$124,241	$124,241

C. Other Information.

The aggregate fund balance of canceled and closed accounts that have been reopened for the processing accounting adjustments and remained open at the end of the fiscal year is $4.5 billion . Balances related to the reopened canceled and closed accounts have no effect on these financial statements and have been disclosed for information purposes only.

For Entity Fund Balance with Treasury, the account balances in the Department of the Army's financial records differed from the Treasury by $3,692 thousand.

Note 3. Cash and Other Monetary Assets:

($ in thousands)

	Entity Assets	Non-Entity Assets
A Cash	$0	$137,227
B. Foreign Currency	0	14,172
C. Other Monetary Assets	0	0
D. Total Cash, Foreign Currency, and Other Monetary Assets	$0	$151,399

E Other Information· None

Note 4. Investments, Net:

The Army Gift Fund was established to control and account for the disbursement and use of monies donated to the Army and the receipt of interest arising from investment of such donations. The related earnings are allocated to appropriate Army activities to be used in accordance with the directions of the donor. As of September 30, 1998, the Army reported $ 1 Million of investments.

($ in thousands)

	(1) Cost	(2) Amortization Method	(3) Amortized Premium/ (Discount)	(4) Investments Net	(5) Other Adjust-ments	(6) Market Value Disclosure
A Intragovernmental Securities:						
(1) Marketable	$1,074		$0	$1,074	$0	$1,074
(2) Non-Marketable Par Value	0		0	0	0	0
(3) Non-Marketable Market Based	0		0	0	0	0
Subtotal	$1,074		$0	$1,074	$0	$1,074
(4) Accrued Interest	0					0
Total	$1,074					$1,074
B. Other Securities:						
(1) Commercial Paper	$0		$0	$0		$0
(2) Other	0		0	0		0
Subtotal	0		0	0		0
(3) Accrued Interest	$0					$0
C. Total	$1,074					$1,074

D. Other Information: None

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.

($ in thousands)

	(1) Gross Amount Due	(2) Allowance For Estimated Uncollectibles	(3) Net Amount Due
A. Entity Receivables:			
Intragovernmental	$1,288,550	N/A	$1,288,550
With the Public	220,136	24,839	195,297
B. Non-Entity Receivables.			
Intragovernmental	0	N/A	0
With the Public	$54,382	$15,422	$38,960

C. Allowance Method Used:

D. Other Information: Accounts receivable include reimbursements receivable and refunds receivable such as out-of-service debts from former service members, contractor debt and unused travel tickets.

Note 6. Other Assets:

($ in thousands)

A. Other Entity Assets:

1 Intragovernmental	
(a) Assets Returned for Credit	$0
(b) Other	0
Total Intragovernmental	$0
2. Other	
(a) Outstanding Contract Financing Payments	$0.00
(b) Advances	2,802,221
(c) Other Natural Resources	23,051
Total Other	$2,825,272

B Other Information related to entity assets:
"Natural Resources" is based on the revised method of calculating the value of timber reserves reported in the financial statements. FY 98 values are based only on the number of board feet planned to be sold in FY 99.

C. Other Non-entity Assets:

1. Intragovernmental	
(a)	$0
(b)	0
Total Intragovernmental	$0
2. Other	
(a)	$0
(b)	0
Total Other	$0

D Other Information related to non-entity assets: None

Note 7. Direct Loans and Loan Guarantees, Non-Federal Borrowers : Not applicable to Army's Financial Statements.

Note 8. Inventory and Related Property

Note 8A. Inventory
($ in thousands)

	(1) Inventory Amount	(2) Allowance for (Gains) Losses	(3) Inventory, Net	(4) Valuation Method
1 Inventory Categories:				
(a) Held for Current Sale	$669,313	$225,396	$443,917	LAC
(b) Held in Reserve for Future Sale	0.00	0 00	0.00	
(c) Excess, Obsolete and Unserviceable	28,553	0	28,553	NRV
(d) Held for Repair	457,627	0	457,627	LAC
Total	$1,155,493	$225,396	$930,097	

2. Restrictions on Inventory Use, Sale, or Disposition: None

3. Other Information:
Inventory held for current sales is contained in the revolving fund, Army Ammunition Working Capital Fund (AAWCF) "Inventory and Related Property, Net" includes FY 1998 AAWCF adjustments for unserviceable, excess and obsolete inventory The adjustments were based on purpose codes that identify the condition of the asset. The components of the Army's inventory are shown above

Legend: Valuation Methods
LAC = Latest Acquisition Cost
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other

Note 8B. Operating Materials and Supplies (OM&S)
($ in thousands)

	(1) OM&S Amount	(2) Allowance for (Gains) Losses	(3) OM&S, Net	(4) Valuation Method
1 OM&S Categories:				
(a) Held for Use	$935,825	$0	$935,825	LAC
(b) Held in Reserve for Future Use	19,424,069	823	19,423,246	LAC
(c) Excess, Obsolete and Unserviceable	74	0	74	LAC
Total	$20,359,968	$823	$20,359,145	

2 Restrictions on operating materials and supplies:

3 Other Information: None

Legend Valuation Methods
LAC = Latest Acquisition Cost
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other

Note 8C. Stockpile Materials

Note 8. Recap of Inventory and Other Related Property:
($ in thousands)

	Amount
Inventory, Net	$930,097
Operating Materials and Supplies, Net	20,359,145
Stockpile Materials, Net	0
Seized Property, Net	0
Forfeited Property, Net	0
Total	$21,289,242

Note 9. General (PP&E) Net:

($ in thousands)

	(1) Depreciation Method	(2) Service Life	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
Major Classes of Assets					
A Land	N/A	N/A	$344,191	N/A	$344,191
B. Structures, Facilities, & Leasehold Improvements	SL	20-40	30,081,892	19,882,476	10,199,416
C ADP Software	SL	5	14,553	255	14,298
D Equipment	SL	5-10	2,744,395	1,086,242	1,658,153
E Assets Under Capital Lease	SL	Various	167,535	77,242	90,293
F Construction-in-Progress			1,903,415	N/A	1,903,415
G. Other			0	0	0
Total			$35,255,981	$21,046,215	$14,209,766

I. Other Information: None

Legends:

Column (1) above
Depreciation Methods

SL = Straight Line
O = Other (explain)

Note 10. Debt:

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.

Note 11. Other Liabilities:

The schedules on the following pages 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" (With the Public).

Legal actions brought by employees of the Army for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the Department of Labor (DOL). DOL bills Army annually as DOL claims are paid. However, payment on these bills is deferred two years to allow for funding through the budget process. Army has recorded $334 million for DOL bills that, while received, are not yet payable out of current appropriations.

Note 11A. Environmental Cleanup:
($ in thousands)

1. Environmental Cleanup Liabilities Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
(a) Intragovernmental			
(1) Accrued Cleanup Costs	$0	$0	$0
(2) Other Environmental Liabilities	0	0	0
Total	$0	$0	$0
(b) With the Public			
(1) Accrued Cleanup Costs	$0	$0	$0
(2) Other Environmental Liabilities	0	0	0
Total	$0	$0	$0

2 Environmental Cleanup Liabilities Not Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
(a) Intragovernmental			
(1) Accrued Cleanup Costs	$0	$0	$0
(2) Other Environmental Liabilities	0	0	0
Total	$0	$0	$0
(b) With the Public			
(1) Accrued Cleanup Costs	$23,020,002	$0	$23,020,002
(2) Other Environmental Liabilities	0	0	0
Total	$23,020,002	$0	$23,020,002

3 Other Information:

Stated liabilities do not include a Department of the Army liability for responses to unexploded ordnance and other constituents (UXO(C)) at active, inactive, closed, transferring, or transferred military ranges. The Army acknowledges the existence of a significant liability in this area. However, costs are not yet estimable because DoD is presently engaged with Environmental Protection Agency and other stakeholders in developing the regulatory structure and standards to address UXO(C) response actions.

Note 11B. Other Liabilities:
($ in thousands)

1. Other Liabilities Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
a Intragovernmental			
(1) Advances from Others	$0	$399,409	$399,409
(2) Deferred Credits	0	0	0
(3) Deposit Funds and Suspense Account Liabilities	0	276,931	276,931
(4) Liability for Borrowings to be Received	0	0	0
(5) Liability for Subsidy Related to Undisbursed Loans	0	0	0
(6) Other Liabilities	0	0	0
(7) Resources Payable to Treasury	0	0	0
Total	$0	$676,340	$676,340
b With the Public			
(1) Accrued Funded Payroll and Benefits	$0	$2,468,984	$2,468,984
(2) Advances from Others	0	311,306	311,306
(3) Deferred Credits	0	0	0
(4) Deposit Funds and Suspense Accounts	0	0	0
(5) Other Liabilities	0	3,284	3,284
Total	$0	$2,783,574	$2,783,574

3 Other Liabilities not Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
a Intragovernmental			
(1) Accounts Payable - Canceled Accounts	$0	$0	$0
(2) Custodial Liability	0	0	0
(3) Deferred Credits	0	0	0
(4) Liability for Borrowings to be Received	0	0	0
(5) Other Actuarial Liabilities	0	0	0
(6) Other Liabilities	0	334,013	334,013
Total	$0	$334,013	$334,013
b With the Public			
(1) Accounts Payable Canceled	$949	$0	$949
(2) Accrued Cleanup/Cost	0	0	0
(3) Accrued Unfunded Liabilities	0	947,437	947,437
(4) Deferred Credits	0	0	0
(5) Other Liabilities	0	138,300	138,300
(6) Prior Liens Outstanding on Acquired Collateral	0	0	0
Total	$949	$1,085,737	$1,086,686

4 Other Information:
Other Liabilities consists of estimated costs to implement the Panama Canal Treaty Accrued Unfunded Liabilities consists of Civilian Leave - $733,389 thousand and Military Leave - $214,048 thousand

The following schedule provides a breakout showing the various liabilities that account for the majority of recorded "Environmental Cleanup Liabilities" not covered by budgetary resources. Liabilities relating to Chemical Demil and Environmental Restoration- BRAC Programs are recognized as required by the Statement of Federal Financial Accounting Standards (SFFAS) Number 5.

	(Thousands)
Chemical Demil Program Stockpile	9,100,000
Chemical Demil Program Non-Stockpile	1,100,000
Environmental Restoration	6,159,116
Environmental Restoration-FUDS	5,164,333
Environmental Restoration-BRAC	1,322,000
Environmental Compliance	129,141
Low Level Radioactive Waste Cleanup	24,460

- **Environmental Compliance/Restoration** - Liabilities for the Army's Environmental Program are primarily comprised of estimates to clean up contamination at Army installations.

- **Radioactive Waste** - Liabilities are recognized or disclosed as a result of having to correct the results of improper handling and disposal of low level radioactive waste.

Note 12. Leases:

As of September 30, 1998, the Army was committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for the rental of equipment, space, rights of way, and operating facilities. The Army owns substantially all of the facilities and real property used in its domestic operations. Current DoD accounting policy prohibits reporting buildings and other structures and facilities as assets under capital lease unless a specific agreement with the host nation exists, and the agreement is the equivalent of an installment purchase and meets one of the criteria in Chapter 7 of Volume 4 of DODFMR 7000.14. Consequently, no capital lease liability related specifically to overseas real property assets is required for financial statement recognition. However, the schedules on the following page pertain to Operating and Capital Leases for Section 801 family housing leases (privately owned housing leased by the Army) that have been recognized in the financial statements.

Note 12. Leases
($ in thousands)

A Entity as Lessee:

1 Capital Leases:

a. Summary of Assets Under Capital Lease:

Land and Buildings	$167,535
Machinery and Equipment	$0
Other	$0
Accumulated Amortization	$77,242

b Description of Lease Arrangements: The current portion of the liability is $7,735 thousand and the noncurrent portion is $109,422 thousand. Future executory costs of $(36,114) thousand were based on the FY 97 acutal executory costs. Imputed interest in the amount of $(58,490) thousand was necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases

c Future Payments Due:

	Asset Category			
Fiscal year	(1)	(2)	(3)	Totals
Year 1	$20,785	$0	$0	$20,785
Year 2	20,785	0	0	20,785
Year 3	20,785	0	0	20,785
Year 4	20,785	0	0	20,785
Year 5	20,785	0	0	20,785
After 5 Years	107,836	0	0	107,836
Total Future Lease Payments	$211,761	$0	$0	$211,761
Less: Imputed Interest				
Executory Costs (e g., taxes)	(94,604)	0	0	(94,604)
Net Capital Lease Liability	$117,157	$0	$0	$117,157

d. Liabilities Covered by Budgetary Resources	$0
e Liabilities Not Covered by Budgetary Resources (Included in Line 5G of the Balance Sheet)	$117,157

2. Operating Leases:

a Description of Lease Arrangement: NA

b Future Payments Due:

	Asset Category			
Fiscal year	(1)	(2)	(3)	Totals
Year 1	$16,369	$0	$0	$16,369
Year 2	16,369	0	0	16,369
Year 3	16,369	0	0	16,369
Year 4	16,369	0	0	16,369
Year 5	16,369	0	0	16,369
After 5 Years	81,580	0	0	81,580
Total Future Lease Payments	$163,425	$0	$0	$163,425

B Entity as Lessor:

1 Capital Leases:

a Description of Lease Arrangements:

b Future Rejected Receipts:

	Asset Category			
Fiscal year	(1)	(2)	(3)	Totals
Year 1	$0	$0	$0	$0
Year 2	0	0	0	0
Year 3	0	0	0	0
Year 4	0	0	0	0
Year 5	0	0	0	0
After 5 Years	0	0	0	0
Total Future Capital Lease Receivable	$0	$0	$0	$0

2 Operating Leases:

a Description of Lease Arrangement:

b. Future Projected Receipts:

	Asset Category			
Fiscal year	(1)	(2)	(3)	Totals
Year 1	$0	$0	$0	$0
Year 2	0	0	0	0
Year 3	0	0	0	0
Year 4	0	0	0	0
Year 5	0	0	0	0
After 5 Years	0	0	0	0
Total Future Operating Leases Receivable	$0	$0	$0	$0

Note 13. Pensions and Other Actuarial Liabilities:

Future workers' compensation figures are provided by the Department of Labor. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's, June 10, 1997 economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	Year 2	Year 3	Year 4	Year 5 and thereafter
6.24%	5.82%	5.60%	5.45%	5.40%

The amount of unfunded FECA liability accrued as of September 30, 1997 was $1.3 Billion. A corresponding amount has been established as a future funding requirement.

Note 13. Pensions and Other Actuarial Liabilities
($ in thousands)

Major Program Activities	(1) Actuarial Present Value of Projected Plan Benefits	(2) Assumed Interest Rate (%)	(3) Assets Available to Pay Benefits	(4) Unfunded Actuarial Liability
A. Pension and Health Benefits				
1 Military Retirement Pensions	$0	0.00%	$0	$0
2 Military Retirement Health Benefits	0	0.00%	0	0
B Insurance/Annuity Programs				
1 _____	$0	0.00%	$0	$0
2. _____	0	0.00%	0	0
3 _____	0	0.00%	0	0
Total	$0		$0	$0
C Other				
1. FECA	$1,312,970	0.00%	$0	$1,312,970
2. TERA	228	0.00%	0	228
3 VSIP	832,095	0.00%	0	832,095
Total	$2,145,293		$0	$2,145,293
D Total Lines A+B+C	$2,145,293		$0	$2,145,293

E. Other Information
1. Actuarial Cost Method Used:
2. Assumptions

Note 14. Unexpended Appropriations:

($ in thousands)

A Unexpended Appropriations	
(1) Unobligated	
a Available	$3,442,577
b. Unavailable	891,247
(2) Undelivered Orders	21,250,443
Total	$25,584,267

B Other Information:

Unexpended appropriations is the 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.

Note 15. Contingencies:

($ in thousands)

Included in Line 5G of the Balance Sheet are the following contingent liabilities.

Litigation, Claims, and Assessments	$24,000
Liabilities Attributable to Relocation	1,231
Total	$25,231

The following items do not meet the criteria for liability recognition but are disclosed because there is a reasonable possibility of loss to the Army:

Litigation, Claims, and Assessments	$29,000
Chemical Demolition, Non-Stockpile Program	$8,700,000

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

Note 16A. Suborganization Program Costs: N/A

Note 16B. Cost of National Defense PP&E:

The cost of acquiring, constructing, improving, reconstructing, or renovating National Defense PP&E assets in FY 98 was approximately $4.1 Billion.

Note 16E. Exchange Revenue:

Revenues are amounts earned as a result of normal operations while gains generally relate to all other transactions resulting in a net gain. However, in some limited cases, they may consist of interest income and profits from the sales of securities. The basis for recording an amount as a revenue shall be the delivery of goods and services, a billing to the ordering activity, or the establishment of an accrual evidenced by constructive delivery or percentage of completion.

Note 16H Gross Cost and Earned Revenue by Budget Functional Classification:

($ in thousands)

	Budget Function Code	Gross Cost	Earned Revenue	Net Cost
A. Department of Defense Military	51	$71,248,349	$7,869,295	$63,379,054

Note 16I Other Disclosures:

Imputed expenses in the amount of $809,963 thousand are included in Line 1.A. on the Stateme Net Costs. These expenses relate to service costs for civilian employee pensions, health benefit pr and group life insurance. See Note 18.B.

Note 17. Deferred Maintenance on Property, Plant, and Equipment:

Note 17A Summary of Deferred Maintenance Amounts by Category of Property, Plant, and Equipment
As of September 30, 1998
($ in thousands)

(a) Category	(b)
1. General Property, Plant, and Equipment	$27,910,000
2 National Defense Property, Plant, and Equipment	534,871
3. Heritage Assets	0
4. Stewardship Land	0
Total	$28,444,871

Note 17B General Property, Plant, and Equipment Deferred Maintenance Amounts
As of September 30, 1998
($ in thousands)

(a) Property Type/Major Class	(b)
1 Personal Property	$0
2. Real Property	
A Buildings	27,910,000
B. Structures	0
C. Land	0
D. Total Real Property	$27,910,000
3. Total	$27,910,000

Narrative Statement: The $27,910 thousand reflected above represents deferred RPM (Real Property Maintenance) costs for FY 98. Shown are quality improvement costs to condition code 1 for RPM funded facilities. This total excludes NAF funded activities, dependent schools, other DoD funded facilities, Army Working Capital Fund, Commissary and AAFES facilities.

Note 17C National Defense Property , Plant and Equipment Deferred Maintenance Amounts
As of September 30, 1998
($ in thousands)

(a) Major Type	(b)
1. Aircraft	$54,600
2. Ships	0
3. Missiles	41,700
4. Combat Vehicles	31,900
5. Other Weapons Systems	406,671
Total	$534,871

Narrative Statement:

Army Reserves and National Guard component cannot be broken down by major types at this time The amount of $269,071 thousand pertaining to Army Reserves and National Guard was included under Other Weapons Systems.

Note 18. Footnote Disclosures Related to the Statement of Changes in Net Position:

Note 18.A. Prior Period Adjustments
($ in thousands)

A Prior Period Adjustments	
1. Changes in Accounting Standards	($144,536,432)
2 Errors and Omission in Prior Year Accounting Reports	0
3. Other	0
Total	($144,536,432)

B. Other Information:

Due to the change in accounting standards for Property, Plant, and Equipment, a prior period adjustment was recorded for the FY97 Balances of National Defense Property, Plant, and Equipment removed from the Balance Sheet (see Footnote 1M).

Note 18.B. Other Disclosures to the Statement of Changes in Net Position:
($ in thousands)

A. Other Information:

Imputed financing relates to service costs for civilian employee pensions, health benefit programs, and group life insurance. Service costs represent an estimate of the amount of funds which, if accumulated annually and invested over the careers of covered employees, will be enough to pay their future benefits. Imputed financing represents the difference between the service cost and the contributions by and for their employees.

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

($ in thousands)

1. Net amount of Budgetary Resources Obligated for Undelivered Orders at the End of Period	$21,250,443
2. Available Borrowing and Contract Authority at the End of Period	$0

3. Other information:

The statement does not include any amounts for which the Department of the Treasury is willing to accept corrections to cancelled appropriation accounts, in accordance with SFFAS Number 1. The Consolidated Statement of Budgetary Resources does not include eliminating entries. Eliminating entries would have significantly reduced the amounts reported.

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

Amounts reported on Line 2.B., Costs Capitalized on the Balance Sheet are estimates based on best available data. Recognized liabilities not covered by budgetary resources total $26,728,381 thousand and are reported on the Balance Sheet as Environmental Cleanup, Military Retirement Benefits and Other Employment Related Actuarial Liabilities, and Other Liabilities.

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

Not applicable to Army

Note 22. Inter-Agency Eliminations with Other Federal Agencies:

($ in thousands)

Part A DoD Eliminations of Seller Activity With Other Federal Agencies Arrayed by DoD Entities

	Treasury Index (TI) or TI and Appropriation	Column A Accounts Receivable with Other Federal Entities	Column B Revenue with Other Federal Entities	Column C Unearned Revenue from Other Federal Entities
Department of the Army, General Funds	21	$208,018	$276,264	$2,759

Part B DoD Eliminations of Seller Activity With Other Federal Agencies Arrayed by Other Federal Agencies

	Treasury Index	DoD Accounts Receivable Arrayed by Customer	DoD Revenue Arrayed by Customer	DoD Unearned Revenue by Customer
Executive Office of the President, Defense Security Assistance Agency	11	$2,186	$7,504	($15)
Department of Agriculture	12	1,447	1,976	0
Department of Commerce	13	1,925	349	0
Department of the Interior	14	873	2,523	(548)
Department of Justice	15	16,410	19,165	157
Department of Labor	16	44	45	0
Department of State	19	2,635	2,734	577
Department of the Treasury	20	4,727	14,177	1,410
Office of Personnel Management	24	0	0	0
Nuclear Regulatory Commission	31	(10)	144	0
Department of Veterans Affairs	36	1,454	1,684	655
General Services Administration	47	97,953	130,967	0
National Science Foundation	49	0	0	0
Federal Emergency Management Agency	58	3,378	4,262	0
Environmental Protection Agency	68	870	1,787	104
Department of Transportation	69	18,643	12,846	427
Agency for International Development	72	0	0	0
Small Business Administration	73	0	0	0
Department of Health and Human Services	75	7,137	7,994	1,017
National Aeronautics and Space Administration	80	13,414	27,289	403
Department of Housing and Urban Development	86	1,568	681	0
Department of Energy	89	1,863	4,387	59
Department of Education	91	0	0	0
Social Security Administration	28	0	0	0
Unidentifiable Federal Agency Entity	00	19,537	29,088	(1,487)
Miscellaneous Identifiable Federal Agencies Not Required to Prepare CFO Audited Financial Statements	00	11,964	6,662	0
Total		$208,018	$276,264	$2,759

Note 23. Other Disclosures: As of September 30, 1998, there was a significant decrease in the number of aged unresolved check issue discrepancies between the records of Treasury and Army compared to September 30, 1997. As a result, check issue discrepancies improved from $4.4 billion reported in FY97 to $1.8 billion reported for FY98. These obvious improvements point to the efforts and advances made in the check issue reporting process which have significantly enhanced the ability of the financial community to monitor and initiate research in a more timely fashion than in the past.

REPORTED MATERIAL WEAKNESSES

In the annual assurance statements for FY 98, the Army and the Defense Finance and Accounting Service both reported uncorrected material internal control weaknesses that directly relate to the Army's financial statements. This annex summarizes those weaknesses.

Army Assurance Statement

The Army reported 15 uncorrected material weaknesses for FY 98, and 7 directly relate to the accuracy and reliability of the Army's financial statements.

1. Control of National Guard Personnel, Army (NGPA) Federal Funds. A material weakness persists in the controls over expenditures made from open allotment pay accounts. Based on the lack of controls the current pay and accounting system does not produce reliable data on which to base the budgeting models. The accounts identified represent a significant Total Obligation Authority of about $2 to $3 billion. Consequently, a small fluctuation in the pay model can result in significant budget discrepancies and Anti-Deficiency Act violations. (Identified: FY 93. Resolution Target: FY 00.)

2. Unreliable Payroll Data - Reserve Personnel, Army (RPA). The Defense Joint Military Pay System has systemic management control weaknesses that affect the Army Reserve's ability to ensure that obligations are properly established. These weaknesses include the lack of automated interfaces between the Active and Reserve Component payroll systems to ensure that Army Reserve soldiers are not duplicated in both systems and that individual pay elements are posted to the proper appropriation. The Accounting Service is responsible for the ultimate correction of these weaknesses. (Identified: FY 93. Resolution Target: FY 00.)

3. Equipment In-Transit Visibility. Systems interface and logistics process problems cause a significant portion of the in-transit records displayed by the Continuing Balance System-Expanded to be invalid. Equipment involved had been received and reported as on hand by the receiving units, but the receipt transactions didn't close out the shipment (in-transit) records. As a result, the Army didn't have reliable data about the value of equipment in-transit, and the value of in-transit equipment reported in the Army's financial statements was misstated by

a significant but unknown amount. (Identified: FY 96. Resolution Target: FY 00.)

4. **Information Systems Security.** Unauthorized personnel have successfully attacked and penetrated the Army's unclassified automated information systems and telecommunications networks. These intrusions have lead to the identification of systemic deficiencies in systems and network security design, and implementation. To correct these weaknesses, Army leadership has, in the Command and Control Protect Program Management Plan, outlined the measures it will take to ensure the Army's portion of the Defense information infrastructure is adequately protected. (Identified: FY 96. Resolution Target: FY 03.)

5. **Year 2000 (Y2K) Computer Problem.** Due to the expense or lack of memory capability, many computer systems were designed to use a two-digit "year in century" instead of four digits. As a result, computer systems and applications including hardware, software and firmware that use dates or perform date- or time-sensitive calculations may generate incorrect results beyond 1999. If computer systems aren't assessed, fixed, tested and certified compliant before the year 2000, an undetermined number of weapons, logistics, financial, personnel, medical, and decision support systems will fail. To correct this weakness, Army leadership has developed and implemented a Y2K action Plan. (Identified: FY 97. Resolution Target: FY 99.)

6. **Processing of Reported Potential Violations of the Anti-deficiency Act.** A material weakness exists in the Army National Guard's processing of potential Anti-Deficiency Act violations. The Guard is significantly late in submitting reports to the Assistant Secretary of the Army (Financial Management and Comptroller) and not within required guidelines. The late submission of reports could cause the Army and the Office of the Secretary of Defense to miss their required submission dates. It also gives the appearance of a lack of concern for proper stewardship of funds. (Identified: FY 98. Resolution Target: FY 99.)

7. **Pollution Prevention.** A disconnect between policy setting and funding execution has created an Army accountability issue within the environmental program. This management deficiency has resulted in a failure to identify and implement various pollution prevention requirements and opportunities that could reduce "total ownership cost" for the Army. This could result in the Army not meeting the requirements of Federal, State and local regulations on pollution prevention, and thus likely increasing future costs and potential liabilities associated with environmental compliance and restoration. (Identified: FY 98. Resolution Target: FY 00.)

Defense Finance and Accounting Service Assurance Statement

The Accounting Service reported 47 uncorrected material internal control weaknesses for FY 98. Some of the reported weaknesses that most directly affect the Army's financial statements are paraphrased in the following paragraphs.

1. Inadequate General Ledger Control and Unreliable Financial Reporting. The Accounting Service has a material internal control weakness in general ledger and financial reporting that is attributable to many factors in the control environment, accounting and related systems, and control procedures. Overall, the accounting systems don't have general ledgers that permit adequate recording and reporting of financial transactions. Each DOD accounting system has its own general ledger, and efforts to implement the U.S. Government Standard General Ledger are continuing. Effective control procedures over accounting and reporting will be impossible until a single, standard general ledger is developed and implemented in the DOD systems. (Identified: FY 91. Resolution Target: 03.)

2. Unreliable Financial Reporting of Personal and Real Property. DOD components don't comply with statutory Comptroller General and Under Secretary of Defense (Comptroller) requirements in accounting for real and personal property. Lacking mandated controls and required procedures, the DOD cannot adequately account for real and personal property and provide assurance for the adequacy of controls as required by the Federal Managers' Financial Integrity Act. Many accountable property officers use manual procedures to report summary values because property and accounting systems aren't integrated. Recent financial statement audits found unreliable financial balances of real and personal property. Reasons can be attributable to problems with feeder reports from the accountable property officer, such as not applying the DOD-prescribed capitalization threshold, not reporting all assets including costs of in-house projects under construction and government-furnished property, and using standard price instead of acquisition cost. (Identified: FY 91. Resolution Target: FY 02.)

3. Interface Between Contract Payment and Accounting Systems (Negative Unliquidated Obligations (NULO) and Unmatched Disbursements). Both negative unliquidated obligations and unmatched disbursements are evidence of the same type of weakness: the presence of error conditions in the interface between systems and accounting systems. In DOD, payment operations for the most part are distinct from accounting, even when the payment operations is a component of the same accounting and finance office. Differences between payment

systems and accounting systems are not revealed until payments are improperly recorded in the accounting systems. Large out-of-balances exist in undistributed disbursement and collection accounts and in unliquidated obligation accounts. The capabilities of the accounting systems don't permit the research of unmatched document numbers. Personnel performing reviews aren't adequately trained, and review-sampling methods are inadequate. (Identified: FY 90. Resolution Target: FY 00.)

4. **Check Issue Reporting Discrepancies.** The Treasury Department has reported discrepancies between checks issued as reported by disbursing offices and the monthly summary of checks issued. When these reports don't agree, either the overall liability for outstanding checks or the agencies' accounts are misstated. Failure to reconcile this difference in a timely manner prevents the detection of the possible loss or theft of government funds. (Identified: FY 97. Resolution Target: FY 99.)

5. **Conformity of Defense Finance and Accounting Service Systems to the Year 2000 Requirements.** Computer software that uses two-digit year fields will be unable to differentiate between the years 1900 and 2000. This means that sequencing of dated, date arithmetic and date logic could be adversely affected. The Accounting Service inventoried all its systems (accounting, finance and administrative) and analyzed each system to determine the year 2000 effect. Approximately 80 application systems will need to be modified to become year 2000-compliant. (Identified: FY 96. Resolution Target: FY 00.)

6. **Inadequate Systems Interface Between Computerized Accounts Payable System (CAPS) and Standard Army Finance Systems Redesign (SRD-1).** The ASCII file used to update SRD-1 with accounts payable payment information can be changed. The file is unprotected and can be accessed by anyone who can read and/or change an ASCII file. As a result, any individual with access to the file can alter the information. Also, the Computerized Accounts Payable System does not have the capability to restrict access to the "remit to" address file for associates computing vendor payments. The lack of internal controls, edit checks and audit trail in the Accounts Payable System has the potential for fraud and the misuse of government funds. (Identified: FY 98. Resolution Target: FY 00.)

7. Inadequate Military Payroll Reconciliation of Data Elements in the Military Payroll – Reserve Component (DJMS-RC) and Personnel Data System, Central Site Control. Comparison mismatches between the Reserve Component Master Military Pay File and Standard Installation Division Personnel System United States Army Reserve data must be reviewed to prevent the existence of a "ghost" pay account and aid in the prevention of fraud, waste and loss of funds. The interface between the Personnel System and Reserve Component Master Military Pay File provides database mismatches in such volume that the central site is unable to complete the requirement. Lack of appropriate supervisory review, incomplete or incorrect transaction processing, and lack of review at the field level has created such a significant number of administrative errors that the mismatch listing is an ineffective managerial control tool. The potential exists for undetected fraudulent and erroneous payments. (Identified: FY 98. Resolution Target: FY 05.)

SUPPORTING AUDIT REPORTS

1. Financial Reporting of Accounts Receivable (AA 98-241, 28 May 1998)

2. Financial Reporting of Wholesale Ammunition (AA 99-107, 31 December 1998)

3. Financial Reporting of Equipment, Reportable Item Control Codes (AA 99-108, 31 December 1998)

4. Financial Reporting of Equipment, Followup Issues (AA 99-112, 15 January 1999)

5. Centralized Disbursing, Defense Finance and Accounting Service-Indianapolis Center, (AA 99-115, 27 January 1999)

6. Financial Reporting of Budgetary Resources (AA 99-125, 3 February 1999)

7. Supplemental Stewardship Reporting of National Defense Equipment (To be published)

8. Financial Reporting of Army General Equipment (To be published)

9. Financial Reporting of Real Property and Leases (To be published)

11. Financial Reporting of Liabilities, (To be published)

12. Accountability of Real Property (To be published)

13. Audit of the Compilation of the Army's FY 98 Financial Statements at the Defense Finance and Accounting Service–Indianapolis Center (Inspector General, DOD, Project #xxx-xxxx)

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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
Commanding General, 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, Pacific
- 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 Missile Command
- U.S. Army Communications-Electronics Command
- U.S. Army Industrial Operations Command
- U.S. Army Tank-automotive and Armaments Command
- U.S. Army Logistics Integration Agency
- U.S. Army War Reserves Support Command
- XVIII Airborne Corps and Fort Bragg
- I Corps and Fort Lewis
- 3d Military Police Group, U.S. Army Criminal Investigation Command
- 6th Military Police Group, U.S. Army Criminal Investigation Command

Executive Director, U.S. Army Materiel Command Logistics Support Activity

ANNEX D

Directors
- Armament and Chemical Acquisition and Logistics Activity
- 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

Inspector General, Department of Defense
Directors
- Defense Finance and Accounting Service
- Defense Finance and Accounting Service-Indianapolis Center
- Defense Finance and Accounting Service-Columbus Center
- Defense Intelligence Agency
- Defense Logistics Agency
- Defense Logistics Studies Information Exchange

Auditors General
- Air Force Audit Agency
- Naval Audit Service

Audit Team Members

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

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