Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE INDUSTRIAL FUND - COMMUNICATIONS SERVICES ACTIVITY FINANCIAL STATEMENTS FOR FY 1991

Report Number 92-121

June 30, 1992

Department of Defense

The following abbreviations and acronyms are used in this report.

ADP.....Automated Data Processing
CFO.....Chief Financial Officer
CSIF.....Communications Services Industrial Fund
DSN.....Defense Switched Network
FMFIA.....Federal Managers' Financial Integrity Act
OMB.....Office of Management and Budget
Title 2.....Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies"

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

June 30, 1992

MEMORANDUM FOR SECRETARY OF DEFENSE
COMPTROLLER AND CHIEF FINANCIAL OFFICER, DOD
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Audit Report on the Defense Industrial Fund - Communications Services Activity Financial Statements for FY 1991 (Report No. 92-121)

We are providing this final report for your information and use, and for use by Congress. This audit was required by the Chief Financial Officers Act of 1990. The Act requires the Inspector General to render an opinion on the fairness of the financial statements of the Defense Industrial Fund - Communications Services Activity, in accordance with DoD accounting policies and procedures and generally accepted accounting principles, and to report on the adequacy of internal controls and compliance with laws and regulations.

The audit determined that, with certain exceptions detailed in Part I, the Principal Statements present fairly, in all material respects, the assets, liabilities, and net financial position of the Defense Industrial Fund - Communications Services Activity as of September 30, 1991, and the results of its operations, cash flows, and reconciliation to budget for the year then ended, in accordance with DoD accounting policies and procedures. With one exception, the Notes to the Financial Statements generally meet the requirements of the "DoD Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity," November 13, 1991, and Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies."

We also concluded that there were internal control weaknesses in classifying accounting transactions and accounting for leased assets, and that the Communications Services Activity was not in compliance with all applicable regulations. However, managers of the Activity were taking steps to correct the weaknesses.

An industrial fund needs to have accurate accounting data and financial statements so that customers can be accurately charged for their share of operating costs and managers at all levels can evaluate the efficiency of operations. Management recognized that the accounting system used during our review was significantly flawed. The usefulness of the financial statements will remain limited until the Activity's accounting system is more reliable. An improved accounting system should be operational by the end of FY 1992. Details of the accounting systems are discussed in Part IV, in management's "Overview to Financial Statements."

The courtesies extended to the audit staff during the audit are appreciated. We commend management for revising the original FY 1991 financial statements to resolve discrepancies pointed out during our audit. If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 614-1682 (DSN 224-1682), or Mr. Donald G. Stoll, Project Manager, at (703) 693-0445 (DSN 223-0445). The distribution of this report is listed in Part V, Appendix C.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General

AUDIT REPORT NO. 92-121 **June 30, 1992**
(Project No. 1FH-2001)

FINAL REPORT ON THE DEFENSE INDUSTRIAL FUND - COMMUNICATIONS SERVICES ACTIVITY FINANCIAL STATEMENTS FOR FY 1991

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act requires an annual audit of the Defense Industrial Fund - Communications Services Activity, commonly known as the Communications Services Industrial Fund (CSIF). Congress provided a $20 million corpus when the CSIF was established, and the Military Departments donated about $93 million of various communications assets to the CSIF in FY 1987. The CSIF does not receive an annual appropriation but is to operate on a not-for-profit basis, recouping the cost of operations by assessing its customers a surcharge for the services provided. In FY 1991, the CSIF had sales of $1.3 billion and a net profit of $42 million after the audit adjustments.

Objectives. Our audit objective was to determine whether the CSIF financial statements for FY 1991 were presented fairly in accordance with generally accepted accounting principles for Federal entities. We also evaluated the internal controls established for the CSIF and assessed compliance with applicable laws and regulations that could have a material effect on the financial statements.

Audit Results. The auditors identified needed accounting adjustments to the original FY 1991 CSIF financial statements dated March 10, 1992, that reduced total assets by $26.0 million (6.3 percent), reduced total liabilities by $49.2 million (20.9 percent); increased total equity by $23.3 million (13.3 percent); and increased the net results of operations by $13.7 million (47.8 percent). The CSIF managers agreed with the proposed adjustments and we received the revised financial statements on June 20, 1992.

Auditor's Opinion on the Financial Statements. With the exceptions described in Part I, in our opinion, the Principal Statements, including the Notes to the Principal Statements, present fairly, in all material respects, the assets, liabilities, and net financial position of the CSIF as of September 30, 1991, and the results of its operations, cash flows, and reconciliation to budget for the year then ended, in accordance with DoD accounting policies and procedures. With one exception, the Notes to the Principal Statements generally meet the requirements of the "DoD Guidance on Form and Content of

Financial Statements on FY 1991 Financial Activity," November 13, 1991, and Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies," (Title 2). We also concluded that there were significant internal control weaknesses in classifying accounting transactions and accounting for leased assets, and that the CSIF was not in compliance with all applicable laws and regulations. These weaknesses and the noncompliances contributed to the need to make significant adjustments to the original FY 1991 financial statements.

Internal Controls. Part II contains details of internal control matters regarding proper classification of transactions, and identification of assets under capital lease. Except for the matters noted, we believe there is reasonable assurance that the control structure meets the internal control objectives.

Compliance with Laws and Regulations. Part III explains instances of material noncompliance with the DoD Accounting Manual and Title 2 regarding accounting for orders for goods and services and recording assets as capital leases. Except for these items, we believe that the CSIF complied in all material respects with applicable laws and regulations.

Benefits of the Audit. The audit significantly improved the accuracy of the FY 1991 financial statements; consequently, managers will have more accurate data to use in their decisionmaking processes.

Recommendations. No recommendations were made because ongoing actions by management should resolve the weaknesses in internal controls and ensure compliance with laws and regulations.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 614-6303.

PART I -

INDEPENDENT AUDITOR'S OPINION ON THE PRINCIPAL STATEMENTS OF THE DEFENSE INDUSTRIAL FUND - COMMUNICATIONS SERVICES ACTIVITY FOR FY 1991

PART I -
INDEPENDENT AUDITOR'S OPINION ON THE PRINCIPAL STATEMENTS OF THE DEFENSE INDUSTRIAL FUND - COMMUNICATIONS SERVICES ACTIVITY FOR 1991

TO THE SECRETARY OF DEFENSE:

We have audited the Principal Statements and the Notes to the Principal Statements of the Defense Industrial Fund - Communications Services Activity, commonly known as the Communications Services Industrial Fund (CSIF), as of and for the year ended September 30, 1991. These statements are the responsibility of the CSIF management, which operates under the oversight of the Defense Information Systems Agency (formerly the Defense Communications Agency). Our responsibility is to express an opinion on these statements based on our audit.

Scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and Office of Management and Budget (OMB) Bulletin No. 91-14, "Audit Requirements for Federal Financial Statements," September 10, 1991. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements, including the Notes to the Principal Statements, are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in these statements, including the notes. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the statements. We believe that our audit provides a reasonable basis for our opinion. This financial statement audit was made during the period April 1991 through May 1992.

Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal entities are to be promulgated by the Comptroller General and the Director, OMB, based on advice from the Board. In the interim, Federal agencies are to follow the applicable accounting standards contained in agency accounting policies, procedures manuals, and related guidance.

Limitations of scope. Section D.3.a. of management's "Overview to Financial Statements" (Part IV of this report) explains that donated and procured assets, believed to be valued at over $97 million (about 20 percent of total gross assets), were recorded by CSIF personnel at estimated values, without

verification of their existence. In accordance with the Federal Managers' Financial Integrity Act, "Property and Inventory Management" was reported by management as a material internal control weakness in FYs 1990 and 1991 because there was no assurance that all the assets existed or, if they existed, that they were valued correctly. The weakness is expected to be corrected by the end of FY 1992. Because this internal control weakness was being corrected, we did not attempt to verify the quantities or value of these assets.

In the accompanying "Report on Financial Position," the CSIF excluded from assets and liabilities certain lease obligations for equipment that should be capitalized in order to conform to generally accepted accounting principles. Data were not available for us to determine the total unrecorded value of the lease obligations within the time constraints of the audit. However, we believe that the effects on the property and debt will significantly affect the CSIF financial position.

The "Equity" section of the "Report on Financial Position" (Line 22. b., "Cumulative Results") includes a "Reserve for Capital Assets Depreciation" of $46.8 million (23.5 percent of total equity) that we did not verify. Supporting documentation could not be located to determine whether the amount was reasonable and accounted for appropriately. For this reason, the validity of Note 9 to Line 22 was also not reviewed.

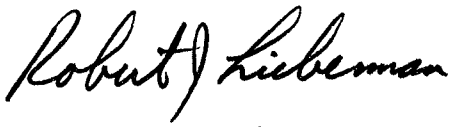
In the accompanying "Report on Reconciliation," "Net Disbursements" are understated by $21.3 million (1.7 percent) because the adjustment, "Accrued expenses not requiring outlays" of $72,174,809, was overstated by $21.3 million. Management adjusted the amount so that it agreed with the net disbursements reported on the "Report of Budget Execution" (Form 1176) for the period ending September 30, 1991. The "Report of Budget Execution" was prepared and submitted to the Defense Finance and Accounting Service for consolidation with data from the Defense Logistics Agency Clothing and Textile Industrial Fund, and was submitted to the Department of the Treasury prior to adjusting the financial statements based on our audit results.

Except for cash balances, we did not determine the validity of the prior year's unaudited yearend figures that form part of the basis for the FY 1991 financial statements.

Opinion on the financial statements. In our opinion, except as discussed above, the "Report on Financial Position" presents fairly, in all material respects, the assets, liabilities, and equity of the CSIF as of September 30, 1991. The "Report on Operations," "Report on Cash Flow," and "Report on Reconciliation," except as discussed above, also fairly present the results of operations, cash flow, and reconciliation for the year then ended in accordance with DoD accounting policies and

procedures. Further, with the exception discussed above, the Notes to the Principal Statements generally meet the requirements of the "DoD Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity," November 13, 1991, and Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies" (Title 2).

Other financial information. Our audit was conducted for the purpose of forming an opinion on the Principal Statements described above. We also reviewed the financial information presented in management's "Overview to Financial Statements of the Defense Industrial Fund - Communications Services Activity (CSIF) for Fiscal Year 1991." Such information has not been audited by us and, accordingly, we do not express our opinion on this information. However, in accordance with Section 6.a.(3), (4), and (5) of OMB Bulletin No. 91-14, the adequacy of the information contained in the "Overview" is addressed in Part III, our "Report on Compliance with Laws and Regulations."



Robert J. Lieberman
Assistant Inspector General
for Auditing

PART II -

REPORT ON INTERNAL CONTROLS

PART II - REPORT ON INTERNAL CONTROLS

Introduction. We have audited the Principal Statements of the Defense Industrial Fund, Communications Services Activity, commonly known as the Communications Services Industrial Fund (CSIF), as of and for the year ended September 30, 1991, and have issued our report dated June 30, 1992.

Objectives and scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States and OMB Bulletin No. 91-14. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements.

In planning and performing our audit of the Principal Statements of the CSIF for the year ended September 30, 1991, we considered its internal control structure. The purposes of this consideration were to determine our auditing procedures for the purpose of expressing our opinion on the Principal Statements, and to determine whether the internal control structure met the objective identified in the preceding paragraph. This included obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances; and for those significant control policies and procedures that have been properly designed and placed in operation, performing sufficient tests to provide reasonable assurance that the controls are effective and working as designed.

Management of the CSIF is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures applicable to CSIF operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over assets.

Internal control categories. For the purpose of this report, the categories of significant internal control policies and procedures include: cash, procurement, expenditures, capital assets, revenue, payroll, and reporting. Our consideration of the internal control structure included all of the categories listed above, except that we did not consider the controls over capital

assets. CSIF management had reported this area as having an uncorrected material internal control weakness.

Reportable conditions. We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the Comptroller General and OMB Bulletin No. 91-14. Reportable conditions are matters that come to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to ensure that obligations and costs are in compliance with applicable law; that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and that revenues and expenditures applicable to CSIF operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over the assets.

Classification of transactions. Internal controls did not ensure the proper classification of transactions and adherence to regulations. The following examples illustrate the consequences when controls are lacking to ensure proper classification of accounting transactions. Overpayments of $216,000 that had been made to various Government agencies were classified as reductions to the CSIF liabilities (accounts payable) rather than as increases to assets (accounts receivable); $52.1 million of Military Interdepartmental Purchase Requests, and a contract valued at $896,000 for installing a new automated accounting system during FY 1992, were classified as liabilities (accounts payable). These contractual obligations should be controlled through budget accounts because an obligation to pay (accounts payable) for goods or services does not occur until the goods or services are received.

Leased assets. "DoD Accounting Manual," Chapter 37, and Title 2, Section L10, require that when assets valued at $15,000 or more are being leased under terms that are essentially equivalent to an installment purchase, they are to be recorded as "Assets Under Capital Lease." Although our review indicated that a significant portion of the leased equipment qualified as "Assets Under Capital Lease," CSIF personnel had not recorded these assets on the accounting records. In order to accurately record assets that qualify, CSIF management has been directed by the Deputy Chief Financial Officer to capitalize and depreciate all property leases (other than land) as required by the DoD Accounting Manual, Chapter 37. To comply, CSIF management will make a detailed review of all contracts to accurately determine the total value of assets that qualify.

Write-off of assets. Automated data processing (ADP) equipment, with unit costs of $15,000 or more and valued at

$3.8 million, was written off as an operating expense at the end of FY 1990. This equipment should have been accounted for as assets and depreciated as required by the "DoD Accounting Manual," Chapter 31, and Title 2, Section P40. Without adjustment, the CSIF's FY 1991 assets would have been understated. An adjustment of $3.8 million was needed to account for the assets. An adjustment of $1.1 million was also needed to record the depreciation of the assets. Since the FY 1990 operating expenses had been overstated by the FY 1990 write-off, the CSIF equity accounts needed similar adjustment.

Unrecorded depreciation. Depreciation of purchased and contributed equipment was not recorded, as required by both the "DoD Accounting Manual," Chapter 31, and Title 2, Section D20. Depreciation was not recorded for FYs 1990 and 1991 because the CSIF had been directed by the Comptroller, DoD, not to recoup depreciation expenses from customers. The equipment should have been depreciated without affecting operating costs. An adjustment of $28.3 million was needed to record the depreciation for FYs 1990 and 1991.

Except for the matters noted above, we believe there is reasonable assurance that the control structure meets the internal control objectives.

Material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the Principal Statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness. We believe the weaknesses discussed above will be corrected as a result of ongoing updates and refinements discussed in management's "Overview to Financial Statements," paragraph D.3.b.

PART III -

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

PART III - REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Introduction. We have audited the Principal Statements of the Defense Industrial Fund - Communications Services Activity, commonly known as the Communications Services Industrial Fund (CSIF), as of and for the year ended September 30, 1991, and have issued our report dated June 30, 1992.

Objectives and scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States, and OMB Bulletin (OMB) No. 91-14. Those standards require that we plan and perform the audit to obtain reasonable assurance that the Principal Statements are free of material misstatement.

Compliance with laws and regulations applicable to the CSIF is the responsibility of management. As part of obtaining reasonable assurance about whether the Principal Statements are free of material misstatement, we tested compliance with laws and regulations that may directly affect the financial statements. We also tested certain other laws and regulations designated by OMB and DoD (see Appendix A, "Laws and Regulations").

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA), and we compared the entity's most recent FMFIA reports with our evaluation of the internal control system. We also reviewed and tested the entity's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the "Overview to Financial Statements" and "Financial Statement Analysis of Attributes, Measures and Indicators." However, our objective was not to provide an opinion on overall compliance with such provisions.

Material noncompliances. Material instances of noncompliance are failures to follow requirements or violations of prohibitions contained in laws or regulations that cause us to conclude that the aggregation of the misstatement resulting from those failures or violations is material to the Principal Statements, or that the sensitivity of the matter would cause it to be perceived as significant by others.

Results of review. The results of our tests of compliance disclosed the following instances of noncompliance with the "DoD Accounting Manual" and Title 2, the effects of which have been partially corrected in the CSIF's Principal Statements for FY 1991.

Military Interdepartmental Purchase Requests. The "DoD Accounting Manual," Chapter 42, requires that when orders for goods or services are placed, the transaction is to be recorded

in the budgetary accounts as an undelivered order until the goods or services are received. Similarly, Title 2, Section A10, provides that the liability (accounts payable) should not be recorded until the goods or services are received. CSIF personnel were recording the orders for goods or services as accounts payable when Military Interdepartmental Purchase Requests were issued. Consequently, the September 30, 1991, balance of accounts payable was overstated by $52.1 million (before adjustment). This amount represented a 50-percent overstatement that has been corrected in the Financial Statements.

Leased assets. Both the "DoD Accounting Manual," Chapter 37, and Title 2, Section L10, require that when assets are being leased under terms that are essentially equivalent to an installment purchase, they be recorded as "Assets Under Capital Lease." An accounting entry must also be made to accounts payable for the value of the lease to show the liability incurred by leasing the equipment. The CSIF did not properly account for assets that met the capital lease criteria. Rather, the expense was accounted for when lease payments were made. Consequently, we believe that assets and liabilities were understated significantly. The value of leased equipment that meets the capital lease criteria must be determined by a detailed review of lease agreements. Although CSIF management had begun implementing corrective action, this problem had not been corrected in the financial statements.

We considered these material instances of noncompliance in forming our opinion on whether the Principal Statements are presented fairly, in all material respects, in conformity with the applicable accounting standards now in effect for the preparation of the entity's financial statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the CSIF complied, in all material respects, with the provisions referred to in the third paragraph of this report. With respect to items not tested, we found nothing that caused us to believe that the CSIF had not complied, in all material respects, with those provisions.

PART IV -

DEFENSE INDUSTRIAL FUND - COMMUNICATIONS SERVICES ACTIVITY

FINANCIAL STATEMENTS - FY 1991

Note: Blank pages in the Defense Industrial Fund-Communications Services Activity financial statements were omitted from this report.

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

JUN 26 1992

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DODIG

SUBJECT: Transmittal of the final Defense Industrial Fund (Communications Services Activity) and DoD Retirement Trust Fund Financial Statements on FY 1991 Financial Activity

The attached Defense Industrial Fund (Communications Services Activity) and DoD Military Retirement Trust Fund financial statements on FY 1991 financial activity are submitted for inclusion in your June 30, 1992, audit reports as required by the Chief Financial Officers Act of 1990.

The Defense Industrial Fund (Communications Services Activity) financial statements incorporate our agreed upon corrections and adjustments to the financial statements submitted for audit on March 10, 1992.

The DoD Military Retirement Trust Fund financial statements includes the actuarial liability for the pension plan as of September 30, 1991. The financial statements were initially submitted for audit on February 25, 1992, and contained actuarial liabilities as of September 30, 1990.

I appreciate the cooperative effort exhibited by you and your staff in the audit of these financial statements and will work to sustain the same level of cooperative effort in the future.

Alvin Tucker
Deputy Chief Financial Officer

Attachments

cc: Assistant Secretary of Defense (Force Management & Personnel)(Requirements & Resources)
Defense Information Systems Agency
Defense Finance and Accounting Service

DEFENSE INFORMATION SYSTEMS AGENCY
DEFENSE INDUSTRIAL FUND
COMMUNICATIONS

OVERVIEW TO
FINANCIAL STATEMENTS OF DEFENSE INDUSTRIAL FUND-
COMMUNICATIONS SERVICES ACTIVITY (CSIF)
FOR FISCAL YEAR 1991

PREPARED IN ACCORDANCE WITH THE
COMPTROLLER OF THE DEPARTMENT OF DEFENSE
IMPLEMENTING INSTRUCTIONS FOR THE
CHIEF FINANCIAL OFFICER'S ACT OF 1990

I. Financial

A. *Preamble/Preface/Disclosure*

This overview of the Defense Business Operations Fund (DBOF) - Communications Services Activity (CSA) (formerly the Defense Industrial Fund (DIF) - Communications Services Activity during the period covered by the financial statements) Financial Statements is provided in accordance with Department of Defense procedures for revolving fund activity reporting under the Chief Financial Officers Act of 1990. No attempt is made to describe the Defense Business Operations Fund as a whole or another operating entity within the Department of Defense. The Financial Statements Overview, Footnotes and related comments apply only to the FY 1991 CSA activity.

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C. *Executive Summary*

1. The Department of Defense Industrial Fund - Communications Services Activity (i.e., CSIF) was established in 1965 by Congressional appropriation. The establishment of the Defense Industrial Fund activity followed the recommendation of a committee chaired by the Secretary of Defense to provide department telecommunications requirements through a revolving fund. The committee further recommended to the Secretary and Congress (who approved) that the activity be established in a "fully competitive manner" such that its customers would be free to select the most technically competent and cost effective vendor (i.e., CSIF or a commercial telecommunications carrier) who met their needs. CSIF joined the Defense Business Operations Fund (DBOF) in Fiscal Year (FY) 1992.

2. The CSIF provides to its customers, through its administrative and operational arm (the Defense Information Systems Agency (DISA), Defense Commercial Communications Office (DECCO)), a single source for the following services:

. High quality, reliable, survivable and secure telecommunications services for command and control.

. Procurement of cost-effective information services covering automated data processing (ADP) and telecommunications (e.g., voice, data and video).

. A clearinghouse where each customer's requirements are individually treated, but where economies of scale are employed through bulk quantity purchasing to obtain the lowest possible price.

. Customer assistance in defining, allocation engineering, procuring, installing and maintaining the necessary support to meet customers' requirements.

3. The CSIF has developed and fine-tuned over the last twenty-five years an operational approach which twice yearly solicits from its customers' a list of funded requirements (demand) for service. These requirements are provided to DECCO for use in production/workload scheduling and to the DISA Program Management Offices for system design and provisioning for services provided by CSIF through DISA-managed Defense Communications System (DCS) resources (approximately 37% of CSIF annual sales). The CSIF, as often as three times a year but at least annually, publishes an extensive unit cost and tariff rate product price catalog of CSIF services covering both execution and POM fiscal years. The CSIF fiscally operates by paying its vendors first, then billing and collecting from its customers using electronic financial transaction instruments available from the U. S. Treasury to collect from its Federal government customers.

4. During the last twenty-five years, the CSIF has grown from $298. million in sales to $1.261 billion (in FY 91). The current customer base includes more than 159 Federal departments and agencies composed of thousands of local individual commands and organizations. Its available resources within the DISA-managed DCS have grown from 1,984 inter-switched trunks to over 41,000; from 5,700 access and tie-line circuits to over 135,000; and from 10 switching units to over 400. During its existence, the CSIF has expanded to become the largest single telecommunications customer of the domestic telecommunications industry.

5. Some significant actions affecting the CSIF during the financial statement period are:

. Technological change continues to occur at an accelerating rate with some equipment technological life-cycles being now less than eighteen months. However, depreciation recovery cycles are five (5) years for ADPE and ten (10) years for other equipment. Thus, accounting cost recovery cycles are seriously "out-of-step" with technological life-cycles and replacement capital is often not available to keep service commercially price competitive.

. Customers are budgeting their operational funds and capital investments in such a way as to further reduce their demand for DISA-managed DCS services by 15% by FY 1995. This reduction is in addition to the over twenty percent (20%) reduction between FY 1988/92. Current DISA-managed DCS systems and the related costs incurred by the CSIF can not be reduced as timely, to match the timing of the significant reductions in sales revenue.

. The AT&T Divestiture Decision vastly increased competition among providers of telecommunications services. In FY 1990 competition was further increased with the addition of GSA's FTS2000 telecommunication system. Under certain circumstances Public Law requires that all non-C2 (non-Warner Amendment exempt) requirements be provided by FTS2000 vice a DISA-managed system without regard to cost to the U. S. taxpayer.

. Current CSIF maintenance upgrades to the accounting and property systems will provide enhanced accounting capabilities for property, depreciation and liabilities at a level of accuracy and detail not previously possible. The DISA and CSIF identified "material weakness" for property reported to DoD(C) and the DoD IG in FY 1990 and the MIPR liability shortcomings of the current accounting system will be corrected through the system maintenance upgrade efforts of KPMG (Peat Marwick) begun at the end of FY 1991 on behalf of the CSIF following a fully competitive procurement. The various Congressional and DoD(C) changes to the Asset Capitalization and Capital Budget Program(s) during the FY 1987/92 period, which could not be addressed in the current accounting system, will be possible and corrected by the system maintenance and upgrade efforts.

. Although CSIF has been able to retain a nominal dollar volume of sales since FY 1988, its sales volume level in real dollars has decreased during the FY 1989/91 period of stiff commercial price competition and DoD worldwide force structure changes. The effect of stiff price competition and the loss of purchasing power materialize through DoD telecommunications resources being technologically outdated and less cost efficient than those of the private vendor in the commercial telecommunications industry.

. The joint formation by DoD(C) and DoD(C3I) of an information services utility organization as a separate unit within DISA (formed 1 May 1992 and called the Defense Information and Technology Organization (DITSO)) will establish a major new CSIF customer within DoD. The customer information requirements challenge that DITSO represents for CSIF is in the establishment of the first DoD detailed ADP and telecommunications "useage-sensitive" data reporting on a monthly basis. The data provides DITSO with the ability to provide its customers with a single product cost/price (made up of both ADP and telecommunications data), on a monthly basis.

6. Review and preparation of the Fiscal Year 1991 CSIF Financial Statements and subsequent audit has identified for the activity the need for accounting system enhancements and definitive policy covering the unique business sub-activities of capital assets, related capital asset depreciation procedures (both acquired and contributed assets), and treatment of capital leases and related amortization in the Federal government as a telecommunications value-added reseller. The preparation of audited financial statements has therefore been of benefit to CSIF management.

7. The next sections of this narrative overview and the footnotes to the financial statements provide additional detail about the CSIF Financial Statements for Fiscal Year 1991 and its activities during Fiscal Year 1991.

8

D. *Discussion*

1. Description of Business Activity (ies)

The Department of Defense Business Operations Fund (DBOF) - Defense Services Activity (DSA) is chartered to procure leased services, such as telecommunications and information systems from the worldwide commercial service industries on behalf of its customers. Also, it procures and manages unique federal government-owned systems (e.g., Defense Communications System Mediterranean (DCS-MED)). The DBOF-DSA was known as the Department of Defense Industrial Fund - Communications Services Activity which was more often referred to as the Communications Services Industrial Fund (CSIF) until October 1991.

The DBOF operates as a "commercial-like" not-for-profit corporation with an annual operating budget and a board of directors, known as the CSIF Resource Management Committee (RMC).

a. Historical and Operational Perspective

(1) Revolving (working capital) funds were first authorized by the National Security Act of 1947, as amended in 1949 and later codified in 10 U.S.C 2208. They were instituted as a means of more effectively controlling the cost of common/shared commercial-like programs and work performed by the U.S. Government. The Department of Defense (DoD) established its own working capital fund in 1950, known as the DoD Industrial Fund.

(2) In late 1964, at the request of the Unites States Air Force, a study was commissioned by the Secretary of Defense and the Comptroller of the Department of Defense (DoD) to determine if a centralized funding method could be created for funding common user telecommunication services within DoD. All of the DoD military departments and agencies participated in the study which was chaired by the Director, Defense Communications Agency (DCA). The study recommended to the Secretary of Defense that the U.S. Congress be asked to establish a DoD department-wide industrial fund activity under the control of DoD(C) within the DoD Industrial fund. Congress established the Communications Services Activity, within the Department of Defense Industrial Fund, by the DoD Appropriations Act for Fiscal Year 1965 and directed that the activity was to be under the direct control of the DoD Comptroller. The activity became known as the Communications Services Industrial Fund (CSIF).

(3) The DoD Comptroller delegated daily operational policy and oversight to the Director, Defense Communications Agency (DCA), now known as the Defense Information Systems Agency (DISA), who redelegated the responsibility directly to the CSIF manager under the DISA Comptroller. Through the Appropriation Act of 1992, the Defense Industrial Fund was renamed the Defense Business Operations Fund (DBOF), under the control of the Comptroller, Department of Defense.

b. General Background/Product/Service

(1) Purpose. The CSIF, through its operational arm, the Defense Commercial Communications Office (DECCO), provides its customers the following services:

. One source for high quality, reliable, survivable and secure telecommunications services for command and control.

. A single source for procurement of cost-effective services, such as automated data processing (ADP) and voice, data and video telecommunications services.

. A clearinghouse for services where each customer's requirements are individually treated, but where economies of scale are employed through bulk quantity purchasing to obtain the lowest possible price.

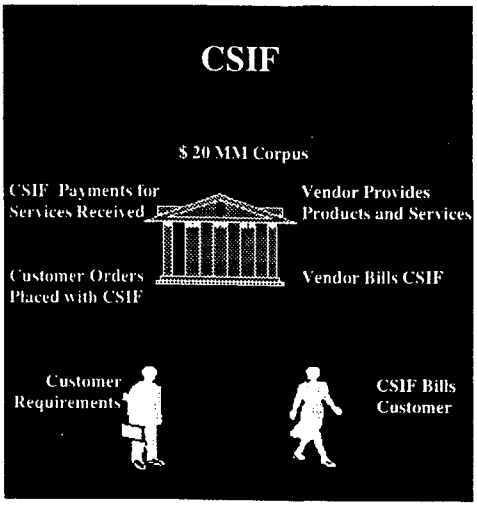
. A single DoD source for assistance in defining, engineering and procuring the necessary support to meet customers' requirements.

(2) CSIF Cycle of Operations

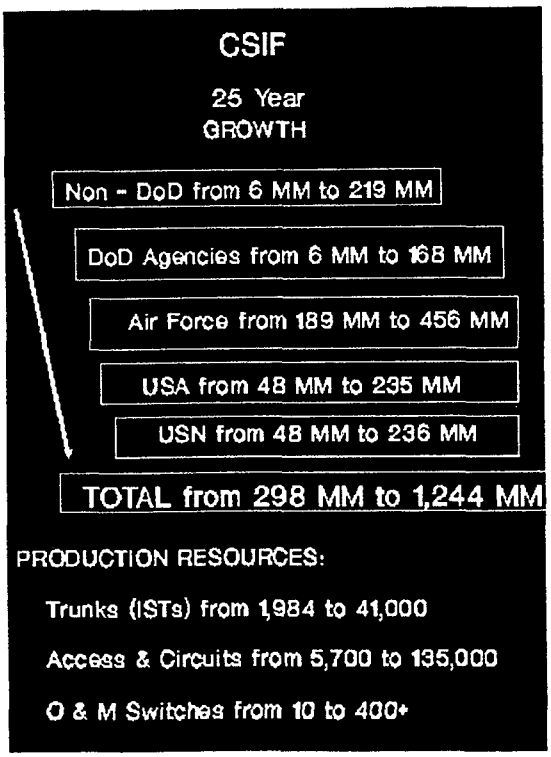
(a) The CSIF operates much like many "not-for-profit" commercial businesses do, with funding derived from sales to its customers. It has a $20 million corpus that was provided by Congress when the fund was established in order to maintain a minimum balance necessary to maintain operations. The CSIF receives no annual appropriated funds.

(b) Twice yearly, the CSIF requests that each customer submit a validated and funded list of requirements (product/service demand) for the following year (plus the next four years for budget planning purposes). The CSIF utilizes the requirements for financial planning and provides them to DECCO and DISA Program Management Offices who will use the identified requirements to contract, procure and/or build the necessary resources in the most cost-effective manner possible.

(c) The CSIF receives monthly bills from its vendors for the services it has ordered on behalf of its customers. It then bills its customers for their share of the cost. The monthly amounts collected by the CSIF from its customers are used to pay the vendors and replenish funds on hand so the CSIF can operate the succeeding month.



(3) CSIF Historical Growth



CSIF Historical Growth

(a) Over the last 25 years, the CSIF has grown from a $298 million corporation to one of over $1.2 billion. Although the growth of the dollar base seems large, when adjusted for inflation, it has risen only 367 percent. An example of the growth is the 2,290 percent increase in the number of switches and circuits now covered by the CSIF and the number of circuits purchased via cost-effective "bulk buy" techniques.

(b) The CSIF with DECCO as its administering agent, has grown from a one office $1.6 million operation at Scott AFB, managed by the United States Air Force (USAF) Air Force Communications Command (AFCC), to an over $22 million operation with geographically dispersed processing locations in each major military theater worldwide.

(c) The CSIF is the largest single commercial customer of services such as commercial telecommunications in the U.S. and is therefore influential in obtaining the lowest prices possible for its customers from commercial vendors.

(d) The types of allowable costs which the CSIF can incur are defined by Congressional Appropriation Acts; 10 U.S.C.; Title 2, USGAO Handbook; DoD Directive 7410.4; DoD Regulation 7410.4R; the DoD Accounting Manual Chapters 32, 33, 76 and 82; and the CSIF Charter.

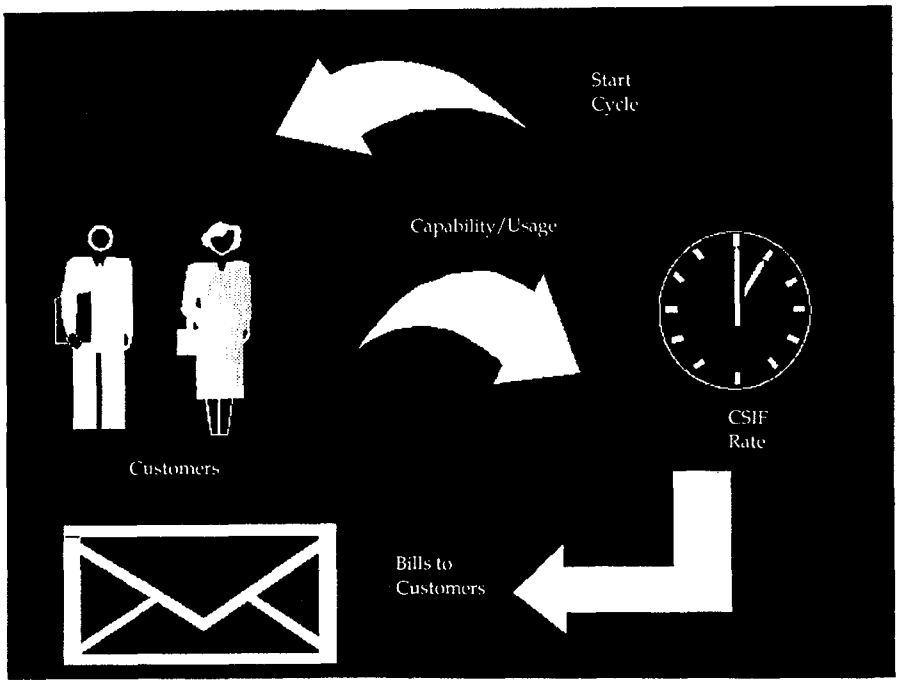
(4) CSIF Historical Overview. The CSIF has different types of products/services and recovers their costs through different approaches. The following represents two ways in which telecommunication rates are computed:

(a) DISA-Managed Defense Communications Systems (DCS) (e.g., AUTODIN, DDN, ISDN, DSN, etc.). DCS program costs are recovered by charging customers for products and services based on CSIF published tariff rates. Rates are developed by examining each communication system by theater, identifying system unique costs and then dividing the total cost of that portion of the communications system by agreed upon units (e.g., weighted units, connections, data packets, minutes of capability, precedence, percent share, etc.). A rate stabilization fee (RSF) (cost of money) and an overhead charge are added to the direct cost recovery rates. The overhead charge covers CSIF (CSIF Headquarters and DECCO) operating costs.

Customers are charged based on the amounts of products/services ordered and/or utilized. The rates are totally updated at least once yearly. DISA-managed systems account for approximately thirty-seven percent of the CSIF sales in FY 1992.

(b) Customer-Managed Systems. Costs for customer-managed systems are recovered by passing along direct costs for the system, plus RSF and overhead. Generally, no unique CSIF rates are published for these services. The CSIF acts mainly as a banking and billing agent and customers maintain management for their own systems. Customer-managed systems account for about sixty-three percent of the CSIF sales in FY 1992.

(5) CSIF Historical - Background Issues



(a) Customers receive monthly bills for the services they receive (i.e., ordered/utilized). Each parent Department or Agency Federal Customer defines the level of detail and the organizational accounting break-out they would like to receive on their monthly bills. DECCO uses Program Designator Codes (PDC) to define the specified billing detail for reporting purposes.

(b) The actual bills received by each department or agency are computed by multiplying the applicable CSIF tariff rates, published in the CSIF rate letter, by the services that each customer has been provided by the CSIF.

(6) Service/Product Cost Cycles The cost of DISA-managed DCS products/services within the CSIF is always intended to be less than when customers procure them on their own. However, the actual cost is often confusing since CSIF provided DCS products/services include all the costs of providing the product/service from end office to end office. Additionally, individual customers costs cited on a bill within a Department or Agency may have been redistributed by the Department or Agency so that some may have higher bills than before, but the total for that department would have decreased.

(7) What is the "Rate Stabilization"? The RSF is the "cost of money" to the CSIF or more specifically, ... the rate of inflation on outlays in the federal government financial system. The RSF was established by Congress in 1982 at the request of DoD(C) Industrial Fund telecommunications customers so that operating costs could be fixed throughout the budget execution year regardless of the inflation during that year. Therefore, all DoD Industrial Fund customers pay the RSF on products/services provided by the fund.

(8) Customer Direct Impact on His/Her Bill. Each CSIF customer's bill is computed based upon the list of approved requested (ordered) funded requirements or actual usage. Bills can be altered by submitting a Telecommunications Service Request (TSR) with revised requirements during the succeeding monthly cycles. The bill will be adjusted after processing of the TSR by DECCO and the DISA Program Management Office (if appropriate).

(9) Defense Commercial Communication Office (DECCO) Mission and Functions as Related to CSIF. DISA, DECCO, headquartered at Scott AFB, is the daily operating arm of the CSIF. Generally, their mission and functions are to:

Procure - To establish contractual arrangements with commercial vendors for required telecommunications products/services.

Account - To account for and pay for telecommunications products, services and equipment acquired and to bill CSIF customers for services provided.

Report - To provide the operational and financial management information needed to budget, fund, manage, inventory assets and control the product/services/equipment acquired by the CSIF.

(10) What Does the CSIF Overhead Surcharge Cover? The overhead rate covers the cost of operating the CSIF headquarters and DECCO. DoD customers are not charged for military personnel costs. In accordance with CSIF RMC guidance, non-DoD customers pay one half percent higher overhead rate to reimburse for financial operating risks.

(11) How Does the Customer Influence CSIF Operations and Management? How do Gains and Losses in the Annual Operations of CSIF Offset Customer Costs?

(a) Each major customer and each Department or Agency of the CSIF has a flag-level representative on the CSIF Resource Management Committee (RMC). Concerns about CSIF operations, costs, billing etc., are brought up to RMC members through their appropriate chain-of-commands.

(b) Gains, if realized, are returned to the customers as a credit (refund). Congress requires that losses be recovered by adjusting the tariff rates for the next fiscal operating year.

2. General Discussion of Activity The CSIF presently provides products and services directly to its customers and through services provided to it by the Defense Information Systems Agency, Defense Network Systems Organization which are then provided to the end user by the CSIF. The range of products are services offered to Federal government Departments and Agencies are addressed in the next sections.

a. Product/Service list

(1) Direct Telecommunications Support (63% of sales)

(a) Voice transmission resources,

(b) Voice switch assets,

(c) Voice origination/termination equipment assets,

(d) Data transmission resources,

(e) Data switch assets,

(f) Data origination/termination equipment assets,

(g) Video transmission resources,

(h) Video switch assets,

(i) Video origination/termination equipment assets,

(j) Voice/Data/Video security and encryption assets,

(2) Direct Telecommunications Support Through DISA (37% of sales). Bulk purchased and resold services through establishment of bulk resource "common-user" systems which provide at a pre-published tariff product/service rate and same services as cited in "a" above.

(3) ADP Hardware and Software Acquisition. Hardware (large, mid-range, small, personal computer, etc.), software (operating and application modules and systems), Modular hardware (e.g., modems, memory cards, etc.), Voice/Data/Video security and encryption assets.

b. Production/Sales and Market Trends The current market trends in telecommunications have become more predictable than at any other time since the AT&T Divestiture Decision of 1984. Also, the first major capital investment phase of the larger commercial vendors has been completed following divestiture actions of 1984/85. The market price fluctuations for telecommunications services has narrowed since the initial years following divestiture due to market competition among the larger commercial vendors. The divestiture directed market pricing altered the ratio between "home" and "commercial" customers which has increased significantly the cost of "home" communications services while lowering the cost to "commercial business" customers. Another significant action since the divestiture is the shortening of the useful technical life cycle of the equipment and the industry push to more rapidly implement and utilize emerging ADP technology as a means to reduce operating costs (especially labor costs) as quickly as possible. The CSIF, due to its "open market" fully commercially competitive environment, must be in accordance with these market trends and match the commercial vendors' competitive price through cost sensitive bulk buying techniques just as other "value-added" resellers do within the telecommunications and ADP industry. The need for CSIF to compete with commercial vendors also in turn requires it to comply with FCC and SEC telecommunication industry accounting practices and procedures.

c. Financial Trends

(1) Measurement and Related Indicators: The CSIF Operation at Scott Air Force Base has developed manpower standards to track and report productivity. Annual reapplications of the manpower standard will be accomplished to determine actual requirements. Currently it is projected no reductions in manpower will occur. However, if the anticipated workload does not become a reality, manpower reductions

will occur. Those decreases will be based upon the measured standards developed and implemented for this purpose.

(2) Production and Financial Output Measurement of the Efficiency of Production Asset Utilizations (i.e., Structural Analysis and Causal Cross-section Analysis)

	FY 89	FY 90	FY 91
(a) Service Starts, Stops and Charges	25,995	26,419	27,098
(b) Contract Amendments	3,498	3,515	1,668
(c) Invoices Paid/ Bills Paid	1,138,300	1,153,600	1,149,522
(d) FCC, PUC, Tariff Charges	272,000	383,000	163,000
(e) AD Service Requests and Jobs Processed	65,620	66,325	56,156
(f) DoD Telecommunications Service Requests Processed	22,000	20,620	23,211

The above data reflects key workload drivers from the manpower/productivity standards. This data does not reflect the additional manpower requirements arising from new business actions, such as Corporate Information Management, or increased business from existing customers, such as FAA's upgrade and modernization of its extensive air control network.

3. Areas of Management Concern The operations of the financial aspects of CSIF during Fiscal Year (FY) 1991 raised significant areas of concern to the fund's management. This section of the overview highlights some of the key areas of: (a) Fixed Property Assets; (b) Accounting system ADP hardware/software maintenance; (c) Depreciation of pre-1991 fixed property; (d) Incorporation of DoD Fee-For-Service (FFS) activities.

a Fixed Property Assets

(1) The DoD initiated (with Congressional approval) a Asset Capital Program (ACP) program in FY 1981/82 for use by DoD Industrial Fund activities to purchase assets for production and service product generation. Due to the unique features of the CSIF, the fund was not incorporated into the DoD ACP program until FY 1987. At the start of FY 1987, the existing telecommunication assets (e.g., AUTODIN/AUTOVON switches, modems, encryption devices, etc.) purchased by the Military Departments (MILDEPs) using appropriated funds and utilized by telecommunication production systems operated by the DISA were placed on the "books of account" of the CSIF at the estimated original cost. At the time, the assets were placed on the accounts of the CSIF without an independent on-site inventory audit being accomplished except for that of the site operators compilation of a list of what was being incorporated. The transferred "contributed" assets were priced at estimated largely undocumented cost values; a methodology not in accordance with AICPA and GAO GAAP practices and procedures of the time.

(2) During FY 1987/89 additional assets were added by the DISA Program Management Offices for DISA-managed Defense Communication System (DCS) programs using CSIF ACP funding. Since the assets were added generally by contractors under their operational management authority, many of the assets were tracked operationally but not fiscally.

(3) During the FY 1990/91 procurement monies were provided by Congress to CSIF and subsequently to the DISA Program Managers for acquisition of capital assets again following the tracking/accounting policies followed in FY 1987/89.

(4) In FY 1990 the DoD Inspector General (IG) and the CSIF manager identified that fixed property inventory and valuation were a material weakness within the operations of the CSIF and it was reported as such to the DoD(C) by the DISA Internal Management Control Office. In accordance with the identification of the material weakness problems CSIF begin an initiative to develop a property "fixed" asset inventory, inventory accounting systems and accounting procedures to properly account for the over $97.0 million in assets purchased or contributed during the FY 1987/91 period of operations.

(5) Thus, the values of fixed property assets reflected in the financial statements will require adjustments in the FY 1991, and future statements based upon the results of the full property asset audit underway and planned for completion by the end of FY 1992.

(6) In accordance with DoD(C) guidance, depreciation for the period FY 1990/91 has not been entered for the pre-FY 1990 assets or the procurement appropriation purchases of FY 1990/91.

b. Accounting System ADP Hardware/Software Maintenance

(1) The CSIF accounting system of today is the patchwork outgrowth of the automated check writing system of 1965 which CSIF inherited from the USAF when the CSIF was capitalized within the Defense Industrial Fund (now DBOF). The accounting, budgeting and contracting features available within the overall system umbrella grew over the 25 years but never reached the point of a full blown accounting system, as required of a Federal commercial operation under the AICPA and GAO GAAP requirements. The system grew to over 2100 COBOL programs maintained by their respective builders without, in many cases, written documentation therefore staff retirements caused the loss of significant capabilities to alter and maintain many of the programs incorporated in the overall system umbrella. In FY 1990, identification of a need to update and technologically consolidate the various features of the system were identified and isolated.

(2) In late FY 1991, following a competitive procurement, a member of the "Big 6" public accounting industry was selected to accomplish the refinement and updates necessary to make the CSIF accounting system (inclusive of the fixed property asset subsystems) compliant with the requirements of the AICPA and GAO GAAP (especially Statement No. 11 requirements) practices as well as the procedures required under the Chief Financial Officers Act of 1990. The changes will impact the financial statements of FY 1991 and FY 1992 while including the recommended DoD IG adjustments already suggested by the DoD IG to the FY 1991 statements.

c. Depreciation of pre-1981 Fixed Property. The depreciation values reflected in the FY 1991 CSIF statements reflect the valuation of assets inclusive of the possibility of errors as noted in fixed assets above. In addition, the assets purchased during FY 1990/91 were depreciated along with FY 1987/89 via "memo-entry" accounting in FY 1990 but even this method was discontinued at the request of DoD(C) in FY 1991. The FY 1992 required depreciation accounting procedures issued by DoD(C) for DBOF require that all prior FY fixed assets be depreciated, if purchased after 1 October 1990 without regard to the type of funding used to purchase the assets. However, current depreciation policies issued by the DoD(C) require refinement as to assets purchased prior to the end of the previous ACP program along with those purchased with procurement appropriation funds. Additionally, the depreciable life table now defined is different from that previously used in the ACP program and therefore a revaluation of the depreciation account is required and should be reflected as an adjustment to Capital Equity in the financial statements of CSIF for FY 1991. The DoD(IG) has requested from DoD(C) clarifying guidance as to the actual depreciation methods to be used in FY 1991 financial statement compilation for revolving fund activities.

d. Incorporation of DoD Fee-For-Service (FFS) Activities. The CSIF, as a member of the new DoD DBOF revolving fund, is working with the DoD(C) ADP Systems Directorate to define the accounting elements and cost recovery elements along with the necessary cost accounting and budgeting features required under the new DBOF and Chief Financial Officers Act requirements. The CSIF, as a DoD Industrial Fund activity, has provided an extensive and very detailed cost recovery telecommunications tariff methodology for its customers in order to be in compliance with FCC and SEC practices and to allow its customers to make price and technologically appropriate purchase decisions. The new DBOF FFS procedures establish unit cost methodologies for services at a more macro economic pricing level than previously utilized by the CSIF. Thus, minor adjustments, as highlighted in the individual statement footnotes, will reflect the necessary cross-walk from prior cost recovery product pricing to the new DBOF FFS unit cost recovery structures.

E. FINANCIAL STATEMENTS COMMUNICATIONS SERVICES

INDUSTRIAL FUND (CSIF)

FOR FISCAL YEAR 1991

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SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Identification:
Department/Agency: **Defense Information Systems Agency**
Bureau/Organizational Unit: **Defense Industrial Fund - Communications**
OMB Identification Code: **Principal Statements**
Basis Used:

ASSETS		**Total**
1. Fund Balance with Treasury and Cash		
a. Fund Balance (See Note 1)	46,644,057	
b. Cash		
c. Foreign Currency, Net		
d. Subtotal		46,644,057
2. Accounts Receivable (See Note 2)		
a. Federal Agencies		
1. Current	297,347,436	
2. Noncurrent		
b. Public		
1. Current	374,130	
2. Noncurrent		
c. Less: Allowances		
d. Subtotal		297,721,566
3. Advances and Prepayments		
a. Federal Agencies	1,654,175	
b. Public		
c. Subtotal		1,654,175
4. Inventories		
a. Operating consumables		
b. Product or Service Components		
c. Stockpiled materials		
d. Other		
e. Subtotal		
5. Investments, Net		
a. Federal Securities		
b. Non-Federal Securities		
c. Other-Public Securities		
d. Subtotal		
6. Loans Receivables		
a. Federal Agencies		
1. Current		
2. Noncurrent		
b. Public		
1. Current		
2. Noncurrent		
c Less: Allowances		
d. Subtotal		

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SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Bureau/Organizational Unit:

ASSETS Continued		**Total**
7. Property, Plant, and Equipment, Net		
a. Structures, Facilities, and Leasehold Improvements	240,465	
b. Military Equipment		
c. ADP Software		
d. Equipment		
e. Assets Under Capital Lease (See Note 3)		
f. Other - ADP Equipment (See Note 4)	38,712,351	
g. Construction-in-Progress		
h. Land		
i. Allowances		
j. Subtotal		38,952,816
8. Other Assets		
a. Acquired Collateral		
b. Deferred Exp from Cap Lease		
c.		
d. Other		
e. Subtotal		
9. TOTAL ASSETS		384,972,615
LIABILITIES		
10. Accounts Payable (See Note 5)		
a. Federal Agencies	50,706,111	
b. Public	82,840,304	
c. Subtotal		133,546,415
11. Interest Payable		
a. Federal Agencies		
b. Public		
c. Subtotal		
12. Accrued Payroll and Benefits (See Note 6)		6,044,465
13. Accrued Unfunded Annual Leave		
14. Unearned Revenue (Advances)		
a. Federal Agencies		
b. Public (See Note 7)	32,851,229	
c. Subtotal		32,851,229
15. Deposit Funds		
16. Debt Issued Under Borrowing		
a. Gross Federal Debt		
b. Intragovernmental Debt		
c. Other Debt		
d. Subtotal		
17. Actuarial Liabilities		
a. Pension Plans		
b. Insurance and Annuity Programs		
c. Subtotal		

SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Liabilities Continued		Total
18. Other Liabilities (See Note 8)		
a. Contingent Liabilities	13,000,000	
b. Accrued Miscellaneous	378,639	
c.		
d.		
e.		
f. Subtotal		13,378,639
19. TOTAL LIABILITIES		185,820,749
EQUITY		
Appropriated Fund Equity		
20. Unexpended Financed Budget Authority		
a. Unexpended Appropriations		
b. Less: Unfilled Customer Orders		
c. Subtotal		
21. Invested Capital		
Revolving Fund Equity		
22. Revolving Fund Balance(s) (See Note 9)		
a. Appropriated Capital	51,332,014	
b. Cumulative Results	147,819,852	
c. Donations		
d. Subtotal		199,151,866
Trust Fund Equity		
23. Trust Fund Balances		
24. TOTAL EQUITY		199,151,866
25. TOTAL LIABILITIES AND EQUITY		384,972,615

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center Operations Directorate Washington, DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

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SF 221

REPORT ON OPERATIONS
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Industrial Fund - Communications**
OMB Identification Code: **Principal Statements**

REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used		
2. Revenue		
a. Federal Sources	1,260,262,150	
b. Public Sources	1,018,098	
c. Subtotal		1,261,280,248
3. Government receipts		
4. Other		
a. Interest Revenue Approp/Fund & Govt		
b. Interest Revenue Approp/Fund & NonGovt		
c. Gains		
d. Other		
e. Subtotal		
5. Less: Receipts Returned to Treasury		
6. Total Financing Sources		1,261,280,248
OPERATING EXPENSES		
7. Cost of Goods Sold		1,194,102,366
8. Operating/Program Expenses, Funded		24,920,294
9. Interest Expense, Funded		
a. Federal Financing Bank/ Treasury Borrowings		
b. Federal Securities		
c. Other		
d. Subtotal		
10. Other Funded Expenses		
a. Loss on Disposition of Assets		
b. Inventory Losses		
c. Investment Losses		
d. Other Losses		
e. Subtotal		

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SF 222

REPORT ON CASH FLOW
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Industrial Fund - Communications**
OMB Identification Code: **Principal Statements**
Basis Used:

Description		Total
1. Fund balance with Treasury and cash, beginning of period (PY SF 220)		154,824,779
2. Sources of funds:		
a. Increase in debt		
b. Appropriations		
c. Revenue	1,261,280,248	
d. Sale of assets		
e. Increase in payables	-68,394,709	
f. Decrease in receivables and advances	-126,884,703	
g. Other (See Note 10)	87,041,102	
h. Total		1,153,041,938
3. Application of funds:		
a. Operating expenses (SF 221)	1,219,022,660	
b. Less: Expenses not requiring outlays (SF 221)		
c. Increase in investments		
d. Increase in inventory		
e. Purchase of property, plant and equipment		
f. Other (See Note 11)	42,200,000	
g. Total		1,261,222,660
4. Fund balance with Treasury and cash, end of period (SF 220)		46,644,057

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center Washington, DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

SF 223

REPORT ON RECONCILIATION
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Industrial Fund - Communications**
OMB Identification Code: **Principal Statements**
Basis Used:

Description	Total
1. Total operating expenses (SF 221)	1,219,022,660
2. Adjustments:	
Add:	
a. Capital expenditures	
b. Increase(decrease) in inventories	
Deduct:	
a. Increase(decrease) in accounts payable	-68,394,709
b. Accrued expenses not requiring outlays	72,174,809
3. Total gross disbursements	1,215,242,560
4. Less: Offsetting collections credited	
5. Net disbursements	1,215,242,560

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center Washington DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

Consolidating Statements

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Note: The Consolidating Statements are omitted from this report because they duplicate the Principal Statements.

Supporting SF 220's

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Note: The Supporting SF 220's are omitted from this report because they duplicate the Principal Statements.

Notes to the Financial Statements

NOTES TO FINANCIAL STATEMENTS FOR DEFENSE INDUSTRIAL FUND - COMMUNICATIONS SERVICES ACTIVITY (CSIF) FISCAL YEAR ENDING SEPTEMBER 30, 1991

Note 1. Assets - Fund Balance with Treasury:

The Treasury functional cycle at DECCO is comprised of two functions consisting of the customer billing/ collection and disbursement of funds. Collections and disbursements are reconciled to the U.S. Treasury (TUS) cash reports, monthly. As of 30 September 1991, CSIF DECCO had reported a funds balance in its records of $75,844,056.79 while TUS reported $46,644,057. The TUS funds balance reflects an DoD(C) initiated SF 1151 of FY 1990 which transferred $29.2 million between the CSIF appropriation and the Defense Logistics Agency appropriation at the direction of Congress. As of the end of FY 1991, CSIF DECCO had not received the SF 1151 for processing from the TBO system within DoD.

Note 2. Assets - Accounts Receivable:

As presented in the financial statements, accounts receivable represent reimbursement due from public and private sector concerns. For DoD departments and agencies, reimbursement is done electronically through the DoD SF 1080 cross-disbursement system with TUS. The non-DoD public sectors customers are collected by electronically using the TUS OPAC electronic payment system or by check. Private sector customers are collected by electronic funds transfer, electronic or manual direct debiting, or check with expansion of electronic direct debiting being explored. Accounts Receivable balance as of 30 September 1991 was 297,721,566.33. The CSIF follows accrual accounting practices and procedures as outlined in the U.S.C. Title 2 and the Chief Financial Officers Act (CFO) of 1990.

Note 3. Assets - Under Capital Lease:

A review is underway of all contracts for applicability of Financial Accounting Standards Board Statement 13 (FASB STMT 13). After completion of this review and valuation, the appropriate value will be reflected in the FY 1992 statements.

Note 4. Assets - ADP Equipment:

ADP Equipment is valued at the prior recorded value. Currently, a full inventory including world-wide deployed assets is underway in clearance of the identified FY 1990 "Material Weakness". All equipment (inclusive of any applicable furniture and fixtures) will be valued and depreciated following Office of Management and Budget (OMB) Chief Financial Officers Act of 1990; General Accounting Office (GAO) Regulations and U.S.C. Title 2; DoD Regulations and Directives; and American Institute of Certified Public Accountants (AICPA) and Financial Accounting Standards Board (FASB) pronouncements with final recordation in the FY 1992 statements.

Note 5. Liabilities - Accounts Payable:

As presented in the financial statements, accounts payable represents the amount due public and private sector concerns for services, materials and supplies. Due to accounting system limitations now under maintenance revision this account also reflects the total amount of MIPRs outstanding (in excess of $50 million in cancelable MIPRs) without regard to year of liability. This account should only reflect the current accrued MIPR liability of the CSIF. Outstanding accounts payable as of 30 September 1991 was $133,546,415.37. The CSIF follows accrual accounting practices and procedures as outlined by: (1) U.S.C. Title 2 and GAO regulations; (2) the Chief Financial Officers Act (CFO) of 1990; (3) DoD(C) Accounting Manual Chapter 82, Revolving Funds; (4) AICPA/FASB accrual accounting pronouncements; (5) GASB Statement 11 requirements; (6) FCC; and SEC USOC accounting regulations.

Note 6. Liabilities - Accrued Payroll and Benefits:

Accrued leave: Civilian annual leave is accrued as earned and the accrued amounts are reduced as leave is taken. The balance in annual leave represents the unused accrued leave as of 30 September 1991 was $930,210.14. Accrued annual leave applicable to initial activity capitalization has been fully retired.

Accrued Payroll: The outstanding balance represents the accrued unpaid amounts of salaries and wages due the civilian employees for work performed or leave taken. The balance in accrued payroll as of 30 September 1991 was $ 2,159,297.67. Accrued payroll applicable to initial activity capitalization has been fully retired.

Accrued Sick Leave: The accrued value of civilian earned but not used sick leave is represented by this accounts accrued value. The balance in accrued sick leave as of 30 September 1991 was $ 2,954,957.19. Accrued sick leave applicable to initial activity capitalization has been fully retired.

Account Recap:

Accrued Leave:	$ 930,210.14
Accrued Payroll:	2,159,297.67
Accrued Sick Leave:	2,954,957.19
Total:	$ 6,044,465.04

Note 7. Unearned Revenue (Advances):

The CSIF, as the DoD agent, is party to a contract between the U.S. government (Department of State is the U.S. agent) and the government of Turkey to develop and install a new modern telecommunications system in Turkey for use by DoD, Turkish and allied military forces. The contract was initiated as a progress payment type contract in late FY 1989 by the Turkish and U.S. governments (USAF acting as the U.S. Program Manager) with completion scheduled for early FY 1992 with progress payments at contract milestones. However, due to the Iraq and allied military actions the contractual on-site efforts were suspended between July 1990 and May/June 1991 time period. The CSIF had published cost recovery rates for the period of FY 1989/97 and systematically collected for expected costs during the period FY 1989/91. However, only a portion of the contract progress payments have actually been made at the request of the Turkish and U.S. governments (USAF). The unearned revenue account recognizes the $32,851,229.00 in progress payments collected from CSIF customers but not yet paid to the Turkish government under the contract. It is anticipated that most of the unpaid portion of the contract will be paid by the CSIF to the Turkish government in FY 1992.

Note 8. Liabilities - Other:

Contingent Liabilities: GTE/Hawaiian Telephone Company provided services to CSIF customers during the period of FY 1986/88 which was billed by the company in FY 1991 in an amount in excess of $ 17,000,000. The company states the cost claims are valid while the customers have questioned the charges. The bill is being verified and negotiated by CSIF, DECCO and United States Navy staff on behalf of CSIF with the current vendor claimed liability of $ 13,000,000.00.

Other Liabilities: Accrued miscellaneous other liabilities at year-end were $378,639.04.

Note 9. Equity - Revolving Fund Balances:

The CSIF Net Worth is segmented into three parts: (1) Initial Congressional capitalization less liabilities assumes; (2) Fixed Assets Purchased or Contributed; (3) Net Accumulated Operating Results (i.e., net profit or loss) of the Activity from inception to the end of the current fiscal year. The respective balances as of 30 September 1992 are:

Appropriated Capital	-	$	51,323,278.79
Purchased Fixed Assets	-		22,797,873.97
Contributed Fixed Assets	-		47,780,212.85
Accumulated Net Operating Results	-		77,236,641.53
Total		$	199,138,007.14

Assets purchased during FY 1987/89 were part of the Asset Capitalization Program (ACP). The Congress and the Comptroller of the Department of Defense (DoD(C)) discontinued the Asset Capitalization program at the end of FY 1989 and initiated a Capital Budget Program with the beginning of FY 1992. The FY 1992 program is intended to provide capital fixed assets for CSIF fixed asset replacement in the future.

The Accumulated Net Operating Results recognizes income from advance collections (See Note 7) in the period of FY 1989/91 which will be recognized and reflected as an expense when services are performed and billed in arrears by the Turkish Government, thereby reducing accumulated results by $32,851,229.00 (a prior year expense adjustment in FY 1992 (Note 7)).

Note 10. Sources of Funds - Other:

The CSIF Source of Funds - Other Category including audit adjustments is represented by the following entries:

Other Liabilities	-	$	50,889,695.67
Liabilities Assumed at Capitalization	-		107,059.34
Prior Period Adjustments	-		36,044,346.79
Total		$	87,041,101.80

Note 11. Application of Funds - Other:

The CSIF Application of Funds - Other Category including audit adjustments is represented by the following entries:

Contingent Liability	-	$ 13,000,000.00
Fiscal Year 1991 Funding Authority Transferred	-	29,200,000.00
Total	-	$ 42,200,000.00

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F. Financial Statement Analysis of Attirbutes, Measures and Indicators

An overview of the fiscal attributes, measures, and related indicators for the CSIF Fiscal Year 1991 financial statements reflects the following: (Shown in dollars)

- Operating Cost Attribute -

Operating Cost	$ 1,219,022,660	(SF 221)
Percent Change 1990/91	-1.26 %	

- Operating Results Attribute -

Net results	$ 42,257,588	(SF 221)
Percentage of Revenue	+ 3.35 %	
Percent of Revenue Change 1990/91	-28.01 %	

- Operating Efficiency Attribute- The CSIF provides in excess of 2,000 different products and services which are priced (in local currency and dollars) for commercial competitiveness based upon the geographical area of the world where the product is sold. Thus, a single ratio is not developed for management but an individual analysis is performed on each product/service operating efficiency (cost to revenue to price) at least annually.

- Capital Investment Attribute- The CSIF joined the DoD Asset Capital Program in 1987 through Congressional approval of a surcharge added to each sale to establish the necessary equity to begin purchasing capital assets. Also the activity received, as contributed assets, the equipment capitalized in 1987 from the Military Departments. During FY 1990/91 the CSIF capital program was funded by Congress through direct procurement appropriation to "Other Procurement Defense Agencies" and treated as a contributed assets by the activity in accord with DoD direction. Thus, this ratio was not developed for 1991 since capital equipment purchases were other than from operations.

- Financial Oblilgations Attribute -

Current Ratio (Current Assets to Current Liabilities)	+ 2.01:1 (SF 220)
Ratio of Equity to Long Term Liabilities (i.e., Other Liabilities)	+14.89:1 (SF 220)

- Financial Condition Attributes -

Current Ratio (Current Assets to Current Liabilities)	+ 2.01:1 (SF 220)
Debt-to Asset Ratio (Debt Obligations to Total Assets)	+ 0.48:1 (SF 220)

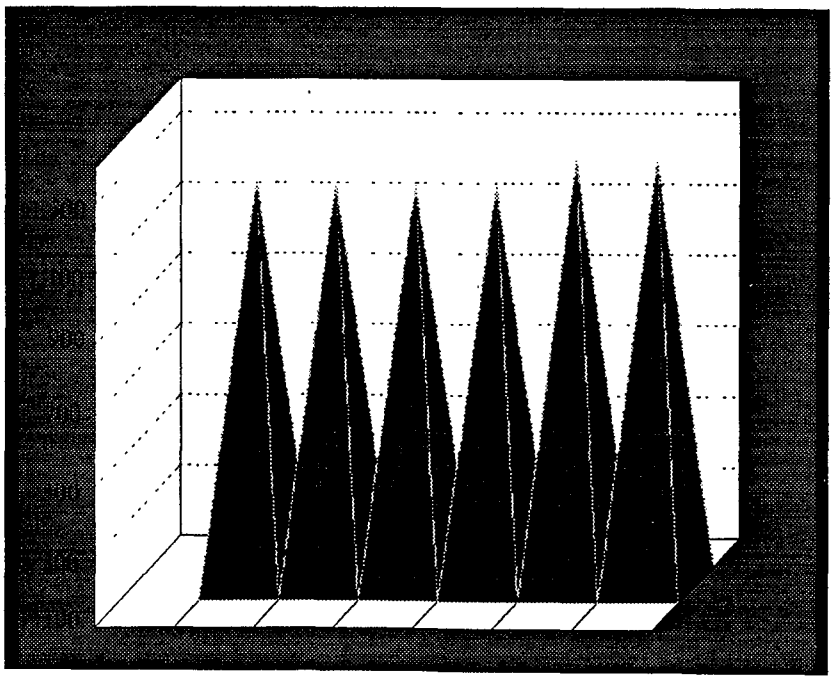
- Trend Analysis -

The following graphic charts reflect:

- Changes in revenue FY 1988-93;
- Changes in operating cost FY 1988-93;
- Annualized net operating results FY 1988-93;
- Sales related to Defense Information Systems Agency (DISA) DISA-managed Defense Communicaiton System (DCS);
- Sales revenue within the non-DISA managed DCS related to non-DoD sales.

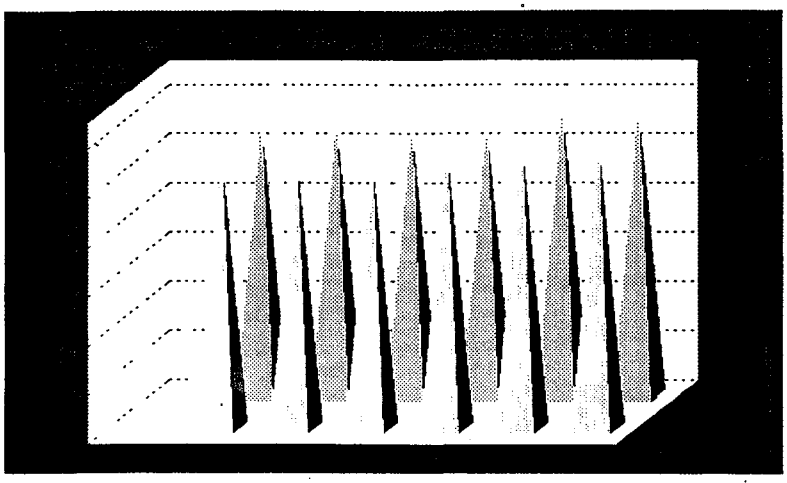
The charts illustrate the growth and planned decline in sales related to DISA-managed DCS programs and show the increasing non-DoD sales anticipated from FTS2000, FIA, DOT, DOS and other civilian agency customers. Although general production costs decreased during the period FY 1988-93 (when inflation adjusted) following the telecommunications divesture decision of 1984 the current indications are that long distance rates (INTER-LATA) are beginning to show increasing costs. Also, as technology affords the localized (INTRA-LATA) DoD customer the ability to manage his own local and long-haul telecommunications resources from his/her post/camp/station the DISA-managed portion of sales will continue to decline. The Department of Defense budget decreases being applied to telecommunications world-wide is further depressing CSIF sales during the period.

CSIF OPERATING COSTS BY YEAR ($ In Millions)



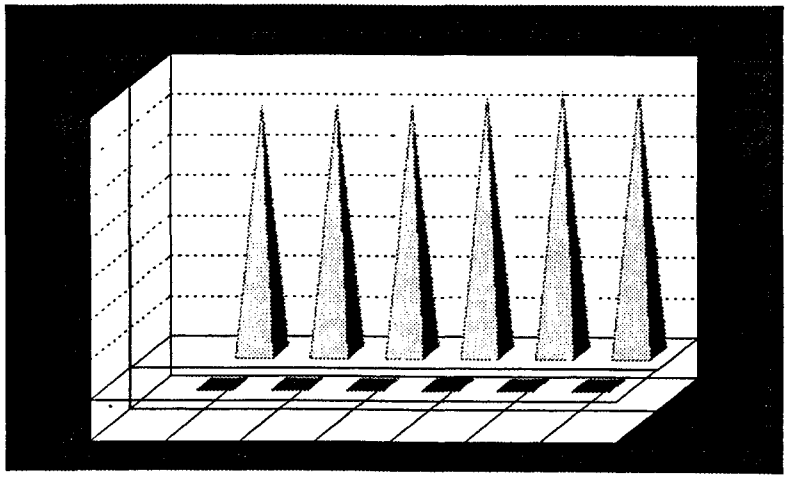
	1988	1989	1990	1991	1992	1993
TOTAL	1,237 9	1,227 8	1,223 4	1,219 1	1,298 7	1,296 6
PRODUCTION	1,223 1	1,209 8	739 7	683 9	704 9	737 1
OVERHEAD	14 8	18	19 8	24 9	23 7	27 3

CSIF COST .VS. REVENUE ANALYSIS BY YEAR ($ In Millions)



	1988	1989	1990	1991	1992	1993
EXPENSES	1237 9	1227.8	1,223.4	1,219.1	1,298.7	1,296 9
REVENUE	1,222	1,229 9	1,224.7	1,261 3	1,298.7	1,296 9
NOR	-15.9	10.1	1.3	42.2	0	0

CSIF COST .VS. REVENUE ANALYSIS BY YEAR ($ In Millions)



	1988	1989	1990	1991	1992	1993
EXPENSES	1,237.9	1,227.8	1,223.4	1,219.1	1,298.7	1,296.9
REVENUE	1,222	1,229 9	1,224.7	1,261 3	1,298.7	1,296.9
NOR	-15.9	10.1	1.3	42 2	0	0

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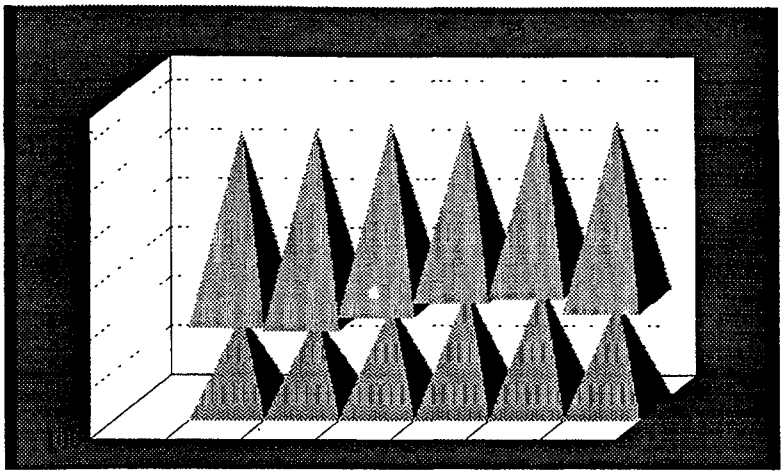
CSIF REVENUE BY FISCAL YEAR ($ In Millions)

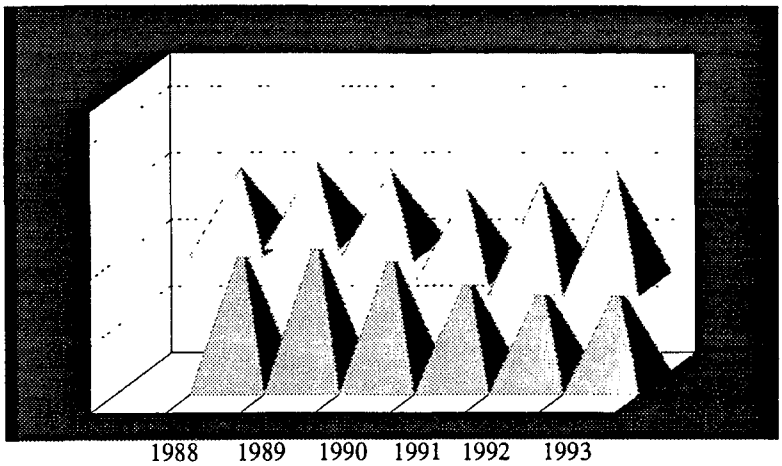
DCS SALES : DISA-MANAGED & NON-DISA MANAGED & NON-DoD



	1988	1989	1990	1991	1992	1993
DISA-MNGD	476 5	465 4	519 7	577 4	593 8	532 5
NON-DISA	745 5	764 5	739 7	683 9	704 9	737 1
NON-DOD	233	231	241.3	256 3	306.1	341 1

CSIF REVENUE BY FISCAL YEAR

DCS SALES: NON-DISA MANAGED & NON-DOD ($ In Millions)



	1988	1989	1990	1991	1992	1993
DISA-MNGD	476 5	465 4	519 7	577 4	593 8	532 5
NON-DISA	512 5	533 5	498 6	427 6	398 8	396
NON-DOD	233	231	241 3	256 3	306 1	341 1

PART V -

ADDITIONAL INFORMATION

APPENDIX A - Laws and Regulations
APPENDIX B - Activities Visited or Contacted
APPENDIX C - Report Distribution

APPENDIX A. LAWS AND REGULATIONS

Civil Service Retirement Act of 1930
Fair Labor Standards Act of 1938
Budget and Accounting Procedures Act of 1950, P.L. 784
Federal Employees' Health Benefits Act of 1959, P.L. 86-382,
Federal Employees' Group Life Insurance Act of 1980, P.L. 96-427
Prompt Payment Act of 1988, P.L. 100-496
Federal Managers' Financial Integrity Act of 1982, P.L. 97-255
Chief Financial Officers Act of 1990, P.L. 101-576
Title 2 of the General Accounting Office's "Policy and Procedures Manual for Guidance of Federal Agencies"
OMB Bulletin No. 91-15, "Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity," September 10, 1991
OMB Circular A-123, "Internal Control Systems," August 4, 1986
OMB Circular A-125, "Prompt Payment," December 12, 1989
OMB Circular A-127, "Financial Management Systems," December 19, 1984
DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987
DoD Directive 7410.4, "Industrial Fund Policy," July 1, 1988
DoD Manual 7110.1, "DoD Budget Guidance," October 30, 1980
DoD Manual 7220.9, "DoD Accounting Policy," October 22, 1981
DoD Manual 7220.9-M, "DoD Accounting Manual"
"DoD Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity," November 13, 1991

APPENDIX B. ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Deputy Comptroller of the Department of Defense (Management Services), Washington, DC

Department of the Air Force

Civil Engineering Squadron, Scott Air Force Base, IL

Defense Agencies

Defense Finance and Accounting Service - Washington Center, Washington, DC
Defense Information Systems Agency, Washington, DC
Defense Commercial Communications Office, Scott Air Force Base, IL

Non-DoD Federal Organizations

Department of the Treasury, Washington, DC
General Accounting Office, Washington, DC

APPENDIX C. REPORT DISTRIBUTION

Office of the Secretary of Defense

Assistant Secretary of Defense (Force Management and Personnel)
Assistant Secretary of Defense (Public Affairs)
Comptroller and Chief Financial Officer of the Department of Defense
Deputy Chief Financial Officer of the Department of Defense

Department of the Army

Inspector General, Department of the Army
Auditor General, U.S. Army Audit Agency

Department of the Navy

Comptroller of the Navy
Director, Naval Audit Service

Department of the Air Force

Auditor General, U.S. Air Force Audit Agency

Defense Agencies

Director, Defense Finance and Accounting Service

Non-DoD Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
NSAID Technical Information Center

Chairmen and Ranking Minority Members of the following Congressional Committees:

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 Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

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