
**Department of Defense
Office of Inspector General**

**Financial Statements
As of and for the Year Ended September 30, 2004**

Submitted By

Leon Snead & Company, P.C.
Certified Public Accountants & Management Consultants

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Inspector General, Department of Defense

Independent Auditor's Report

We have audited the balance sheet of the Department of Defense (DOD), Office of Inspector General (OIG) as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, and financing (the financial statements) for the year then ended. The objective of our audit was to express an opinion on the fair presentation of those financial statements. In connection with our audit, we also considered the OIG's internal control over financial reporting and tested the OIG's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, we found that the OIG's financial statements as of and for the year ended September 30, 2004, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants. Our testing of internal control identified no material weaknesses in financial reporting operations or processes under the direct control of the OIG. However, we identified matters within service providers concerning financial management systems and processes that we consider to be material weaknesses in relation to the OIG's financial statements.

The results of our tests of compliance with certain provisions of laws and regulations disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The following sections discuss in more detail our opinion on the OIG's financial statements, our consideration of the OIG's internal control over financial reporting, our tests of the OIG's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheet of the DOD OIG as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position, net cost, changes in net position, budgetary resources, and financing of the OIG as of and for the years ended September 30, 2004, in conformity with accounting principles generally accepted in the United States of America. We did not audit the financial statements as of and for the year ended September 30, 2003, and we do not express an opinion on those statements.

The information in the Management's Discussion and Analysis section is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of OIG management regarding the methods of measurement and presentation of the supplementary information and analysis of the information for consistency with the financial statements. However, we did not audit the information and express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. Our testing of internal control identified no material weaknesses in financial reporting operations or processes under the direct control of the OIG. However, we identified matters, related to

Departmental financial management systems used to record, process, summarize and report OIG activities and results that we consider to be material weaknesses in relation to the OIG's financial statements.

OIG's service providers do not have a single system that retains all of the transaction level detail necessary to support the OIG's financial statement amounts. The basic accounting system captures data using object classes¹, not general ledger accounts. The object classes are translated into DoD general ledger account totals using an automated program. As a result of the translation, the service provider must post numerous, often material adjustments to re-create beginning balances in net position accounts, reconcile proprietary accounts to budgetary accounts, and create a trial balance in U.S. Standard General Ledger (SGL) format.

This issue is a part of long-standing, well-documented financial management systems weaknesses that have been reported by the Defense Financial Auditing Service and the Government Accountability Office in previous years' reports on the DoD financial statements and the government-wide financial statements, respectively. The Department does not maintain systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. SGL at the transaction level.

We noted other matters involving internal control over financial reporting and its operation that we have reported to the management of the OIG in a separate letter dated October 29, 2004.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

As noted above, Departmental financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, or the SGL at the transaction level.

RESPONSIBILITIES

Management Responsibilities

Management of the OIG is responsible for: (1) preparing the financial statements in conformity with generally accepted accounting principles; (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control

¹ Object classes are categories in a classification system that presents obligations by the items or services purchased by the Federal government, such as salaries, benefits, travel, rent, etc. General ledgers capture data by accounting classification, such as assets, liabilities, revenues, and expenses.

objectives of the FMFIA are met; and (3) complying with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies.

Auditor Responsibilities

Our responsibility is to express an opinion on the fiscal year 2004 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes (1) examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our audit, we considered the OIG's internal control over financial reporting by obtaining an understanding of the agency's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.

We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by FMFIA. Our procedures were not designed to provide assurance on internal control over financial reporting. Consequently, we do not express an opinion thereon.

As required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined to be key and reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and significant provisions of contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the OIG. Providing an

opinion on compliance with certain provisions of laws, regulations, and significant contract provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

Federal law (31 USC Sec. 3512) requires designated departments and agencies to comply with the Federal Financial Management Improvement Act (FFMIA) of 1996. OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, requires auditors for Executive Branch departments and several designated agencies to report whether the audited entity's financial management systems substantially comply with FFMIA. Although the Department is subject to FFMIA, the DoD OIG is not among the entities designated by the Federal law or the OMB guidance to be subject to the compliance or audit requirements of FFMIA. Our procedures were not designed to provide assurance on whether the DoD OIG systems substantially comply with FFMIA and, accordingly, we do not provide an opinion thereon.

AGENCY COMMENTS AND AUDITOR EVALUATION

In commenting on the draft of this report, the management of OIG concurred with the facts and conclusions in our report. A copy of management's response accompanies this report.

DISTRIBUTION

This report is intended solely for the information and use of the management of the DoD OIG, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Leon Snead & COMPANY, P.C.
Leon Snead & Company, P.C.
October 29, 2004



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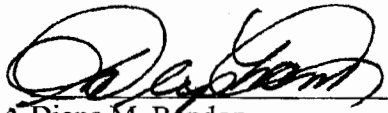
November 5, 2004

Mr. Leon Snead, President
Leon Snead & Company, P.C.
416 Hungerford Drive, Suite 400
Rockville, Maryland 20850

Dear Mr. Snead:

We are providing this letter in connection with your financial statement audit of the Department of Defense (DoD) Office of Inspector General (OIG) as of September 30, 2004. We have reviewed the October 29, 2004 Draft Independent Auditor's Report provided at the Exit Conference held on November 1, 2004 at the Office of the Inspector General. We concur with the findings, as documented, in the report. Also, we are aware of the problems addressed in the Internal Control Over Financial Reporting section of the report.

Specifically, we know that the OIG's finance and accounting service provider uses a legacy system that does not contain all of the transaction level detail necessary to support the OIG's financial statement amounts. This is well documented and has been reported by Department of Defense. The Defense Finance and Accounting Service is working to address these weaknesses and is building a business case to develop a replacement accounting system.


Diane M. Randon
Comptroller

Department of Defense
Office of the Inspector General



Management's Discussion
and Analysis

Management's Discussion & Analysis

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I. Mission Statement

The Office of the Inspector General of the Department of Defense (OIG DoD) was established by Congress as one of the “independent and objective units [within listed ‘establishments,’ including the Department of Defense] to conduct and supervise audits and investigations relating to the programs and operations of those establishments.” As the principal advisor to the Secretary of Defense in all Inspector General matters, the Inspector General serves as an extension of “the eyes, ears, and conscience”² of the Secretary. In support of the mission of the Department of Defense, the Office of the Inspector General endeavors to:

- “Provide leadership...to promote economy, efficiency and effectiveness”³ of the Department of Defense, i.e. [military] readiness in peace and victory in war;
- Prevent and detect “fraud, waste, and abuse”⁴;
- “Provide policy direction for audits and investigations”⁵;
- “Provide a means for keeping the Secretary of Defense and the Congress fully and currently informed about problems and deficiencies”⁶; and
- “Give particular regard to the activities of the internal audit, inspection, and investigative units of the military departments with a view toward avoiding duplication and insuring effective coordination and cooperation.”⁷

II. Vision Statement

One professional team of auditors, inspectors, and investigators, inspiring by paradigm a culture of integrity, accountability, and “intelligent risk-taking” throughout the Department of Defense.⁸

III. Core Values

Accountability⁹ • Integrity & Efficiency¹⁰

IV. Organization

As stated above, the OIG DoD conducts and supervises audits and investigations relating to the programs and operations of those establishments. It also provides leadership to promote economy, efficiency and effectiveness.

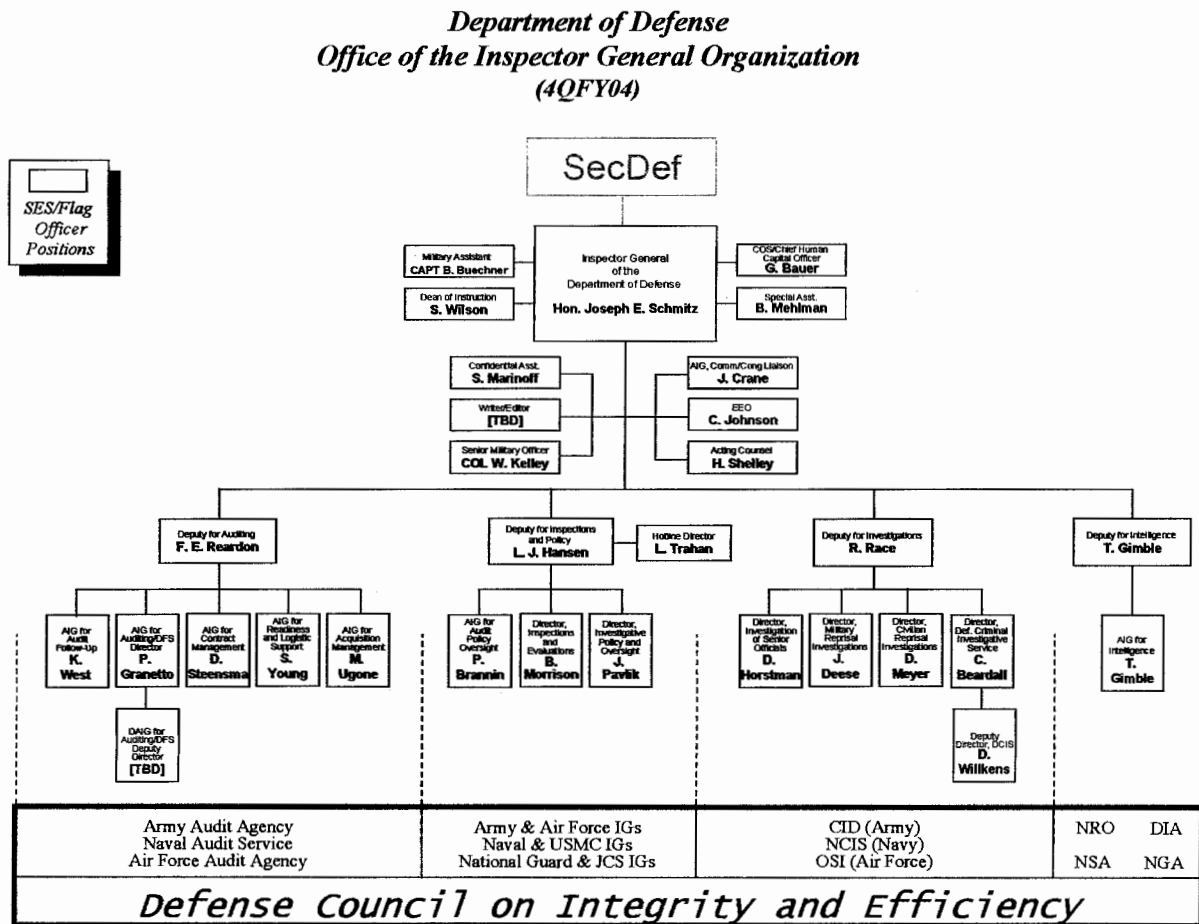


Figure 1. OIG DoD's Organizational Structure as of September 30, 2004

The OIG DoD had a September 30, 2004 end strength of approximately 1,271 employees, of which 19 were the rank of Senior Executive Service (SES). Figure 1 depicts the OIG DoD's organizational structure as of September 30, 2004.

V. Budgetary and Financial Aspects

The OIG DoD’s budget has been structured to respond to existing and emerging “core mission” OIG activities which include audit, inspection, and investigative coverage. Although all OIG Components have seen growth in the scope of their respective missions areas (i.e. Congressionally requested audits and inspections, investigative coverage since 9/11 and statutorily required audits), the OIG DoD budget has remained relatively flat. This Agency has been challenged to respond to growing demands for audit, inspection and investigative coverage while having to absorb inflation and annual pay increases from the existing funding program.

There are two areas of mission expansion that have provided commensurate budget growth. First, the audit mission has grown to include funding to support its annual requirements to audit DoD financial statements and systems that DoD Components assert as reliable for audit. The Office of the Under Secretary of Defense (Comptroller) has set a goal for the Department to obtain clean audit opinions on its financial statements by FY 2007 and has required DoD Components to submit financial improvement initiatives that outline how each component plans to meet this goal. The financial improvement initiatives will improve processes and controls so that accurate information can be transferred from DoD’s current environment into the reengineered environment. The initiatives are approved and overseen by the Executive Steering Committee, which is chaired by the OSD Deputy Chief Financial Officer. In FY04, the OIG DoD successfully pursued a reprogramming of funds, approximately \$5.7M, from other services to begin this financial statement audit initiative. In FY05, the President’s Budget was passed with an approved \$33.0M growth to continue these audits. Second, the investigative coverage in forward deployed areas, like Afghanistan and Iraq, has burdened the already constrained Agency budget. In FY04, the OIG received \$900K in reimbursements for incremental growth in costs associated with travel, training, overtime and hazardous duty pay. We continue to support the Global War on Terrorism in FY05, using our current available budget and will seek relief from OSD, again.

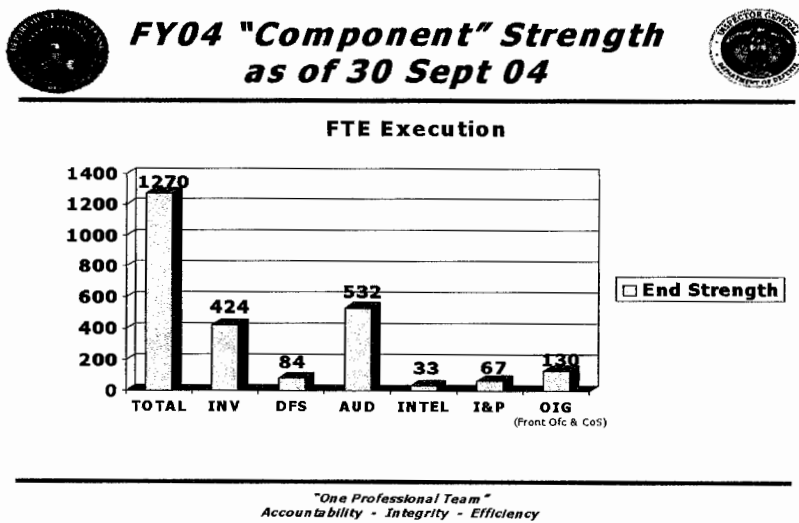


Figure Total Strength as of September 30, 2004.

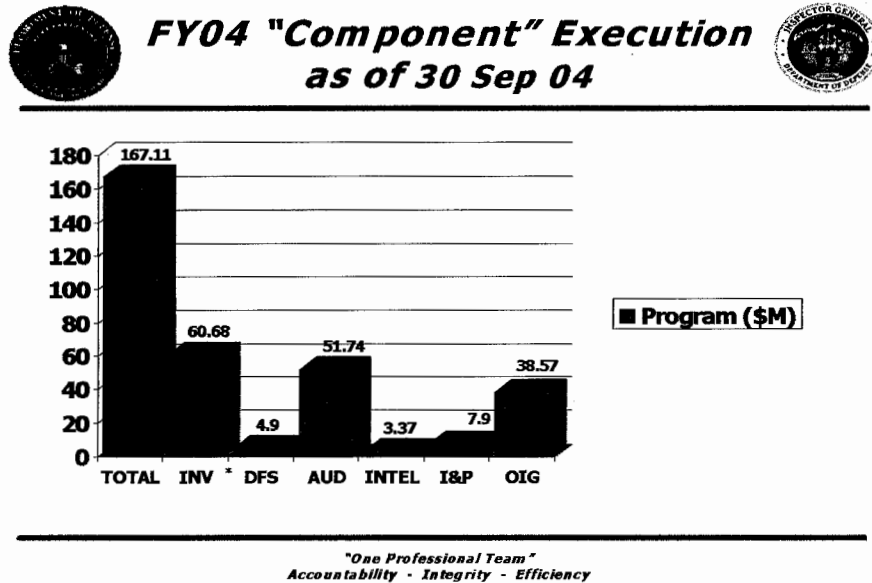


Figure FY 2004 Funding given to executing components

Financial Condition

The OIG DoD's operations are primarily Operations and Maintenance. As a result, the OIG DoD conducts and supervises audits and investigations relating to the programs and operations of DoD agencies and components.

The OIG DoD's annual appropriation for FY 2004 was \$162.45 million. During the FY 04 the OIG DoD received an additional \$6.637 million in reprogramming to cover expenses such initiatives as Mid-Range Financial Improvement, Drug Interdiction & Counter Drug Activities, and support to Global War on Terrorism.

Fund Balance with Treasury decreased by \$9.1 million or 36% from FY 2003 to FY 2004. The decrease was a result of an increase in personnel cost associated with the increase auditor support for the audit for DoD Financial Statements and for the increased operational cost associated with the support to Global War on Terrorism, and the Coalition Provisional Authority- Inspector General.

Unexpended appropriations decreased by \$13.0 million or 61% from FY 2003 to FY 2004. Unobligated, available balances decreased by \$3.1 or 76.% million as a result of obligating over \$2.0 million in available FY 2002 and FY 2003 procurement dollars and returning over \$1.1 million in available balance to OSD to fund the Foreign Currency Fluctuation Account shortfalls.

Limitations to the Financial Statements

The financial statements have been prepared to report the financial position and results of operations for the entity. These statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget, and guidance provided by the Department and in accordance with mandatory reporting requirements and regulations as stated in the DoD Financial Management Regulation (FMR).

To the extent possible, the financial statements have been prepared in accordance with federal accounting standards and generally accepted accounting principles. However, at times, the Department has been unable to implement all elements of the standard due to financial management systems limitations and standards generally used throughout the DoD-wide. The Department continues to implement system improvements to address these limitations.

The statements presented should be read with the realization that they are for a component of the U.S. Government, Department of Defense, or a sovereign. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

VI. Systems, Controls, and Legal Compliance

OIG DoD Systems

The OIG DoD depends on a variety of DoD systems to record, summarize, and report its financial information. Some of the systems include:

- Washington Allotment and Accounting System (WAAS)
- Defense Departmental Reporting System (DDRS)
- Headquarters Accounting and reporting System (HQARS)
- CFO Loan and Reconciliation System (CLRS)

Currently, the DoD systems are not in full compliance with the requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. In its effort to ensure that the Department-wide critical accounting, finance, and feeder systems comply with federal financial management requirements, the DoD established the Senior Financial Management Oversight Council (SFMOC). This council will oversee and provide guidance in the implementation of the Financial and Feeder Systems Compliance.

Due to the complexity and multiple systems currently used by DoD to process its financial transactions and prepare its financial statements, it will take time for its financial accounting systems to become fully compliant with applicable laws and regulations, including FFMIA.

Controls and Legal compliance

FY 2004 is the first year that the OIG DoD's financial statements are subject to an audit. In an effort to prepare for the audit of its financial statements, the OIG DoD tasked an internal group of auditors to perform an assessment of the FY 2002 financial statements to determine the OIG DoD readiness for audit. The assessment included reviews of Fund Balance with Treasury, Expenses, Internal Controls, and compliance with laws and regulations.

The result of our assessment indicated that the process and key internal controls used by the OIG DoD provided reasonable assurance of achieving financial management objectives. Nevertheless, the assessment also indicated that the internal controls at Defense Finance Accounting Service (DFAS) Indianapolis were not operating as intended and that the DoD-wide systemic deficiencies in financial management systems also affected internal controls at DFAS Indianapolis.

We recognize that the assessment has significant challenges to overcome in improving the overall financial position. Many of the issues identified by the assessment team relates to matters that are not under the OIG DoD direct control.

VII. Performance Information

Strategic Goals and Objectives

Goal 1: Inspire by paradigm and strive for excellence in the management of audits, inspections, and investigations, thereby laying the foundation for a culture of creativity, accountability and intelligent-risk taking throughout the Department of Defense.

Objectives:

- 1) Ensure that all Office of the Inspector General (OIG) operations are performed pursuant to prescribed OIG implementing guidance for all the duties, responsibilities, and powers specified in the Inspector General Act and in any other applicable statutes, regulations, or directives.
- 2) Develop and implement a robust cross-directorate and inter-agency Leadership Development and Succession Plan.
- 3) Above all, "lead by example"¹¹ in efforts to implement the President's Management Agenda initiatives of: strategic management of human capital¹²; competitive sourcing; improved financial performance; expanded electronic government; and budget and performance integration,¹³ within OIG DoD.
- 4) "Give particular regard to the activities of the internal audit, inspection, and investigative units of the military departments with a view toward avoiding duplication and insuring effective coordination and cooperation."¹⁴

5) Improve the effectiveness of all Department of Defense Inspector General operations.

6) Improve the efficiency of all Department of Defense Inspector General operations, through reductions in cycle times, and other means.

7) Ensure the integrity of the Inspector General by “[complying] with standards established by the Comptroller General...for audits of Federal establishments.”¹⁵ Accordingly, determine “whether internal quality controls are in place and operating and whether established audit standards, policies and procedures are being followed,”¹⁶ and ensure external reviews occur regularly.

8) Build and sustain a diverse workforce with the right skill mix, providing equal opportunity for all, thus inspiring by paradigm and fostering the vision of "one professional team" for the OIG.

9) Ensure all Personnel Security Investigations are kept current.

10) Provide transparent, seamless, timely, and courteous logistical and administrative support to the overall OIG DoD mission to include: policy analysis and coordination; records management; publications; facilities; procurement; supply, accountable property; travel and transportation; and mail and correspondence handling and distribution.

Goal 2: “Promote economy, efficiency and effectiveness in the administration of”¹⁷ all Department of Defense programs, by means of “audits and investigations”¹⁸ and inspections, to thereby ensure that the Inspector General is a catalyst in implementing the transformation efforts of the Secretary of Defense.

Objectives:

1) Promote the effectiveness of Department of Defense programs, strategic goals, and mission.

2) Promote the economy and efficiency of all Department of Defense programs.

3) Improve intelligence products so as to promote the effectiveness of associated Department of Defense programs.

Goal 3: Lead efforts “relating to the prevention and detection of fraud, waste, and abuse in the programs and operations of the Department,”²⁰ and thereby ensure that the Inspector General is a catalyst in implementing the transformation efforts of the Secretary of Defense.

Objectives:

1) Significantly contribute to the elimination of waste, fraud and abuse.

2) "The Inspector General may receive and investigate complaints or information from an employee of the establishment concerning the possible existence of an activity constituting a violation of law, rules, or regulations, or mismanagement, gross waste of funds, abuse of authority or a substantial and specific danger to the public health and safety."²¹

Goal 4: "Foster and promote public accountability and integrity"²² within the Department of Defense.

Objective:

1) Foster and promote a culture of personal and professional integrity and accountability within the Department of Defense²³.

Goal 5: Keep "the head of the establishment [Secretary of Defense] and the Congress fully and currently informed about problems and deficiencies relating to the administration of [Department of Defense] programs and operations and the necessity for and progress of corrective action."²⁴

Objectives:

1) Report immediately to the Secretary of Defense "particularly serious or flagrant problems, abuses or deficiencies."²⁵

2) "To keep the [Secretary of Defense] and the Congress fully and currently informed by means of [semiannual reports] and otherwise, concerning fraud and other serious problems, abuses and deficiencies relating to the administration of programs and operations administered or financed by [the Department of Defense], to recommend corrective action concerning such problems, abuses and deficiencies, and to report on the progress made in implementing such corrective action."²⁶ "To review existing and proposed legislation and regulations relating to programs and operations of [the Department of Defense] to make recommendations in the semiannual reports."²⁷

3) "Give particular regard to the activities of the Comptroller General of the United States with a view toward avoiding duplication and [e]nsuring effective coordination and cooperation."²⁸

4) Expeditiously report (1) "to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law"²⁹ and; (2) "suspected or alleged violations of chapter 47 of title 10, United States Code (Uniform Code of Military Justice), to the Secretary of the military department concerned or the Secretary of Defense."

Results:

Although the Office of the Inspector General is not legally bound to the requirements set forth in the Government Performance and Results Act (GPRA) of 1993, it has voluntarily implemented and complied with all of the requirements of the act.

The DoD OIG is the first statutory OIG with a strategic plan focused on achieving the goals of the President's Management Agenda (PMA) for both itself and the Department. In FY 2004, the DoD IG made progress in addressing the areas of strategic management of human capital and expanding electronic government. Aside from hiring a PMA expert for the OIG, PMA-related initiatives underway include: development of on-line exit surveys; creation of an overall IG professional recruitment plan; achieving a 100 percent mandatory training rate; and greater automation through expanded use of the Defense Audit Management Information System (DAMIS).

For FY 2004, 86 percent of annual performance goals are on-track. The remaining 14% encompass 5 goals that were unattainable for FY 2004.

VIII. Events, Trends, and Risks

In testifying before Congress earlier this year, Secretary of Defense Donald Rumsfeld noted the common challenge faced by the Department and the Congress "to support the troops and to make sure they have what they will need to defend the nation in the years ahead." The Secretary told Congress, "We are working to do that in a number of ways:

- By giving them the tools they need to win the global war on terror;
- By transforming for the 21st century, so they will have the training and tools they need to prevail in the next wars our nation may have to fight—wars which could be notably different from today's challenges;
- And by working to ensure that we manage the force properly—so we can continue to attract and retain the best and brightest, and sustain the quality of the all-volunteer force."

The Office of the Inspector General is committed to assisting the Department and the Congress in meeting this challenge. Our recent efforts in support of the Global War on Terror and to improve the programs and operations of the Department include:

- IG Support to the Global War on Terror:

In direct support to all aspects of the Global War on Terror (GWOT), this office has provided approximately \$3.6 million worth of audit, inspection, and investigative services in the 2nd quarter of FY 2004.

Currently, the Office of the Inspector General has 125 staff members providing support to the Coalition Provisional Authority (CPA) and the CPA Inspector General pursuant to the "Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004" (Public Law

108-106) which requires that that the CPA IG “shall coordinate with, and receive the cooperation of, the Inspector General of the Department of Defense.” The DoD IG also has a statutory duty under Section (4)(c) of the Inspector General Act of 1978 requiring that: “In carrying out the duties and responsibilities established under this Act, each Inspector General shall give particular regard to the activities of the Comptroller General of the United States with a view toward avoiding duplication and insuring effective coordination and cooperation.” In that regard, in addition to our audit work on the Office of Reconstruction and Humanitarian Assistance (the predecessor to the CPA), this office has continued to monitor and coordinate with the General Accounting Office, the Defense Contract Audit Agency, the Army Audit Agency, the Agency for International Development, and the Department of State Office of the Inspector General on the on-going and planned audit work for Operation Enduring Freedom, Operation Iraqi Freedom, and Operation Noble Eagle.

- Public Confidence in Integrity of DoD Programs and Operations:

We initiated an audit of the Air Force Boeing 767 tanker program, focusing on acquisition and contract management issues, in response to the following request from the Deputy Secretary of Defense: “In light of recent revelations by The Boeing Company concerning improprieties by two of the company’s executives, please determine whether there is any compelling reason why the Department of the Air Force should not proceed with its Tanker Lease Program.” In our March 29, 2004, report, we reported that the short answer to the Deputy's questions was "no"; however, we recommended that the Department not proceed until it resolves five statutory requirements and related issues. As a result of a parallel investigation by the investigative component of this office, one of the aforementioned Boeing executives subsequently plead guilty to criminal conspiracy in federal district court.

By memorandum dated January 30, 2004, the Deputy Secretary established a DoD "zero tolerance" policy on trafficking in persons, following our assessments of DoD efforts to combat trafficking in Korea and the Balkans. The DoD policy has since become the model for the draft of a NATO policy document currently in staffing. We continue to monitor DoD activities in this area as part of ongoing inspection efforts.

In addition to support for the Global War on Terror, this Office is also committing substantial resources to assist Department initiatives to improve financial management and to support the Base Realignment and Closure process. The significant growth and complexity of DoD business operations, human capital requirements, and information technology infrastructure have resulted in an increase in Departmental and congressional requirements placed on the Office of Inspector General. Although we project continued involvement in these operations, there is no commensurate increase in funding or personnel resources to our appropriation. We will continue to pursue additional resources for the financial statement initiatives and GWOT support through DOD based on our projected requirements.

**Summary Table:
Current Program and Requested Adjustments
Based on Projected Requirements
(TOA in \$M)**

	<u>FY05</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>
FY05 President's Budget	\$244.6	\$168.9	\$175.0	\$178.8	\$182.1		
<u>FY06 PROGRAM</u>							
Base Fiscal Guidance		\$168.1	\$174.1	\$177.8	\$181.4	\$185.8	\$190.3
Workyears - Civilian		1,160	1,154	1,140	1,130	1,117	1,110
Workyears - Military		29	29	29	29	29	29
<u>REQUESTED ADJUSTMENTS</u>							
<i>Fiscal Adjustments - Total</i>		\$67.6	\$80.1	\$91.6	\$104.7	\$118.8	\$133.1
I. DFS Emerging		\$37.5	\$39.1	\$39.9	\$41.1	\$42.7	\$43.4
II. "Core Mission" Recurring		\$18.5	\$29.3	\$49.0	\$51.4	\$63.6	\$76.1
III. GWOT Emerging		\$11.6	\$11.7	\$12.7	\$12.2	\$12.5	\$13.6
<i>Civilian Workyear Adjustments - Total</i>		451	520	578	652	734	802
I. DFS Emerging		288	299	298	298	298	298
II. "Core Mission" Recurring		96	154	213	287	369	437
III. GWOT Emerging		67	67	67	67	67	67
<i>REVISED Fiscal Guidance</i>		\$235.7	\$254.2	\$269.4	\$286.1	\$304.6	\$323.4
<i>REVISED Civilian Workyears</i>		1,611	1,674	1,718	1,782	1,851	1,912

Figure Above Guidance Submission – Program Objective Memorandum FY06-11

IX. End Notes

¹ Inspector General Act of 1978, as amended, Sections 2(1) (“to conduct and supervise audits and investigations relating to the programs and operations of the establishments listed in section 11(2)”) & 11(2) (“the term ‘establishment’ means the Department of Agriculture, Commerce, Defense. . .”).

² Army Regulation 20-1, *Inspector General Activities and Procedures* 5 (Department of the Army 2002).

³ Inspector General Act of 1978, as amended, Section 2(2)(A).

⁴ Inspector General Act of 1978, as amended, Section 8(c)(1). *See also* 2(2)(B).

⁵ Inspector General Act of 1978, as amended, Section 8(c)(3).

⁶ Inspector General Act of 1978, as amended, Section 2(3). *See also* 4(a)(5).

⁷ Inspector General Act of 1978, as amended, Section 8(c)(9).

⁸ *See* remarks by the President at U.S. Naval Academy Commencement, May 25, 2001; comments by Secretary Rumsfeld, DoD News Briefing – Secretary Rumsfeld and Gen. Myers, December 27, 2001; *see also* Association of Inspectors General, *Principles and Standards for Offices of Inspector General*, at 1 (May 2001) (“the purpose of the Association [of Inspectors General] is to: foster and promote public accountability and integrity in the general areas of the prevention, examination, investigation, audit, detection, elimination and prosecution of fraud, waste and abuse. . .”).

⁹ *See* U.S. Constitution, Article I, Section 9 (“a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time”).

¹⁰ Executive Order 12805 of May 11, 1992 (“Integrity and Efficiency in Federal Programs”).

¹¹ Secretary Rumsfeld’s comments at 9/17/02 Staff Meeting (subsequently approved for IG dissemination by Secretary Rumsfeld).

¹² Inspector General Regulation 1400.8.

¹³ Executive Office of the President, Office of Management and Budget, *The President’s Management Agenda, Fiscal Year 2002*.

¹⁴ Inspector General Act of 1978, as amended, Section 8(c)(9).

¹⁵ Inspector General Act of 1978, as amended, Section 4(b)(1)(A).

¹⁶ Inspector General Act of 1978, as amended, Section 4(b)(2).

- 17 Inspector General Act of 1978, as amended, Section 2(2)(A).
- 18 Inspector General Act of 1978, as amended, Section 8(c)(2).
- 19 Department of Defense Performance and Accountability Report, Working Draft of 11/6/2003.
- 20 Inspector General Act of 1978, as amended, Section 8(c)(1).
- 21 Inspector General Act of 1978, as amended, Section 7(a).
- 22 Association of Inspectors General, *Principles and Standards for Offices of Inspector General*, at 1 (May 2001).
- 23 Inspector General Regulation 1400.8.
- 24 Inspector General Act of 1978, as amended, Section 2(3).
- 25 Inspector General Act of 1978, as amended, Section 5(d).
- 26 Inspector General Act of 1978, as amended, Section 4(a)(5).
- 27 Inspector General Act of 1978, as amended, Section 4(a)(2).
- 28 Inspector General Act of 1978, as amended, Section 4(c).
- 29 Inspector General Act of 1978, as amended, Section 4(d).

Department of Defense
Other Defense Organizations General Funds - Inspector General, Department of Defense
CONSOLIDATED BALANCE SHEET
As of September 30, 2004 and 2003
(In Thousands)

	<u>2004 Consolidated</u>	<u>2003 Consolidated (Unaudited)</u>
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 16,115	\$ 25,306
Non-Entity Seized Iraqi Cash	0	0
Non-Entity-Other	0	0
Investments	0	0
Accounts Receivable (Note 4)	8,893	0
Other Assets	0	0
Total Intragovernmental Assets	<u>\$ 25,008</u>	<u>\$ 25,306</u>
Cash and Other Monetary Assets	\$ 0	\$ 0
Accounts Receivable (Note 4)	30	19
Loans Receivable	0	0
Inventory and Related Property	0	0
General Property, Plant and Equipment (Note 5)	228	680
Investments	0	0
Other Assets	207	211
TOTAL ASSETS	<u><u>\$ 25,473</u></u>	<u><u>\$ 26,216</u></u>
LIABILITIES (Note 6)		
Intragovernmental:		
Accounts Payable (Note 7)	\$ 30	\$ 0
Debt	0	0
Environmental Liabilities	0	0
Other Liabilities (Note 8)	1,767	1,518
Total Intragovernmental Liabilities	<u>\$ 1,797</u>	<u>\$ 1,518</u>
Accounts Payable (Note 7)	\$ 259	\$ 0
Military Retirement Benefits and Other Employment-Related	5,096	5,667
Actuarial Liabilities (Note 9)		
Environmental Liabilities	0	0
Loan Guarantee Liability	0	0
Other Liabilities (Note 8)	12,952	11,096
Debt Held by Public	0	0
TOTAL LIABILITIES	<u><u>\$ 20,104</u></u>	<u><u>\$ 18,281</u></u>
NET POSITION		
Unexpended Appropriations (Note 10)	\$ 8,576	\$ 21,569
Cumulative Results of Operations	(3,207)	(13,634)
TOTAL NET POSITION	<u><u>\$ 5,369</u></u>	<u><u>\$ 7,935</u></u>
TOTAL LIABILITIES AND NET POSITION	<u><u>\$ 25,473</u></u>	<u><u>\$ 26,216</u></u>

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

CONSOLIDATED STATEMENT OF NET COST

For the periods ended September 30, 2004 and 2003

(In Thousands)

	<u>2004 Consolidated</u>	<u>2003 Consolidated (Unaudited)</u>
Program Costs		
Intragovernmental Gross Costs	\$ 41,616	\$ 36,008
(Less: Intragovernmental Earned Revenue)	(11,302)	0
Intragovernmental Net Costs	\$ 30,314	\$ 36,008
Gross Costs With the Public	149,109	126,535
(Less: Earned Revenue From the Public)	0	19
Net Costs With the Public	\$ 149,109	\$ 126,554
Total Net Cost	\$ 179,423	\$ 162,562
Cost Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	<u>\$ 179,423</u>	<u>\$ 162,562</u>

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended September 30, 2004 and 2003

(In Thousands)

	2004 Consolidated	2003 Consolidated (Unaudited)
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ (13,634)	\$ (16,405)
Prior period adjustments (+/-)		
Prior Period Adjustments - Restated (+/-)	0	0
Beginning Balance, Restated	(13,634)	(16,405)
Prior Period Adjustments - Not Restated (+/-)	0	0
Beginning Balances, as adjusted	(13,634)	(16,405)
Budgetary Financing Sources:		
Appropriations received	0	0
Appropriations transferred-in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	180,849	156,011
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers-in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	(618)	252
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers-in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	9,619	9,070
Other (+/-)	0	0
Total Financing Sources	189,851	165,333
Net Cost of Operations (+/-)	179,423	162,562
Ending Balances	\$ (3,207)	\$ (13,634)

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended September 30, 2004 and 2003

(In Thousands)

	2004 Consolidated	2003 Consolidated (Unaudited)
UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$ 21,569	\$ 21,459
Prior period adjustments (+/-)		
Prior Period Adjustments - Restated (+/-)	0	0
Beginning Balance, Restated	21,569	21,459
Prior Period Adjustments - Not Restated (+/-)	0	0
Beginning Balances, as adjusted	21,569	21,459
Budgetary Financing Sources:		
Appropriations received	162,449	157,165
Appropriations transferred-in/out (+/-)	6,353	515
Other adjustments (rescissions, etc) (+/-)	(946)	(1,559)
Appropriations used	(180,849)	(156,011)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers-in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers-in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	(12,993)	110
Net Cost of Operations (+/-)		
Ending Balances	\$ 8,576	\$ 21,569

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended September 30, 2004 and 2003

(In Thousands)

	2004 Combined	2003 Combined (Unaudited)
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	\$ 162,449	\$ 157,165
Borrowing authority	0	0
Contract authority	0	0
Net transfers (+/-)	6,637	515
Other	0	0
Unobligated balance:		
Beginning of period	5,065	8,267
Net transfers, actual (+/-)	(284)	0
Anticipated Transfers balances	0	0
Spending authority from offsetting collections:		
Earned	0	0
Collected	2,428	56
Receivable from Federal sources	8,875	(75)
Change in unfilled customer orders	0	0
Advance received	0	0
Without advance from Federal sources	374	38
Anticipated for the rest of year, without advances	0	0
Transfers from trust funds	0	0
Subtotal	<u>11,677</u>	<u>19</u>
Recoveries of prior year obligations	3,382	1,276
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(946)	(1,559)
Total Budgetary Resources	<u>\$ 187,980</u>	<u>\$ 165,683</u>

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended September 30, 2004 and 2003

(In Thousands)

	2004 Combined	2003 Combined (Unaudited)
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	\$ 172,391	\$ 160,575
Reimbursable	11,747	43
Subtotal	184,138	160,618
Unobligated balance:		
Apportioned	984	4,122
Exempt from apportionment	0	0
Other available	0	0
Unobligated Balances Not Available	2,858	943
Total, Status of Budgetary Resources	\$ 187,980	\$ 165,683
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net - beginning of period	\$ 20,592	\$ 13,464
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, Net - end of period:		
Accounts receivable	(8,893)	(19)
Unfilled customer order from Federal sources	(417)	(43)
Undelivered orders	17,494	17,513
Accounts payable	4,089	3,141
Outlays:		
Disbursements	179,826	152,251
Collections	(2,428)	(56)
Subtotal	177,398	152,195
Less: Offsetting receipts	0	0
Net Outlays	\$ 177,398	\$ 152,195

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

COMBINED STATEMENT OF FINANCING

For the periods ended September 30, 2004 and 2003

(In Thousands)

	2004 Combined	2003 Combined (Unaudited)
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	\$ 184,138	\$ 160,618
Less: Spending authority from offsetting collections and recoveries (-)	(15,059)	(1,295)
Obligations net of offsetting collections and recoveries	169,079	159,323
Less: Offsetting receipts (-)	0	0
Net obligations	169,079	159,323
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	9,619	9,070
Other (+/-)	0	0
Net other resources used to finance activities	9,619	9,070
Total resources used to finance activities	178,698	168,393
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered Orders (-)	22	(7,185)
Unfilled Customer Orders	374	38
Resources that fund expenses recognized in prior periods	(570)	(46)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0
Resources that finance the acquisition of assets	0	(177)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Other (+/-)	0	0
	0	0
Total resources used to finance items not part of the net cost of operations	(174)	(7,370)
Total resources used to finance the net cost of operations	178,524	161,023

Department of Defense

Other Defense Organizations General Funds - Inspector General, Department of Defense

COMBINED STATEMENT OF FINANCING

For the periods ended September 30, 2004 and 2003

(In Thousands)

	2004 Combined	2003 Combined (Unaudited)
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	0	0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	713	815
Total components of Net Cost of Operations that will require or generate resources in future periods	713	815
Components not Requiring or Generating Resources:		
Depreciation and amortization	186	348
Revaluation of assets or liabilities (+/-)	0	0
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	0	0
Operating Material & Supplies Used	0	0
Other	0	376
Total components of Net Cost of Operations that will not require or generate resources	186	724
Total components of net cost of operations that will not require or generate resources in the current period	899	1,539
Net Cost of Operations	179,423	162,562

Note 1. SIGNIFICANT ACCOUNTING POLICIES

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Office of the Inspector General of the Department of Defense (OIG DoD), as required by the "Chief Financial Officers Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the *OIG DoD* in accordance with the "DoD Financial Management Regulation," OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements," and to the extent possible Federal GAAP. The accompanying financial statements account for all resources for which the *OIG DoD* is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The *OIG DoD's* financial statements are in addition to the financial reports also prepared by the *OIG DoD* pursuant to OMB directives that are used to monitor and control the *OIG DoD's* use of budgetary resources.

1.B. Mission of the Reporting Entity

The Inspector General of the Department of Defense (DoD Directive 5106.1), under the provisions set forth by Public Law 95-452, serves as an independent and objective official in the Department of Defense who is responsible for conducting, supervising, monitoring, and initiating audits, investigations, and inspections relating to programs and operations of the Department of Defense. The Inspector General provides leadership and coordination and recommends policies for activities designed to promote economy, efficiency, and effectiveness in the administration of, and to prevent and detect fraud and abuse in, such programs and operations. The Inspector General is also responsible for keeping the Secretary of Defense and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for, and progress of, corrective action.

1.C. Appropriations and Funds

The *OIG DoD's* appropriations and funds are general funds. These appropriations and funds are used to fund and report how the resources have been used in the course of executing the *OIG DoD's* missions.

General funds are used for financial transactions arising under congressional appropriations, including, operation and maintenance, research and development, and procurement accounts.

1.D. Basis of Accounting

The Department of Defense (DoD) provides financial management services to the Office of the Inspector General. For FY 2004, the *DoD's* financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the *DoD's* financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP. The *DoD* has undertaken efforts to determine the actions required bringing its financial and nonfinancial feeder systems and processes into compliance with all elements of Federal GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Government Standard General Ledger (USSGL). Until such time as all of the *DoD's* General Funds financial and nonfinancial feeder systems and processes are updated to collect and report financial processes are updated to collect and report financial information as required by Federal GAAP, the *DoD's* financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities. However, when possible, the financial statements are presented on the accrual basis of accounting as required. One example of

information presented on the budgetary basis is the data on the Statement on Net Cost. Much of this information is based on obligations and disbursements and may not always represent accrued costs.

1.E. Revenues and Other Financing Sources

Financing sources for general funds are provided primarily through congressional appropriations that are received on both an annual and a multiyear basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The *OIG DoD* recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Revenue is recognized when earned under the reimbursable order process.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the *OIG DoD*'s financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, and accounts payable. Expenditures for capital and other long-term assets are not recognized as expenses in the *OIG DoD*'s operations until depreciated in the case of Property, Plant and Equipment (PP&E). Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

1.G. Accounting for Intra-governmental Activities

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

The *OIG DoD*'s proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The *OIG DoD*'s financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

The *OIG DoD*'s civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement Systems (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The *OIG DoD* funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The *OIG DoD* recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

The Department of Defense reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund (MRF) financial statements. The Department recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization General Fund column of the DoD Agency-wide consolidating/combining statements.

The DoD summary level seller accounts receivables were compared to DoD IG accounts payable. An adjustment was posted to the DoD IG accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the DoD IG. Positive differences were treated as unrecognized accounts payable and in the case of the DoD IG, accounts payable were adjusted accordingly.

The Department (DoD) intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing or foreseeable resources.

1.H. Funds with the U.S. Treasury

The *OIG DoD's* financial resources are maintained in U.S. Treasury accounts. The majority of collections, disbursements, and adjustments are processed at the Defense Finance and Accounting Services (DFAS) disbursing stations. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers and deposits.

In addition, the DFAS sites submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the *OIG DoD's* recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at note 3.

1.I. Accounts Receivable

As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies. Material disclosures are provided at note 4.

1.J. Use of Estimates

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amount of assets and liabilities, at the date of the financial statements, and the amount of revenues and costs reported during the period. Actual results could differ from those estimates.

1.K. General Property, Plant and Equipment

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of \$100,000. Also, improvement costs over the DoD capitalization threshold of \$100,000 for General PP&E are required to be capitalized. The Department contracted with two certified public accounting (CPA) firms to obtain an independent assessment of the validity of the General PP&E capitalization threshold. At the conclusion of the studies, both CPA firms recommended that the Department retain its current capitalization threshold of \$100,000. All General PP&E is depreciated on a straight-line basis.

To bring the *OIG DoD* into fuller compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD Components to maintain, in DoD Component property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.L. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

1. M. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) and the value equals or exceeds the current DoD capitalization threshold, the applicable asset and liability are recorded. The amount recorded is the lesser of the present value of the rental and other lease payments during the lease term, excluding that portion of the payments representing executory costs paid to the lessor, or the asset's fair value. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and recorded as expenses as payments are made over the lease term.

1. N. Other Assets

The *OIG DoD* conducts business with commercial contractors under two primary types of contracts--fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the *OIG DoD* provides financing payments. One type of financing payment that the *OIG DoD* makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in note 5, General PP&E, Net. In addition, based on the provision of the Federal Acquisition Regulation, the *OIG DoD* makes financing payments under fixed price contracts that are not based on a percentage of completion. The *OIG DoD* reports these financing payments as advances or prepayments in the "Other Assets" line item. The *OIG DoD* treats these payments as advances or prepayments because the *OIG DoD* becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the *OIG DoD* is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the *OIG DoD* for the full amount of the advance.

The Department has completed a review of all applicable federal accounting standards; applicable public laws on contract financing; Federal Acquisition Regulation Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, "Prompt Payment." The Department has concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering what further action is appropriate.

1.O. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the *OIG DoD*. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss can be reasonably estimated. Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments.

1.P. Accrued Leave

Civilian annual leave and military leave that have been accrued and not used as of the balance sheet date are reported as liabilities. The liability reported at the end of the fiscal year reflects the current pay rates.

1.Q. Net Position

Net Position 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 legal liabilities for payments have not been incurred.

Cumulative results of operations represent the balances that results from subtracting expenses and losses, from financing sources including appropriations, revenue, and gains since the inception of the activity. Beginning with FY 1998, this included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.R. Comparative Data

The *OIG DoD* presents the current and previous year's financial data for comparative purposes. This data is presented in the financial statements, as well as in the notes to the principal statements.

1.S. Unexpended Obligations

The *OIG DoD* records obligations for goods and services that have been ordered but not yet received. No liability for payment has been established in the financial statements because goods or services have yet to be delivered.

Note 2. NONENTITY ASSETS (IN THOUSANDS)

As of September 30, 2004	2004	2003 (Unaudited)
Intra-governmental Assets	\$ 0	\$ 0
Non-Federal Assets		
Accounts Receivable	30	0
Total Non-Entity Assets	\$ 30	\$ 0
Total Entity Assets	\$ 25,443	\$ 26,216
Total Assets	\$ 25,473	\$ 26,216

Asset accounts are categorized either as entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or when management is legally obligated to use funds to meet entity obligations. Nonentity accounts are assets that are held by an entity, but are not available for use in the operations of the entity.

COMPOSITION OF NONENTITY ASSETS

Non-Federal Assets

The total of non-federal accounts receivable for 4th Quarter, FY 2004 is \$30 thousand. This increase results from an undistributed collection that was not captured and reported to Treasury.

NOTE 3. FUND BALANCE WITH TREASURY (IN THOUSANDS)

As of September 30, 2004

	2004	2003 (Unaudited)
Fund Balances		
Appropriated Funds	\$ 16,115	\$ 25,306
Total Fund Balances	\$ 16,115	\$ 25,306
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	\$ 17,061	\$ 0
Fund Balance per Agency	16,115	25,306
Reconciling Amount	\$ 946	\$ (25,306)

Office of Inspector General (OIG) is a Department of Defense (DoD) agency using Treasury Index 97. The Department of Treasury (Treasury) reports fund balances at the appropriation basic symbol level. The OIG funding is allotted at limit level. Defense Finance and Accounting Indianapolis Center currently performs DoDIG Fund Balance with Treasury reconciliation through the Cash Management Report. Defense Finance and Accounting sites and other defense agencies submit reports to the Treasury by appropriation.

The reconciling amount of \$946 thousand relates to two cancelled appropriations for the 4th Quarter, FY 2004. Referencing OMB Bulletin No. 01-09, Form and Content of Agency Financial Statement, DoDIG is required to report any discrepancies between Fund Balance with Treasury (FBWT). Because this is the first year for which audited OIG statements are being prepared, information concerning the OIG's Fund Balance per Treasury as of September 30, 2003 was no longer available.

FBWT decreased by \$9,191 thousand from the 4th Quarter, FY 2003 to 4th Quarter, FY 2004. The decrease was a result of an increase in personnel cost associated with the increase auditor support for the audit for DoD Financial Statements and for the increased operational cost associated with the support to Global War on Terrorism, and the Coalition Provisional Authority- Inspector General.

NOTE 4. ACCOUNTS RECEIVABLES (IN THOUSANDS)

As of September 30, 2004

	2004			2003 (Unaudited)
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intra-governmental	\$ 8,893	N/A	\$ 8,893	\$ 0
Non-Federal (From the Public):	30	0	30	19
Total Accounts Receivable:	\$ 8,923	0	\$ 8,923	\$ 19

Allowance method:

Other information:

Fluctuations and Abnormalities:

Intragovernmental Receivables

The increase in federal accounts receivables for \$8,893 thousand is attributed to the reimbursement received from Coalition Provisional Authority- Inspector General for support in FY 2004. Additionally, DoD IG received funding from Defense Agencies to contract with Independent Public Accountants for the audit of their Financial Statements.

Non-federal Receivables (from the Public)

The increase in non-federal accounts receivable for \$10 thousand is attributed to two canceled appropriations. This increase results from an undistributed collection that was not captured and reported to Treasury.

Information Related to Accounts Receivable

Allocation of Undistributed Collections

The Department of Defense (DoD) policy is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable. For unsupported undistributed transactions, there is no logical formula to apply that would provide meaningful support. Therefore, the amount of unsupported undistributed collections are posted to the liability for deposit funds, clearing account and undeposited.

Elimination Adjustments

The DoD IG entities' accounting systems do capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, ODO-GF entities were not able to reconcile intragovernmental accounts receivable balances with its trading partners. Through the ongoing Business Management Modernization Program (BMMP), the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

NOTE 5. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET (IN THOUSANDS)

As of September 30, 2004

	2004				2003 (Unaudited)	
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
General Equipment	S/L	5 or 10	\$ 654	\$ (426)	\$ 228	\$ 680
Total General PP&E			\$ 654	\$ (426)	\$ 228	\$ 680

Legend for Valuation Methods:

S/L = Straight Line N/A = Not Applicable

Other Information:

Fluctuations and Abnormalities:

Total general property, plant and equipment, net book value decreased by \$452 thousand for FY 2004. Test Lab equipment was recorded in error with an acquisition cost of \$351 thousand as capitalized asset when in fact the asset was not ready for its intended use. The acquisition cost and other costs necessary to bring the asset to an operable condition are capitalized if the total cost equal or exceeds the current capitalization threshold and it has an estimated useful life of two or more years.

Note 6. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES (IN THOUSANDS)

As of September 30, 2004

	2004	2003 (Unaudited)
Intra-governmental Liabilities		
Other	\$ 1,118	\$ 1,077
Total	\$ 1,118	\$ 1,077
Non-Federal Liabilities		
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	5,096	5,667
Other Liabilities	9,099	8,396
Total Non-Federal Liabilities	\$ 14,195	\$ 14,063
Total Liabilities Not Covered by Budgetary Resources	\$ 15,313	\$ 15,140
Total Liabilities Covered by Budgetary Resources	\$ 4,791	\$ 3,141
Total Liabilities	\$ 20,104	\$ 18,281

Liabilities Not Covered by Budgetary Resources

Liabilities that are not considered covered by realized budgetary resources as of the Balance Sheet date. Budgetary resources encompass the following:

- New budget authority.
- Spending authority from offsetting collections (credited to an appropriation or fund account).
- Recoveries of unexpired budget authority through downward adjustments of prior-year obligations.
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year.
- Borrowing authority or permanent indefinite appropriations, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Liabilities Covered by Budgetary Resources

Resources incurred by the reporting entity which are covered by realized budget resources as of the balance sheet date. Budgetary resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include the following:

- New budget authority.
- Spending authority from offsetting collections (credited to an appropriation or fund account).
- Recoveries of unexpired budget authority through downward adjustments of prior year obligations.
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year.
- Borrowing authority or permanent indefinite appropriations, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Fluctuations and Abnormalities:

Non-Federal Liabilities Not Covered by Budgetary Resources:

Military Retirement Benefits and Other Employment Actuarial Liabilities: The Office of Inspector General experienced a decrease in FECA liabilities totaling \$570,590 thousand during the 4th Quarter, FY 2003 to 4th Quarter, FY 2004. Projected liabilities are reduced because the Agency has experienced a reduction in claims and actual payments from FY 2002 to FY 2004.

Note 7. ACCOUNTS PAYABLE (IN THOUSANDS)

As of September, 30, 2004

	2004	2003 (Unaudited)
Accounts Payable		Total
Intra-governmental	\$ 30	\$ 0
Non-Federal (to the Public)	259	0
Total	\$ 289	\$ 0

Intragovernmental accounts payable consists of amounts owed to other federal agencies for good or services ordered and received but not yet paid. Interest, penalties and administrative fees are not applicable to intragovernmental payables. Non-federal payables (to the public) include payments to nonfederal government entities.

Fluctuations and Abnormalities:

Intragovernmental Payables

Intragovernmental payables increased by \$30 thousand due to an erroneous posting of non-federal. Non-federal funds were reported as federal funds in the amount of \$17 thousand. Accruals and disbursements were not in agreement resulting in unliquidated obligations as well as unmatched disbursements. The remaining \$13 thousand were prevalidation accruals for MIPR Disbursements.

Non- Federal Payables

Travel accruals increased by \$259 thousand for non-federal payables resulting from the conversion to DTS full system. The DTS conversion obligates and accruals transactions simultaneously when posted.

NOTE 8. OTHER LIABILITIES (IN THOUSANDS)

As of September 30, 2004

	2004			2003 (Unaudited)
	Current Liability	Noncurrent Liability	Total	Total
Intra-governmental:				
FECA	\$ 0	\$ 1,088	\$ 1,088	\$ 1,077
Other Liabilities	649	30	679	441
Total	\$ 649	\$ 1,118	\$ 1,767	\$ 1,518
Non-Federal:				
Accrued Funded Payroll and Benefits	\$ 3,516	\$ 0	\$ 3,516	\$ 2,481
Accrued Unfunded Annual Leave	9,099	0	9,099	8,396
Other Liabilities	337	0	337	219
Total Non-Federal Other Liabilities	\$ 12,952	\$ 0	\$ 12,952	\$ 11,096
Total Other Liabilities:	\$ 13,601	\$ 1,118	\$ 14,719	\$ 12,614

Fluctuations and Abnormalities:

Intra-governmental

The increase in other liabilities by \$208 thousand from 4th Quarter, FY 2003 to 4th Quarter, FY 2004 is attributable to increased cost for health benefits, life insurance and retirement. DoD IG also reports an increase in non-current, custodial liability in the amount of \$30 thousand. This increase results from an undistributed collection that was not captured and reported to Treasury.

Non-Federal

Accrued funded payroll and benefits (Current Liability)

Accrued funded payroll and benefits increased \$1,035 thousand, because there were two additional days of accrued pay in benefits in the last pay period of FY 2004 as compared to FY 2003.

The increase in non-federal other liabilities totaling \$118 thousand reflects the increase of DoD IG's contribution to the Thrift Savings Plan.

Other Information Related to Other Liabilities

Types	4 th Quarter FY 2004 (\$ in thousands)	4 th Quarter FY 2003 (Unaudited) (\$ in thousands)
Intra-Governmental – Other Liabilities		
Retirement	\$450	\$307
Health Benefits	194	130
VSIP	0	
Life	5	3
Other	0	0
Total	\$649	\$440

Note 9. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT RELATED ACTUARIAL LIABILITIES (IN THOUSANDS)

As of September 30

	2004		2003 (Unaudited)
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	Unfunded Actuarial Liability
Pension and Health Benefits	\$ 0		\$ 0
Other:			
FECA	\$ 5,096		\$ 5,667
Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	\$ 5,096		\$ 5,667

Federal Employees Compensation Act (FECA)

Assumptions:

The actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DoD IG at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined by using historical benefit payment patterns to predict the future payments. Cost-of-living adjustments and medical inflation factors are also included in the calculation of projected future benefits. Consistent with past practices, these projected annual benefit payments are then discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	3.84%
Year 2	4.35%
Year 3 and thereafter	4.35%

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost-of-living adjustments or COLAs) and medical inflation factors (consumer price index-medical, or CPIMs) were applied to the calculation of projected future benefits. These factors were also used in adjusting the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

<u>CBY</u>	<u>COLA</u>	<u>CPIM</u>
2004	2.30%	3.21%
2005	2.00%	3.54%
2006	1.83%	3.64%
2007	1.97%	3.80%
2008+	2.17%	3.92%

The model's resulting projections were critically analyzed to insure that the estimates were reliable. The analysis was primarily based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year, as calculated for the current projection to the liability-payment ratio calculated for the prior projection.

DoD IG experienced a decrease in FECA liabilities totaling \$570,590 thousand during the 4th Quarter, FY 2003 to 4th Quarter, FY 2004. Projected liabilities are reduced because the Agency has experienced a reduction in claims and actual payments from FY 2002 to FY 2004.

NOTE 10. UNEXPENDED APPROPRIATIONS (IN THOUSANDS)

As of September 30, 2004

	<u>2004</u>	<u>2003</u> <u>(Unaudited)</u>
Unexpended Appropriations:		
Unobligated, Available	\$ 984	\$ 4,122
Unobligated, Unavailable	2,858	943
Unexpended Obligations	4,734	16,504
Total Unexpended Appropriations	\$ 8,576	\$ 21,569

Other Information Pertaining to Unexpended Appropriations:

Unexpended appropriations are the amount of budget authority remaining for disbursement against current or future obligations.

Unobligated balances represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding commitments and obligations. Unobligated balances are classified as available or unavailable. Unobligated balances associated with appropriations expiring at fiscal year end remain available only for obligation adjustments until the account is closed.

Unexpended obligations represent funds that have been committed for goods that have not been received or services that have not been performed.

Fluctuations and Abnormalities:

Unexpended appropriations decreased by \$12,993 thousand from 4th Quarter, FY 2003 to 4th Quarter, FY 2004. Unobligated, available balances decreased by \$3,138 thousand as a result of obligating over \$2,072 thousand in available FY 2002 and FY 2003 procurement dollars and returning over \$1,100 thousand dollars in available balance to OSD to fund the Foreign Currency Fluctuation Account shortfalls. Unexpended obligations decreased because resources were more aggressively executed earlier in the FY 2004 which caused earlier outlays of cash. DoD IG supported the Global War on Terrorism and the Coalition Provisional Authority- Inspector General in all categories of expense. DoD IG increased their audit staff by 68 personnel and increased associated operations to support the audit of DoD Financial Statements. These costs (increased payroll, rents and other operational costs) are expensed monthly, thereby reducing unexpended obligations from a year ago.

Information Related to Unexpended Appropriation

Unexpended Obligations: Unexpended obligations reported as a component of Unexpended Appropriations include both Undelivered Orders-Unpaid and Undelivered Orders-Paid only for direct appropriated funds. The amount is distinct from line 12, Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided, on the Statement of Financing. This line on the Statement of Financing includes the change during the fiscal year in Unexpended Obligations against budget authority from all Military Services.

Note 11.A GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Disclosures Related to the Statement of Net Cost

The Consolidated Statement of Net Cost (SoNC) in the federal government is unique because its principles are driven on understanding the net cost of programs and/or organizations that the federal government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

Fluctuations and Abnormalities:

Intragovernmental Gross Costs

The overall change of \$5,609 thousand is attributable to an increase in personnel cost associated with the increase auditor support for the audit for DoD Financial Statements and for the increased operational cost associated with the support to Global War on Terrorism, and the Coalition Provisional Authority- Inspector General.

Intragovernmental Earned Revenue

The overall increase of \$11,302 thousand is attributed to revenue from Coalition Provisional Authority- Inspector General for support in FY 2004.

Earned Revenue from the Public

DoDIG experience an increase of \$19 thousand in earned revenue from the public between FY 2003 and FY 2004. In FY 2004, the DoDIG reported no earned revenue from the public.

Note 11.B. IMPUTED EXPENSES (IN THOUSANDS)

As of September 30, 2004

	Cumulative Results of Operations 2004	Cumulative Results of Operations 2003 (Unaudited)
Civilian (e.g., CSRS/FERS) Retirement	\$ 4,900	\$ 5,055
Civilian Health	4,701	3,998
Civilian Life Insurance	18	17
Total Imputed Expenses	<u>\$ 9,619</u>	<u>\$ 9,070</u>

Other Information

The increase in civilian health by \$704 thousand from 4th Quarter, FY 2003 to 4th Quarter, FY 2004 is attributable to an additional increase in end-strength and the cost for health care benefits.

Note 12. DISCLOSURES RELATED TO THE STATEMENTS OF CHANGES IN NET POSITION (IN THOUSANDS)

As of September 30, 2004

	2004	2003 (Unaudited)
Prior Period Adjustments	\$ 0	\$ 0
Imputed Financing:		
Civilian CSRS/FERS Retirement	4,900	5,055
Civilian Health	4,701	3,998
Civilian Life Insurance	18	17
Total Imputed Financing	<u>\$ 9,619</u>	<u>\$ 9,070</u>

Other Information:

Information Related to the Statement of Changes in Net Position

The financial statements and accompanying notes to the financial statements report on the financial position and results of operations as of the 4th Quarter, FY 2004 for the Office of the Inspector general of the Department of Defense.

Imputed Financing

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), Federal Employee Retirement System (FERS), Federal Employees Health Benefits Program (FEHB) and the Federal Employee Group Life Insurance Program (FEGLI) do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employee contributions made by and for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computing imputed financing costs. The DFAS provides computed costs to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD(P&R)) for validation

and approval. The official imputed costs are then provided to the reporting components for inclusion in their financial statements.

- CSRS and FERS – The cost factor for the CSRS and FERS is the portion of gross pay from which withholdings are made. The FY 2004 cost factors for CSRS and FERS are 25 percent and 12 percent (respectively) of basic pay and constitute the total service cost for retirement. The difference between the service cost and contributions is the imputed cost for retirement.
- FEHB – The calculation for imputed costs is an ascertainment of actual enrollment in the FEHB at the beginning and at the end of two quarters: January 1, 2003, and June 30, 2004. The aggregate total is divided by two, determining constructed FEHB enrollment. Constructed FEHB enrollment is multiplied by the FY 2004 cost factor of \$1,133 to arrive at the FEHB imputed cost for FY 2004.
- FEGLI – The imputed cost for providing post-retirement FEGLI benefits is computed using a cost factor of .02 percent of basic pay for all employees covered by basic life insurance.
- Judgement Fund – The Judgement Fund is an account in which funds have been set aside as available for settling court judgements and Justice Department compromise settlements of lawsuits against the Department of Defense.

Fluctuations and Abnormalities:

The increase in imputed costs of \$548 thousand from 4th Quarter, FY 2003 to 4th Quarter, FY 2004 is attributable to an increase in personnel and the cost for health care benefits.

Note 13. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES (IN THOUSANDS)

As of September 30, 2004

	2004	2003 (Unaudited)
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 17,702	\$ 17,724
Available Borrowing and Contract Authority at the End of the Period	0	0

Other Information:

Information Related to the Statement of Budgetary Resources

Undelivered Orders

Undelivered Orders presented in the Statement of Budgetary Resources (SBR) include Undelivered Orders-Unpaid for both direct and reimbursable funds.

Spending Authority from Offsetting Collections

Adjustments to funds that are temporarily not available pursuant to Public Law and adjustments to funds that are permanently not available (included in the Adjustments line on the SBR) are not included in the

Spending Authority from Offsetting Collections and Adjustments line on the SBR nor on the Spending Authority for Offsetting Collections and Adjustments line on the Statement of Financing.

Fluctuations and Abnormalities:

Budgetary Accounts

The increase of \$6,122 thousand of net transfers is result of activities providing funds in support of additional audit activity generated in FY 2004.

The 100 percent change in unobligated balance net transfers is attributable to the movement of fund activity used in support of DoD Inspector General (DoDIG) audit activity generated in FY 2004.

Collections and receivables from federal sources increased in the amount of \$2,372 thousand and \$8,949 thousand respectively between 4th Quarter, FY 2004 and 4th Quarter, FY2003. Both increases are a result of additional finances and services generated in support of a larger audit workload and overhead costs incurred.

The increase of \$336 thousand in unfilled customer orders without advance from federal sources between 4th Quarter, FY 2004 and 4th Quarter, FY2003 is attributable to the increase in audit service required from other intragovernmental activities as a result of initiatives incorporated in FY 2004 to achieve auditable financial statements.

The increase of \$2,107 thousand in recoveries of prior year obligations is the result of internal clean-up effort of unliquidated obligations identified in the prior year.

The increase of \$11,704 thousand in reimbursable budgetary resources between 4th Quarter, FY 2004 and 4th Quarter, FY 2003 is a result of additional audit workload requested by other federal activity.

The decrease of \$3,138 thousand in apportioned unobligated balance is contributed to the obligation of operation and maintenance funds due to expire by September FY 2004.

The increase of \$1,915 thousand in unobligated balances not available between 4th Quarter, FY 2004 and 4th Quarter, FY 2003 is the result of unobligated fund not executed at the end of FY 2003.

The increase of \$7,128 thousand in obligated balance, net beginning of period between 4th Quarter, FY 2004 and 4th Quarter, FY 2003 is a result of improvement in management forecasting of appropriation based on anticipated need in support of future reimbursable activity with the Coalition Provisional Authority – Inspector General and the Defense Finance and Accounting Service activities.

The change in obligated balance net end of period in accounts receivable and unfilled customer order from federal sources in the amount of \$8,874 thousand and \$374 thousand respectively is attributable to the increase in unliquidated funding authority.

The increase in disbursements outlays in the amount of \$27,575 thousand is attributable to the execution of funding received in support of additional audit workload acquired in FY 2004.

Note 14. DISCLOSURES RELATED TO THE STATEMENT OF FINANCING

Components of the Net Cost of Operations that will not Require or Generate Resources in Future Period:

“Other” consists of FECA Expenses, Future Funded Expenses and the change in miscellaneous Actuarial Liability. The decrease of \$101 thousand from 4th Quarter FY 2003 to 4th Quarter FY 2004 is a result of change in unfunded liabilities and changes to employer contribution to employee benefit programs not requiring current year budget authority.

Components not Requiring or Generating Resources:

“Other” consists of bringing the Statement of Financing into agreement with the Statement of Net Cost. The decrease is result of no adjustment was necessary to bring the statements into agreement in FY 2004.

Fluctuations and Abnormalities:

Obligations Incurred

The increase of \$23,520 thousand from 4th Quarter FY 2003 to 4th Quarter FY 2004 in obligations is a result of the DoD Office of Inspector General (DoDIG) receiving funds from other entities supporting the audit review initiatives identified in FY 2004.

Spending authority from offsetting collections and recoveries

The increase of \$13,764 thousand from 4th Quarter FY 2003 to 4th Quarter FY 2004 in spending authority resulted from the increase in funding authority based on redistribution's from other entities in support of the audit initiatives requirements identified in FY 2004.

Change in budgetary resources obligated for goods, services and benefits ordered not yet provided

The change in Undelivered Orders and Unfilled Customers Orders from 4th Quarter FY 2003 to 4th Quarter FY 2004 is a result of accruals and disbursements not in agreement resulting in unliquidated as well as unmatched disbursements.

Resources that fund expenses recognized in prior periods

The increase in the amount of \$525 thousand from 4th Quarter FY 2003 to 4th Quarter FY 2004 in fund expenses recognized in prior periods is a result of considerations included in the actuarial liability estimation of future workers compensation benefit amounts.

Resources that finance the acquisition of assets

Resources that finance the acquisition of assets decreased by \$177 thousand from 4th Quarter FY 2003 to 4th Quarter FY 2004. The decrease is a result of DoDIG disposal of capitalized assets in FY 2004.

Depreciation and amortization

The decrease in the amount of \$162 thousand from 4th Quarter FY 2003 to 4th Quarter FY 2004 in depreciation and amortization is a result of depreciation being erroneously reported within operations and maintenance in FY 2003. In addition, DoDIG responded to a data call to bring depreciation into agreement with what the ending balance should be for FY 2004.

Note 15. OTHER DISCLOSURES (IN THOUSANDS)

Minimum Lease Payments:	Land and Buildings 2004	2003 (Unaudited)
<u>Fiscal Year</u>		
2005	\$ 10,657	\$ 0
2006	4,697	0
2007	3,424	0
2008	2,663	0
2009	1,898	0
After 5 Years	3,500	0
Total Future Lease Payments		
Due	\$ 26,839	\$ 0

Definitions

- Lessee – A person or entity who receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.
- Operating Lease - A lease which does not transfer substantially all the benefits and risk of ownership. Payments should be charged to expense over the lease term as it becomes payable.

Description of Leases:

- Description – Office Space
- **Lease Period -- From 3 to 10 years**
- Lease Terms Renting of office space

Other Information – According to the FMR Volume 6B, Chapter 10, the inspector General must disclose information relating to operating lease such as the existence and terms of renewal options, escalation clauses, restrictions imposed by lease agreements, contingent rental and the lease period. We projected fiscal years FY05-FY09 and five years after. Our calculations were based on our current expiration lease agreements shown in the GSA website. There is a 100% change from prior years because this is the first time the OIG-DoD reports operating leases.

Office buildings in the amount of \$ 26,839 thousand represent renting office space. The lease periods are from three to ten years. There are no escalations clauses or contingent rental restrictions.