

**Department of Defense
Office of the Inspector General**



**Financial Statement Audit
Fiscal Year 2007**

Submitted by



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Management Discussion and Analysis

I. Background

The Inspector General Act of 1978 established civilian Offices of Inspectors General in six cabinet-level federal departments and in an additional six federal agencies. Although inspectors general have been a part of the armed forces since the Revolutionary War, the Department of Defense Office of Inspector General (DoD OIG), was not established until much later when Congress amended the Inspector General Act in the National Defense Authorization Act for Fiscal Year 1983 (P.L. 97-252, enacted on September 8, 1982).

Pursuant to the Inspector General Act of 1978, as amended, "the Inspector General of the Department of Defense shall . . . be the principal adviser to the Secretary of Defense for matters relating to the prevention of fraud, waste, and abuse in the programs and operations of the Department."

The law also requires the Inspector General "to keep the [Secretary of Defense] and the Congress fully and currently informed . . . concerning fraud and other serious problems, abuses, and deficiencies . . ." In carrying out all of the other statutory duties, the Inspector General of the Department of Defense is obligated by law to "give particular regard to the activities of the Government Accountability Office with a view towards avoiding duplication and insuring effective coordination and cooperation." As a matter of policy and practice, the Office of the Inspector General also gives particular regard to the activities of the internal audit, inspection, and investigative units of the military departments with a view towards avoiding duplication and insuring effective coordination and cooperation.

II. Vision Statement

One professional team strengthening the integrity, efficiency, and effectiveness of Department of Defense programs and operations.

III. Mission Statement

The Office of the Inspector General promotes integrity, accountability, and improvement of Department of Defense personnel, programs and operations to support the Department's mission and to serve the public interest.

IV. Core Values

- Accountability
- Integrity & Efficiency

V. Organization

The Office of Inspector General (OIG) audits, investigates, inspects, and evaluates the programs and operations of the Department of Defense (DoD) and, as a result, recommends policies and process improvements that promote economy, efficiency, and effectiveness in the DoD programs

and operations. For the last three years, the OIG has achieved \$23.9 billion in savings and \$4.1 billion in recovery for the nation. The Inspector General (IG) is the DoD official responsible for issuing opinions on the financial statements of the DoD. The DoD OIG also informs DoD management and Congress about the problems and deficiencies in programs and operations and the progress of corrective actions.

As of 28 August 07

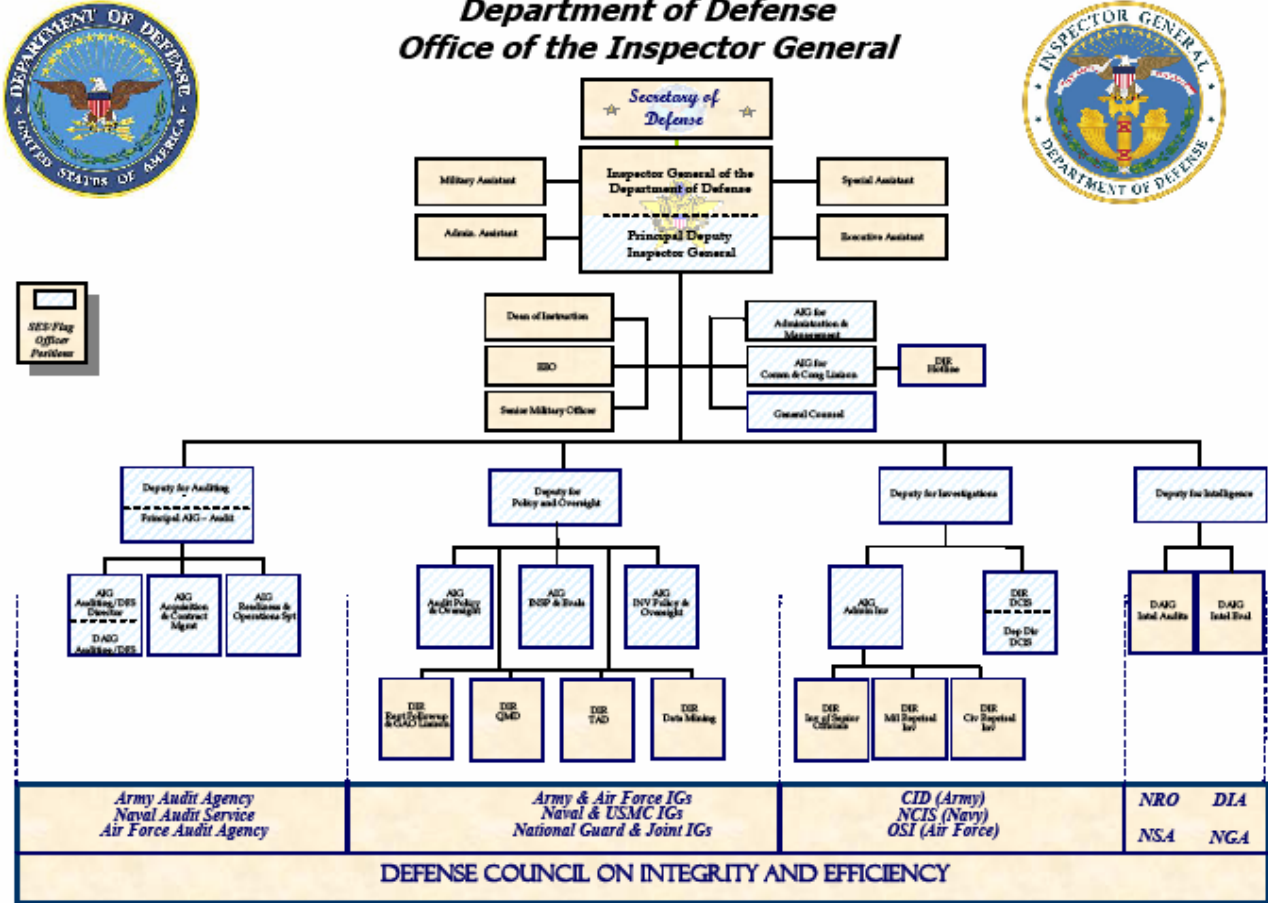


Figure 1. DoD OIG’s Organizational Structure as of September 30, 2007

The Inspector General’s vision is ‘one professional team strengthening the integrity, efficiency, and effectiveness of Department of Defense programs and operations.’ A key tenet of the DoD OIG strategy is to link resources to achieve mission-based results.

Auditing

Section 3 (d) of the Inspector General Act establishes the requirement for the audit function within the OIG. The Office of the Deputy Inspector General for Auditing (ODIG-AUD) conducts audits on all facets of DoD operations. The work results in recommendations for reducing costs, eliminating fraud, waste, and abuse of authority; improving performance of

business operations; strengthening internal controls; improving military service member effectiveness and safety; and achieving compliance with laws, regulations, and policies. Audit topics are determined by law, requests from the Secretary of Defense (SECDEF) and other DoD leadership, hotline allegations, congressional requests, and OIG risk analyses of DoD programs. In addition to all of the ongoing auditing requirements, OIG auditors continue to focus effort on Base Realignment and Closure (BRAC) by performing additional assessments that are related to the BRAC implementation process and military construction. Auditors also continue to review the support being provided by the DoD to relief efforts related to Hurricane Katrina.

Investigations

The Office of the Deputy Inspector General for Investigations (ODIG-INV) comprises the investigations components of the OIG -- the Defense Criminal Investigative Service (DCIS) and the Office of the Assistant Inspector General for Administrative Investigations, the latter consisting of Investigations of Senior Officials (ISO), Military Reprisal Investigations (MRI), and Civilian Reprisal Investigations (CRI).

DCIS uses several methods to evaluate performance. The most significant of which is the importance of the matter under investigation, e.g., stopping the attempt to export aircraft parts that may be used by adversaries against American warfighters, preventing infiltration of military installations by suspected terrorists, or stopping a doctor from conducting unnecessary surgeries on DoD family members. DCIS also monitors indictments, convictions, fines, recoveries, restitution, and the percentage of cases accepted for prosecution to ensure consistency in effort and historical output and the resourceful use of assets.

ISO ensures, through aggressive investigations, those ethical violations, abuses of authority, or misuses of public office do not undermine the credibility of the national command structure. ISO is the only DoD component that possesses the independence needed to ensure that allegations against top DoD leaders are credibly investigated and to provide effective oversight of Service IG senior official investigations.

MRI conducts and oversees investigations of whistleblower reprisal under three Federal whistleblower protection statutes: 10 U.S.C. 1034 (military members); 10 U.S.C. 1587 (nonappropriated fund employees); and 10 U.S.C. 2409 (DoD contractor employees).

CRI reviews and investigates whistleblower reprisal allegations submitted to the DoD Hotline by DoD civilian appropriated fund employees. The CRI remains the sole centralized resource for investigating reprisals against DoD intelligence and counter-intelligence whistleblowers.

Policy and Oversight

In accordance with Sections 4 and 8 of the Inspector General Act of 1978, as amended, the Office of the Deputy Inspector General for Policy and Oversight (ODIG-P&O) provides policy, guidance, and oversight to audit, investigative, and hotline activities within the DoD and provides analysis and comments on all proposed draft DoD policy issuances. In addition, the ODIG-P&O provides technical support to audit, investigative, and other OIG organizations;

provides the report follow-up function for the DoD OIG, and does evaluations of DoD programs and functions. To support the War on Terror and Southwest Asia efforts, the ODIG-P&O will continue to evaluate both the DoD war fighting mission and its stabilization, security, transition, and reconstruction mission. The ODIG-P&O also will continue to respond to congressional and management requests to review investigations, audits, and inquiries conducted by the DoD or others in support of the DoD mission. In addition, ODIG-P&O will continue to work with other Federal Agencies to provide interagency evaluations in those common areas that support Southwest Asia, National Security Presidential Directive (NSPD) 44 “Management of Interagency Efforts Concerning Reconstruction and Stabilization,” and DoD Directive 3000.05 “Military Support for Stability, Security, Transition, and Reconstruction (SSTR) Operations” efforts.

Intelligence

The Office of the Deputy Inspector General for Intelligence (ODIG-INTEL) audits, reviews, evaluates, and monitors the programs, policies, procedures, and functions of the DoD Intelligence Community, including intelligence-related activities within the DoD components and Combatant Commands, Special Access Programs, and Nuclear Surety Issues within the DoD, to ensure proper, effective, and efficient management of intelligence and intelligence-related resources. The ODIG-INTEL provides independent, objective, and relevant information to the DoD, Congress, and other Government agencies and is the OIG’s primary advisor to the SECDEF on intelligence audit and evaluation matters. The ODIG-INTEL provides recommendations to improve the efficiency and effectiveness of the DoD intelligence personnel, programs and operations, reduce costs, strengthen internal controls, and achieve compliance with laws and regulations. The ODIG-INTEL external audit, review, and evaluation topics are determined by law, requests from the SECDEF and other DoD leadership, hotline allegations, congressional requests, and internal analyses of risk in DoD programs. The ODIG-INTEL strategically focuses its reviews based on goals of the President’s Management Agenda (PMA), SECDEF Organizational Priorities, DoD Management Challenges, and Government Accountability Office (GAO) High Risk Areas. Particular emphasis will be placed on the DoD organizational priorities to win the Global War on Terror (GWOT), in order to significantly improve military intelligence capabilities, and improve effectiveness and efficiency across the board.

Strategic Plan

The OIG’s Strategic Plan supports the DoD’s mission (to include priorities identified by the SECDEF) and the PMA. The OIG mission is to promote integrity, accountability, and improvement of the DoD personnel, programs, and operations to support the DoD’s mission, including winning the GWOT and other SECDEF top priorities, full and timely implementation of the PMA’s primary goals and objectives, and addressing management challenges identified by the OIG and the GAO’s High Risk Areas.

The OIG’s Strategic Plan includes goals to improve the economy, efficiency, and effectiveness of the DoD personnel, programs, and operations; eliminate fraud, waste, and abuse in the programs and operations of the DoD; and improve the efficiency and effectiveness of OIG

products, processes, and operations. Key objectives include: providing independent, objective, and relevant information to the DoD, Congress, other government agencies, and the public; promoting ethics and integrity within the DoD; preventing and detecting fraud, waste, and abuse; achieving the PMA initiatives; ensuring accountability for mission accomplishment and strategic human capital management and merit system principles; and improving the planning and use of OIG resources to ensure relevant and timely information to senior-level decision makers on critical issues. To monitor performance against the plan, the OIG complies with the Government Performance and Results Act of 1993, as amended, and tracks goal attainment to help ensure that progress and results are realized to ensure a return on investment of taxpayer dollars.

VI. Budgetary and Financial Aspects

The DoD OIG works closely with the DoD to address long-standing financial management problems and supports the DoD's goal of achieving a favorable audit opinion for the DoD agency-wide financial statements. This commitment includes continuing to work with the DoD components to identify deficiencies and recommend corrective actions, focusing on financial statements, systems, internal controls, compliance, and other financial-related audits to assist the DoD to achieve auditable financial statements. Also, the DoD OIG continues to support congressional audit requirements for three DoD intelligence agencies and audits of Defense agencies that will help to render a favorable audit opinion on the DoD agency-wide financial statements.

Financial Condition

The DoD OIG annually assesses the most serious management and performance challenges faced by the DoD based on the findings and recommendations of audits, inspections, and investigations conducted during the year. The DoD OIG's Comptroller Office provides effective stewardship of resources, provides timely and accurate financial information, and ensures quality customer service.

The DoD OIG's annual appropriation for FY 2007 was \$215.5 million. The DoD OIG also received \$122,000 for the employee drug testing program. The funding amount increased available funds by \$7.4 million from FY 2006 to FY 2007 in order to successfully meet the DoD goal to obtain clean audit opinions on its financial statements. The additional funding will allow the Defense Financial Auditing Service to grow ahead of the increasing number of assertions as proclaimed by DoD components stating that their financial statements and systems are ready for audit. Funds will be used to increase auditor staff, expand field offices, and provide for essential operational costs. The DoD OIG returned \$3.5 million for reprogramming to the Washington Headquarters Services as the executive agent for implementing BRAC 2005 recommendation 133 (Co-locate miscellaneous OSD, Defense Agencies, and Field Activities from leased locations to Fort Belvoir, VA).

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

(OMB), and guidance provided by the DoD and in accordance with mandatory reporting requirements and regulations.

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

VII. Systems, Controls, and Legal Compliance

DoD OIG Systems

The DoD OIG 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's systems are not in full compliance with the requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. In its effort to ensure the DoD-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 oversees and provides 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

The DoD OIG's transactions are executed in accordance with budgetary and financial standards and other requirements, consistent with the purpose authorized and are recorded in accordance with federal accounting standards, generally accepted accounting principles, and Statements of Federal Accounting Standards. Assets are properly acquired and used, safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud. Performance measurement information is adequately supported.

The DoD OIG's senior management evaluated the system of internal accounting and administrative control, in effect during the fiscal year ending September 30, 2007, in accordance with the guidance in OMB Circular No. A-123 (Revised), "Management Accountability and Control," dated June 21, 1995, as implemented by DoD Directive 5010.38, "Management Control (MC) Program," dated August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," dated August 28, 1996. The OMB guidelines were issued in consultation with the Comptroller General of the United States, as required by the "Federal Managers' Financial Integrity Act of 1982." Included is an evaluation of whether the system of

internal accounting and administrative control for the OIG is in compliance with standards prescribed by the Comptroller General.

The objectives of the system of internal accounting and administrative control of the OIG are to provide reasonable assurance that:

- The obligations and costs are in compliance with applicable laws.
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial, and statistical reports and to maintain accountability over the assets.

The results indicate that the OIG system of internal accounting and administrative control, in effect during the fiscal year ending September 30, 2007, provides reasonable assurance that management controls are in place, operating effectively, and being used.

VIII. Performance Information

Improve the economy, efficiency, and effectiveness of DoD personnel, programs and operations.

Objectives:

- Recommend solutions to resolve identified risks and weaknesses.
- Provide independent, objective, and relevant information to the DoD, Congress, other Government agencies, and the public.

Eliminate fraud, waste, and abuse in the programs and operations of the DoD.

Objectives:

- Promote ethics and integrity within the DoD.
- Prevent and detect fraud, waste, and abuse.
- Provide independent, objective, and relevant information to the DoD, Congress, other Government agencies, and the public.
- Promote public confidence in the DoD leadership and programs.

Improve the efficiency and effectiveness of the OIG products, processes, and operations.

Objectives:

- Establish short and long term priorities for the OIG.
- Achieve PMA initiatives.
- Ensure accountability for mission accomplishment and strategic human capital management and merit system principles.
- Improve the planning and use of the OIG resources to ensure relevant and timely information to senior-level decision makers on critical issues.

- Enhance the follow-up process to focus on outcomes and impacts.
- Identify opportunities for improvement of component unique operations.

IX. Results

The ODIG-AUD produced 131 reports which claim potential monetary benefits totaling \$1.2 billion. During FY 2007, the ODIG-AUD also achieved \$697 million in monetary benefits from reports issued in FY 2006 and earlier (i.e., funds were put to better use because of actions completed on audit recommendations). Since FY 2005, there has been an average return on investment of \$12.8 million in monetary benefits achieved per the OIG auditor each year. As of December 31, 2006, the DoD has approximately 1,162 acquisition category I-IV programs with an estimated total cost of \$2.3 trillion. Increased audit coverage of major acquisition programs and contracting issues could lead to greater monetary benefits for the DoD and the mitigation of institutional risk. The Congress and senior DoD officials requested and used the OIG audit products on BRAC, Homeland Security, information system projects, readiness, chemical and biological defense, acquisition processes, information assurance, maintenance, supply management, use of government credit cards, financial management, health care, and environmental issues. Two initiatives in progress are the implementation of customer satisfaction surveys and improvement of reporting venues to ensure that the result of the ODIG-AUD's work adds maximum value to the DoD.

Priority demands on audit resources include:

- The Chief Financial Officer's Act of 1990, as amended by the Federal Financial Management Act of 1994;
- The Intelligence Authorization Act for FY 2002 which requires the OIG to audit the form and content of the financial statements of the National Security Agency, National Geospatial-Intelligence Agency, and Defense Intelligence Agency;
- The need to expand the OIG presence in Southwest Asia and increase coverage of GWOT-related contracting, programs, and operations;
- Reports required or requested by Congress and senior DoD officials or resulting from hotline allegations;
- Reports focused on improving contract surveillance, funds management, and other accountability issues;
- Reports on improving weapons acquisition and general contract management with emphasis on identifying potential procurement fraud; and
- Efforts to improve DoD processes which, while beneficial, do not result in reports that can be reflected in the OIG productivity statistics.

DoD operations are experiencing a period of higher than normal risks due to the disruptions caused by ongoing military operations; continued restructuring; ever-increasing reliance on automated information systems; security vulnerabilities; and the introduction of new processes, many of which are untried in DoD settings and not well understood by the workforce. The DoD OIG will focus its audit efforts on high-risk areas including weapon and information systems acquisition, contract management, information security and privacy, health care costs, and inventory management, within the limits of available resources.

DCIS investigations resulted in 281 criminal indictments, 235 convictions, and over \$878 million in criminal, civil, and administrative recoveries (excluding headquarters and field managers, an average of \$2.86 million per agent, per year). These investigative results exceeded all previous accomplishments. Since its creation, DCIS has participated in cases that have resulted in over \$13.1 billion in criminal, civil, and administrative recoveries. Further, DCIS' effectiveness in conducting significant criminal investigations in support of crucial national defense priorities has been outstanding. DCIS accomplished this by: ensuring that limited investigative resources are used effectively and efficiently; placing primary emphasis on investigations of terrorism, product substitution/defective parts, computer crimes targeting the Global Information Grid, illegal technology transfer, and public corruption; and identifying offenders and/or detecting, disrupting, or dismantling the associated criminal activities.

It is often difficult to quantify the results of criminal investigative operations. For example, in bribery and kickback cases, the dollar impact on the cost of a major contract is at times not readily or clearly identifiable, yet bribes and kickbacks undermine the integrity and efficiency of departmental programs and operations. Further, DCIS consistently identifies vulnerabilities regarding DoD activities and ensures that the DoD takes action to correct deficiencies. Another valuable byproduct of criminal investigative activities is the deterrent effect, which results from an awareness of the vigorous pursuit of violations of the law. This effect was patently demonstrated in the Gulf coast after Hurricane Katrina when a Zero Tolerance policy on fraud was pursued. DCIS encourages DoD components to take administrative action such as suspensions and debarments of disreputable contractors or the administrative recovery of monies, regardless of whether prosecutions are obtained.

Military Reprisal Investigations (MRI) has the statutorily-mandated mission of whistleblower protection for military service members, DoD nonappropriated fund employees, and DoD contractor employees. During FY 2007, MRI closed 506 reprisal complaints that included in-house cases and oversight reviews of Military Department IG cases. Of these, 308 cases were closed after preliminary inquiries. Full investigations were conducted for 191 cases, of which 40 investigations substantiated reprisal allegations and 20 investigations found procedural violations of the DoD directive for referral of military members to commander-directed mental health evaluations. Faced with a continuing increase in whistleblower reprisal allegations received by both the OIG and the Military Department IGs (from 320 complaints received in FY 1997 to 554 complaints received up to July 1, 2007), MRI strives to implement policies and procedural efficiencies to improve the timeliness in processing and resolving such allegations. In its continuing effort to strengthen the DoD program to protect military whistleblowers from reprisal, MRI conducts periodic training workshops for representatives of the Military Services, the Joint Chiefs of Staff, and other defense agencies. Additionally, MRI authored and obtained Deputy Secretary of Defense approval for the first revision to the DoD Policy Directive on Military Whistleblower Protection in 7 years. The new Directive significantly strengthens protection for Service members.

Civilian Reprisal Investigations (CRI) has the primary mission of whistleblower protection for civilian appropriated fund personnel. In FY 2007, the Directorate closed nine cases and docketed three. One of the closed cases addressed a matter of national integrity relating to the

handling of the DoD intelligence prior to September 11, 2001. The CRI conducted 38 preliminary inquiries and accepted three cases, with the highest priority given to contractor fraud and abuse within the defense intelligence and counter-intelligence communities.

Investigations of Senior Officials (ISO) Directorate completed 64 inquiries or investigations during FY 2007. The ISO also oversaw 267 investigations by the DoD components and evaluated the impact that those investigations may have on public confidence in the DoD leaders and ultimately on national security. Investigative impact may be evaluated by the percentage of investigations that were of significance to DoD or congressional leaders, and the percentage of investigations that substantiated alleged misconduct. Thirty-two percent of investigations conducted by the ISO in FY 2007, had significant media, SECDEF, or congressional interest, with results provided directly to the SECDEF or members of Congress. Examples include investigations into alleged conflicts of interest and misuse of authority on the part of senior DoD officials, alleged misrepresentation by senior military officers of circumstances surrounding the friendly fire death of a soldier; improper support to a non-Federal entity by several general officers; misuse of military aircraft, and the arrangement of official travel for personal benefit. Over 14 percent of the investigations substantiated allegations against senior officials and resulted in immediate removal from command, reprimands, reductions in rank, and reimbursement to the Government, thereby demonstrating that the DoD holds senior leaders accountable for misconduct. Both statistics indicate the increasing complexity of allegations involving senior officials and associated requirement for comprehensive, manpower intensive investigative work. As part of its responsibility to fully inform the President and Senate of adverse information concerning senior officials being nominated for promotion, reassignment, or other action, the office conducted over 11,000 name checks on DoD senior officials in the past year. The Senate Armed Services Committee relies exclusively on checks completed by the ISO before confirming military officer promotions.

The ODIG-P&O has 110 civilian auditors, investigators, analysts, and professionals in areas such as engineering, information assurance and security, and quantitative methods.

The ODIG-P&O top priorities in its on-going work include seven GWOT projects including reviews of military death investigations and care of military personnel; two DoD safety projects; developing and updating eight DoD issuances; developing fraud indicators, scenarios and tool kits for DoD auditors and evaluators; the OIG subpoena program; and the DoD voluntary disclosure program; and oversight of over 6,000 DoD auditors, in over 20 DoD organizations, and of non-federal auditors contracted for auditing DoD programs and funds.

The ODIG-P&O significant accomplishments for FY 2007 include 23 reports addressing such divergent issues as an assessment of compliance with auditing standards for the largest Federal audit organizations, the death of a well-known football player by friendly fire in Afghanistan, and an assessment of Iraqi police training. The ODIG-P&O completed seven other projects, primarily hotlines addressing audit or auditor-related issues. The ODIG-P&O's reports and projects supported over \$53 million in recoveries related to DoD programs and funds. The ODIG-P&O processed 302 subpoenas, a record number, while reducing the processing time; published three DoD issuances; coordinated and commented on over 260 DoD policies, government financial and audit issuances and Federal contracting guidance; facilitated the

resolution of disputed issues in ten DoD OIG reports and facilitated review of 230 GAO reviews and 371 reports; tracked the status of over 1,100 recommendations; and provided engineering technical support, information assurance specialists, statisticians/operations research analysts, and computer-aided audit specialists for over 200 projects.

Challenges facing the ODIG-P&O include the need to adequately resource increasing requests for support in areas such as tracking report recommendations, requests for technical support, including subpoenas; coverage in the voluntary disclosure area; oversight in areas deferred because of staffing shortages, and new areas of oversight coverage, such as DoD hotlines; and the increasing number of high visibility cases being referred such as reviews of death cases from Iraq and other requests from Congress and DoD management. Examples include a request to review medical record processing and a review of DoD implementation of relevant aspects of National Security Presidential Directive 44, related to providing security, stabilization, transformation and reconstruction of developing nations. The ODIG-P&O operations are evaluated on the reviews conducted, as measured by the significance and quality of audit and investigative policy provided; oversight and evaluation reports issued; voluntary disclosures processed; subpoenas processed; timeliness and quality of technical support provided; positive impact on draft DoD policy issuances; follow-up of DoD report recommendations; and outcomes from evaluations of significant DoD programs and functions. In FY 2007, the ODIG-P&O issued 28 reports, commented and coordinated on 200 draft DoD policies for the DoD OIG, provided technical support to 195 audit and investigative projects, and facilitated the follow-up on over 240 DoD OIG and GAO reports.

The Inspections and Evaluations (IE) Directorate is completing a multi-year evaluation of the DoD Safety Program responding to the SECDEF's goal to reduce mishaps and accidents by 75 percent by FY 2008. The evaluation will develop and recommend a roadmap for overcoming identified challenges to improve the effectiveness of the DoD Safety Program. In FY 2007, the IE issued six reports, including two interagency reports: Evaluation of the Afghan National Police done jointly with the State Department; and Evaluation of the U.S. Counter Narcotics Program in Afghanistan done jointly with the Departments of State and Justice.

The ODIG-INTEL focuses on assessing the efficient, effective, and appropriate use of intelligence personnel and resources with emphasis on support to the warfighter and national command authority. In FY 2007, the ODIG-INTEL provided the DoD leadership and Congress 14 intelligence evaluation and audit reports on topics such as Electromagnetic Pulse Testing and Survivability issues, National Security Agency programs and initiatives, and Special Access Programs. Specific high-interest issues included Pre-Iraqi War Activities of the Under Secretary of Defense for Policy, the Threat and Local Observation Notice (TALON) Program Reporting, and DoD's involvement with the Rendon Group. Congressionally directed actions or requests, management requests, or DoD Hotline complaints initiate 71 percent of ongoing projects. The other 29 percent comes from a proactive process of identifying projects to promote effective operations and ensure efficient use of resources in vital intelligence and related mission areas in support of the DoD's goals and the OIG Strategic Plan.

For FY 2007, the ODIG-INTEL included a performance measure in its Strategic Plan to plan, staff, and manage projects so that projects are completed within an average of 300 days, a ten

percent reduction from FY 2006. For FY 2007, the actual average was 295 days. The ODIG-INTEL will continue to define project scope and objectives for FY 2008 and FY 2009 projects to effect additional efficiencies in project cycle time. The ODIG-INTEL will continue participating in quarterly meetings of the Intelligence Community Inspectors General (ICIG) Forum and chair the Joint Intelligence Oversight Coordination Group (JIOCG) to prevent duplication and overlap between the OIG, Service audit agencies, Military IGs, and other Intelligence Agencies components, or jointly with DoD Intelligence Agency IGs and Intelligence Community IG Forum members.

X. Events, Trends, and Risks

Global War on Terror

The DoD OIG is committed to supporting the GWOT and the needs of the men and women fighting this war. The DoD OIG has established the following goals:

Goal 1: Expand the DoD OIG presence in Southwest Asia (SWA) to work on priority issues directly supporting efforts for Operation Enduring Freedom and Operation Iraqi Freedom.

Goal 2: Increase coverage of DoD GWOT-related contracting, programs, and operations, including issues such as healthcare for the warfighter.

Goal 3: Increase support to the Joint Terrorism Task Forces and increase Project Shield America activities.

The DoD OIG is supporting the GWOT and the warfighter by conducting audits, inspections, and investigations that seek to detect and prevent fraud, identify funds that can be used more effectively, and improve the management of DoD programs.

Increasing Southwest Asia Presence

To provide a more effective and efficient oversight role, the DoD OIG continues to move forward in establishing key in-theater presence. Key placement of the DoD OIG personnel will facilitate timely reviews and reporting of results in-theater and minimize disruption to command. The DoD OIG has already established an audit field office in Qatar as an in-theater base of operations. The staff in the Qatar office conducts audits as required in Iraq, Afghanistan, and Kuwait. Additionally, the DoD OIG has a forward deployed presence in Iraq and Kuwait, and is in the process of establishing a field office at Camp Victory, Baghdad. During this period, the OIG detailed two employees to the Multi-National Security Transition Command-Iraq in Baghdad as advisors for the Iraqi Inspectors General System. In this capacity, they provided assistance, advice, training, and mentoring for the Inspectors General of the Ministry of Defense, Ministry of Interior, and the Joint Headquarters of the Iraqi military.

The DoD OIG is also in the process of initiating efforts to establish a forward deployed presence in Afghanistan. The DoD OIG established a field office in Qatar. The Qatar field office is staffed with up to eight auditors at a time, on a rotational basis, serving tours of four to six months. The Qatar field office is responsible for performing audits and other reviews as required throughout

the U.S. Central Command area of responsibility. Auditors from the Qatar field office have traveled throughout the AOR to perform specific reviews, such as the Audit of Potable and Non-Potable Water. Additionally, Qatar field office auditors facilitate and may augment other teams that require temporary travel in-theater to conduct specific reviews.

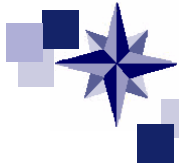
Iraq – A Forward Deployed Presence

In coordination with the Commanding General, Multi-National Force-Iraq, the DoD OIG is establishing a field office at Camp Victory, Baghdad. Currently, the DoD OIG has forward deployed eight audit, inspection, and investigative personnel in Baghdad, and has another four auditors in Iraq performing audits.

Other Planned SWA Presence

To maintain a more effective and efficient oversight role in Afghanistan, the DoD OIG is in the planning stages to establish a forward deployed presence. Additionally, the Defense Criminal Investigative Service currently is collocated with the Army Criminal Investigation Command in Kuwait.

The GWOT continues to be the top priority of the DoD OIG and its four operational components (Audit, Investigations, Policy and Oversight, and Intelligence) have 106 ongoing or completed projects; 29 in Audit, 65 in Investigations, six in Policy and Oversight, and six in Intelligence. Those 105 projects provide oversight and probe in various functions and activities such as readiness, contracts, logistics, contract fraud, theft, corruption, and intelligence efforts. The DoD OIG has completed or is conducting oversight efforts that cover approximately \$75 billion related to the DoD GWOT efforts.



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Independent Auditors' Report

Introduction

We have audited the balance sheets of the Department of Defense Office of the Inspector General (DoD OIG) as of September 30, 2007 and 2006, as well as the related statements of net cost, changes in net position, and budgetary resources (the financial statements) for the years then ended. The objective of our audit was to express an opinion on the fair presentation of those financial statements. In connection with our audits, we also considered the DoD OIG's internal controls over financial reporting and tested the DoD OIG's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

As stated in our opinion of the financial statements, we found that the DoD OIG's financial statements as of and for the year ended September 30, 2007 and 2006, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal controls would not necessarily disclose all significant deficiencies in the internal controls over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants (AICPA). Our testing of internal controls identified a material weakness in financial reporting. Additionally, we identified significant deficiencies with a service provider concerning financial management systems and processes that we consider to be a material weakness in relation to the DoD OIG's financial statements. The financial systems used by the DoD OIG are not in compliance with the requirements of FFMIA.

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. 07-04, *Audit Requirements for Federal Financial Statements*.

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

Independent Auditors' Report

We have audited the accompanying balance sheets of the DoD OIG as of September 30, 2007 and 2006, and the related statements of net cost, changes in net position, and budgetary resources for the years then ended. These financial statements are the responsibility of the DoD OIG management. Our responsibility is to express an opinion of these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and the OMB bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of misstatement. Our audits included consideration of internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DoD OIG's internal controls over financial reporting. Accordingly, we do not express such an opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

As provided in OMB Circular No. A-136, *Financial Reporting Requirements*, effective for fiscal year 2007, the Statement of Financing will be presented as a note per OMB's authority under SFFAS No. 7, *Accounting for Revenue and Other Financing Sources And Concepts for Reconciling Budgetary and Financial Accounting*, and will no longer be considered a basic statement. In the current year, the Statement of Financing will be displayed in Note 14, Reconciliation of the Net Cost of Operations to Budget. The information is presented on a comparative basis for the years ended September 30, 2007 and 2006.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD OIG as of September 30, 2007 and 2006, and its net cost of operations, changes in net position, and budgetary resources, for the years ended September 30, 2007 and 2006, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have issued our report dated November 7, 2007, on our consideration of the DoD OIG's internal controls over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts, agreements and other matters. The purpose of that report is to describe the scope of our testing of internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal controls over financial reporting or on compliance. That report is an integral part of an

audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying required supplementary information, referred to as the Management Discussion and Analysis, 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, OMB Circular No. A-136. The supplementary information is the responsibility of the DoD OIG management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

Independent Auditors' Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters Based on Audits Performed in Accordance with Government Auditing Standards

Our responsibility is to express an opinion on the financial statements as of and for the year ended September 30, 2007 and 2006, based on our audits. We conducted our audits 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. 07-04. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit, we considered the DoD OIG's internal controls over financial reporting by obtaining an understanding of the agency's internal controls, determining whether internal controls had been placed in operation, assessing control risks, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion of the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by Federal Managers Financial Integrity Act. Our procedures were not designed to provide assurance on internal controls over financial reporting. Consequently, we do not express an opinion thereon.

Our consideration of internal controls would not necessarily disclose all matters in internal controls that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. Under standards issued by the AICPA, a significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affect the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity financial statements that is more than

inconsequential will not be prevented or detected. A material weakness, as defined by the AICPA and OMB Bulletin 07-04, is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. We believe that the following significant deficiencies are material weaknesses in financial reporting under the direct control of the DoD OIG. Additionally, we identified matters, related to Defense Finance and Accounting Service's financial management systems, used to record, process, summarize and report the DoD OIG activities and results that we consider to be material weaknesses in relation to the DoD OIG's financial statements.

Financial Reporting

In the prior year, we reported that the DoD OIG management relies on the processes that have been designed within the DoD to process, record and report on financial transactions. The services for those processes are acquired from the Defense Finance and Accounting Service and discussed in a service level agreement. We reported that the fiduciary stewardship and responsibility over financial reporting that is inherent to management remains with the DoD OIG. We further reported that the DoD OIG does not 1.) perform adequate managerial review of the information processed by DFAS, 2.) have a process in place to ensure the completeness of the quarterly or year-end financial statements, and 3.) have fundamental processes in place to ensure that transactions initiated are appropriately reviewed and approved. In the current year, we observed that the DoD OIG made progress toward improving their financial reporting processes. We believe additional effort will be necessary to fully remediate the conditions.

- In the prior year, we observed that the DoD OIG performed many activities that replicate the actions taken by their service provider. In some cases the activities are more akin to converting data from one format to another (i.e. PDF to Excel). In the current year, initial steps were taken to improve business processes in order to begin to independently validate the information being processed by the service provider. Additional progress needs to be made, in order to assure that data analysis of the financial reporting level is being performed.
- In the current year, the DoD OIG adopted a business process to identify, estimate, and record accruals at each reporting period. We commend the DoD OIG on the implementation of the new business process. The change demonstrates progress in financial reporting controls.
- Last year we reported, and the condition continues in need of remediation, that the DoD OIG in conjunction with their service provider has not fully documented the crosswalks used to develop the DD 1176 from the WAAS general ledger. The DD 1176 serves as an integral piece of the audit trail from the general ledger to the Statement of Budgetary Resources. The DoD OIG did, however, adopt an interim process using alternative procedures by which we were able to validate the DD 1176 and the statement of budgetary resources. Additional actions are necessary to fully remediate this condition.

- We continued to observe that the DoD OIG does not have fully implemented business practices to perform adequate management review of transactions recorded to their books. In the current year, we observed newly implemented business processes to review the validity of lease or facilities costs recorded; however, there continued to be limited progress on the development of policy and the refinement of processes to validate the amounts recorded for personnel and benefits costs. The DoD OIG needs to identify, develop and implement management review and validation techniques to enable them to fulfill their management stewardship responsibilities.

These conditions create a vulnerability for material misstatement, lack of reliability and completeness of the DoD OIG's financial statements; thus we classified this condition as a material weakness in financial reporting.

DoD Systems

As reported in the prior year, the DoD OIG's service providers do not have systems that retain transaction level detail data necessary to support the DoD OIG's financial statement amounts. The basic accounting system captures data using object classes, not general ledger accounts. The object classes are translated into the 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 (USSGL) format.

This issue is a part of long-standing, well-documented financial management systems weaknesses that have been reported by the DoD OIG's 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 DoD does not maintain systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level.

The results of our tests of compliance with certain provisions of laws and regulations disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04.

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

We noted certain matters that we reported to the DoD OIG management in a separate letter dated November 7, 2007.

Agency Comments

The DoD OIG provided comments to the Auditors' Report where they generally concurred with each observation made related to Financial Reporting. The DoD OIG comments and their planned corrective actions are included in Appendix A to this report.

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

Acuity Consulting, Inc.
Acuity Consulting, Inc.
November 7, 2007

Financial Statements

Department of Defense

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

CONSOLIDATED BALANCE SHEET

As of September 30

(Amounts in thousands)

	2007	2006
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 36,461	\$ 42,303
Accounts Receivable (Note 4)	0	0
Total Intragovernmental Assets	<u>\$ 36,461</u>	<u>\$ 42,303</u>
Accounts Receivable, Net (Note 4)	62	49
General Property, Plant and Equipment, Net (Note 6)	0	0
Other Assets (Note 5)	253	254
TOTAL ASSETS	<u><u>\$ 36,776</u></u>	<u><u>\$ 42,606</u></u>
LIABILITIES (Note 7)		
Intragovernmental:		
Accounts Payable (Note 8)	\$ 3,303	\$ 1,486
Other Liabilities (Note 9)	2,584	2,535
Total Intragovernmental Liabilities	<u>\$ 5,887</u>	<u>\$ 4,021</u>
Accounts Payable (Note 8)	\$ 1,303	\$ 1,485
Military Retirement and Other Federal Employment Benefits (Note 10)	6,678	6,399
Other Liabilities (Note 9)	17,757	16,102
TOTAL LIABILITIES	<u><u>\$ 31,625</u></u>	<u><u>\$ 28,007</u></u>
NET POSITION		
Unexpended Appropriations - Other Funds	11,383	19,001
Cumulative Results of Operations - Other Funds	(6,232)	(4,402)
TOTAL NET POSITION	<u><u>\$ 5,151</u></u>	<u><u>\$ 14,599</u></u>
TOTAL LIABILITIES AND NET POSITION	<u><u>\$ 36,776</u></u>	<u><u>\$ 42,606</u></u>

Department of Defense
Other Defense Organizations General Funds - Inspector General, Department of Defense
CONSOLIDATED STATEMENT OF NET COST
For the Years Ended September 30
 (Amounts in thousands)

	2007	2006
Program Costs		
Gross Costs	\$ 229,974	\$ 221,793
(Less: Earned Revenue)	65	40
Net Program Costs	\$ 230,039	\$ 221,833
Cost Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	<u>\$ 230,039</u>	<u>\$ 221,833</u>

Department of Defense
Other Defense Organizations General Funds - Inspector General, Department of Defense
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the Years Ended September 30
(Amounts in thousands)

	2007	2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ (4,402) \$	(528)
Prior Period Adjustments:		
Changes in accounting principles (+/-)	0	0
Corrections of errors (+/-)	0	0
Beginning balances, as adjusted	(4,402)	(528)
Budgetary Financing Sources:		
Other adjustments (rescissions, etc.)	0	0.00
Appropriations used	217,420	207,210
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	10,776	10,762
Other (+/-)	13	(13)
Total Financing Sources	<u>228,209</u>	<u>217,959</u>
Net Cost of Operations (+/-)	230,039	221,833
Net Change	<u>(1,830)</u>	<u>(3,874)</u>
Cumulative Results of Operations	<u><u>(6,232)</u></u>	<u><u>(4,402)</u></u>
 UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$ 19,001 \$	13,826
Prior Period Adjustments:		
Changes in accounting principles	0	0
Corrections of errors	0	0
Beginning balances, as adjusted	19,001	13,826
Budgetary Financing Sources:		
Appropriations received	216,297	215,323
Appropriations transferred-in/out	(4,178)	143
Other adjustments (rescissions, etc)	(2,317)	(3,081)
Appropriations used	<u>(217,420)</u>	<u>(207,210)</u>
Total Budgetary Financing Sources	<u>(7,618)</u>	<u>5,175</u>
Unexpended Appropriations	<u>11,383</u>	<u>19,001</u>
Net Position	<u><u>5,151</u></u>	<u><u>14,599</u></u>

Department of Defense
Other Defense Organizations General Funds - Inspector General, Department of Defense
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30
 (Amounts in thousands)

	2007	2006
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
Unobligated balance, brought forward, October 1	\$ 15,584	\$ 5,337
Recoveries of prior year unpaid obligations	10,626	13,769
Budget authority		
Appropriation	216,297	215,323
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections		
Earned		
Collected	(65)	(50)
Change in receivables from Federal sources	0	10
Change in unfilled customer orders		
Advance received	0	0
Without advance from Federal sources	161	16
Anticipated for rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	<u>216,393</u>	<u>215,299</u>
Nonexpenditure transfers, net, anticipated and actual	(4,178)	143
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(2,317)	(3,081)
Total Budgetary Resources	<u><u>\$ 236,108</u></u>	<u><u>\$ 231,467</u></u>

Department of Defense
Other Defense Organizations General Funds - Inspector General, Department of Defense
COMBINED STATEMENT OF BUDGETARY RESOURCES - Continued
For the Years Ended September 30
 (Amounts in thousands)

	2007	2006
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ 224,405	\$ 215,676
Reimbursable	250	208
Subtotal	<u>224,655</u>	<u>215,884</u>
Unobligated balance:		
Apportioned	2,901	7,488
Exempt from apportionment	0	0
Subtotal	<u>2,901</u>	<u>7,488</u>
Unobligated balance not available	8,552	8,095
Total status of budgetary resources	<u><u>\$ 236,108</u></u>	<u><u>\$ 231,467</u></u>
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	26,758	30,285
Less: Uncollected customer payments		
from Federal sources, brought forward, October 1	\$ (38)	\$ (12)
Total unpaid obligated balance	<u>26,720</u>	<u>30,273</u>
Obligations incurred net (+/-)	\$ 224,666	\$ 215,884
Less: Gross outlays	(215,578)	(205,642)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer		
payments from Federal sources (+/-)	<u>0</u>	<u>0</u>
Total Unpaid obligated balance transferred, net	<u>0</u>	<u>0</u>
Less: Recoveries of prior year unpaid obligations, actual	(10,626)	(13,769)
Change in uncollected customer payments from Federal sources (+/-)	(161)	(26)
Obligated balance, net, end of period		
Unpaid obligations	25,208	26,758
Less: Uncollected customer payments (+/-)		
from Federal sources (-)	<u>(200)</u>	<u>(38)</u>
Total, unpaid obligated balance, net, end of period	<u>25,008</u>	<u>26,720</u>
Net Outlays		
Net Outlays:		
Gross outlays	215,578	205,642
Less: Offsetting collections	65	50
Less: Distributed Offsetting receipts	<u>0</u>	<u>0</u>
Net Outlays	<u><u>\$ 215,643</u></u>	<u><u>\$ 205,692</u></u>

Notes to the Basic Statements

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 Department of Defense Office of the Inspector General (DoD OIG), 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 DoD OIG in accordance with the “DoD Financial Management Regulation,” OMB Bulletin No. 01-09, “Form and Content of Agency Financial Statements,” and Federal GAAP. The accompanying financial statements account for all resources for which the DoD OIG is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The DoD OIG’s financial statements are in addition to the financial reports prepared pursuant to OMB directives that are used to monitor and control the use of budgetary resources.

1.B. Description of the Reporting Entity

The Department of Defense Inspector General (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

The DoD OIG’s appropriations and funds are general funds. These appropriations and funds are used to support the resources that have been used in the course of executing the DoD OIG’s mission.

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

1.D. Basis of Accounting

The Defense Finance and Accounting Service (DFAS) provides financial management services to the Office of the Inspector General. 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. The DoD has undertaken efforts to determine the actions required to bring 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 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 adjustments for known accruals of major items such as payroll expenses, accounts payable, and other accrued liabilities. However, these financial statements are presented on the accrual basis of accounting as required.

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 DoD OIG 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 DoD OIG'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 DoD OIG'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 DoD OIG, 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 DoD OIG as though the agency was a stand-alone entity.

The DoD OIG'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 DoD OIG'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 DoD OIG'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 DoD OIG 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 DoD OIG 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.

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

The DoD OIG's financial resources are maintained in U.S. Treasury accounts. The 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 DoD OIG's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.I. Accounts Receivable

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 DoD OIG does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are resolved between the agencies.

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. All General PP&E is depreciated on a straight-line basis.

1.L. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as assets 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. 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 DoD OIG. 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.

1.O. 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.P. 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

1.Q. Undelivered Orders

The DoD OIG 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

As of September 30	2007	2006
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	\$ 0	\$ 0
B. Accounts Receivable	0	0
C. Total Intragovernmental Assets	\$ 0	\$ 0
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	\$ 0	\$ 0
B. Accounts Receivable	0	0
C. Other Assets	0	0
D. Total Nonfederal Assets	\$ 0	\$ 0
3. Total Nonentity Assets	\$ 0	\$ 0
4. Total Entity Assets	\$ 36,776	\$ 42,606
5. Total Assets	\$ 36,776	\$ 42,606

Asset accounts are categorized either as entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or funds that management is legally obligated to use 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.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30	2007	2006
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	\$ 36,461	\$ 42,303
B. Revolving Funds	0	0
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	\$ 36,461	\$ 42,303
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 0	\$ 0
B. Fund Balance per Agency	36,461	42,303
3. Reconciling Amount	\$ (36,461)	\$ (42,303)

The OIG is a DoD agency using Treasury Index 97. The Department of Treasury (Treasury) reports fund balances at the appropriation basic symbol level. The DoD OIG funding is allotted at limit level.

STATUS OF FUND BALANCE WITH TREASURY

As of September 30	2007	2006
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	\$ 2,901	\$ 7,488
B. Unavailable	8,552	8,095
2. Obligated Balance not yet Disbursed	\$ 25,208	\$ 26,758
3. Nonbudgetary FBWT	\$ 0	\$ 0
4. NonFBWT Budgetary Accounts	\$ (200)	\$ (38)
5. Total	\$ 36,461	\$ 42,303

The DoD OIG did not have any suspense or budget clearing accounts to report at September 30, 2007.

NOTE 4. ACCOUNTS RECEIVABLES

As of September 30	2007			2006
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables	\$ 0	N/A	\$ 0	\$ 0
2. Nonfederal Receivables (From the Public)	\$ 62	\$ 0	\$ 62	\$ 49
3. Total Accounts Receivable	<u>\$ 62</u>	<u>\$ 0</u>	<u>\$ 62</u>	<u>\$ 49</u>

The 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. The amount of unsupported undistributed collections are posted to the liability for deposit funds, clearing account and undeposited.

Other Information Related to Accounts Receivable

CATEGORY	Intragovernmental	Nonfederal
Nondelinquent	\$0	\$0
Current		
Noncurrent		
Delinquent		
1 to 30 days		\$0
31 to 60 days		\$0
61 to 90 days		
91 to 180 days		
181 days to 1 year		
Greater than 1 year and less than or equal to 2 years		
Greater than 2 years and less than or equal to 6 years		
Greater than 6 years and less than or equal to 10 years		
Greater than 10 years		
Subtotal		
Less Supported Undistributed Collections	0	0
Less Eliminations	0	0
Less Other	0	0
Total	\$0	\$0

NOTE 5. OTHER ASSETS

As of September 30	2007		2006	
(Amounts in thousands)				
1. Intragovernmental Other Assets				
A. Advances and Prepayments	\$	0	\$	0
B. Other Assets		0		0
C. Total Intragovernmental Other Assets	\$	0	\$	0
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	\$	0	\$	0
B. Other Assets (With the Public)		253		254
C. Total Nonfederal Other Assets	\$	253	\$	254
3. Total Other Assets	\$	253	\$	254

NOTE 6. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

The General Property, Plant and Equipment at September 30, 2007 and 2006, follows:

As of September 30	2007					2006	
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value	
(Amounts in thousands)							
1. Major Asset Classes							
A. Land	N/A	N/A	\$ 0	N/A	\$ 0	\$	0
B. Buildings, Structures, and Facilities	S/L	20 Or 40	0	0	0		0
C. Leasehold Improvements	S/L	Lease Term	0	0	0		0
D. Software	S/L	2-5 Or 10	0	0	0		0
E. General Equipment	S/L	5 or 10	0	0	0		0
F. Military Equipment	S/L	Various	0	0	0		0
G. Assets Under Capital Lease	S/L	Lease Term	0	0	0		0
H. Construction-in-Progress	N/A	N/A	0	N/A	0		0
I. Other			0	0	0		0
J. Total General PP&E			\$ 0	\$ 0	\$ 0	\$	0

Legend for Valuation Methods:

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

NOTE 7. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	2007	2006
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	1,668	1,650
D. Total Intragovernmental Liabilities	\$ 1,668	\$ 1,650
2. Nonfederal Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Military Retirement and Other Federal Employment Benefits	6,678	6,399
C. Environmental Liabilities	0	0
D. Other Liabilities	12,358	11,052
E. Total Nonfederal Liabilities	\$ 19,036	\$ 17,451
3. Total Liabilities Not Covered by Budgetary Resources	\$ 20,704	\$ 19,101
4. Total Liabilities Covered by Budgetary Resources	\$ 10,921	\$ 8,906
5. Total Liabilities	\$ 31,625	\$ 28,007

Liabilities Not Covered by Budgetary Resources

Liabilities that are not considered covered by 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.

NOTE 8. ACCOUNTS PAYABLE

As of September 30	2007			2006
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	\$ 3,303	\$ N/A	\$ 3,303	\$ 1,486
2. Nonfederal Payables (to the Public)	1,303	0	1,303	1,485
3. Total	\$ 4,606	\$ 0	\$ 4,606	\$ 2,971

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.

NOTE 9. OTHER LIABILITIES

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Intragovernmental				
A. Advances from Others	\$ 0	\$ 0	\$ 0	\$ 0
B. Deposit Funds and Suspense Account Liabilities	0	0	0	0
C. Disbursing Officer Cash	0	0	0	0
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	0	1,668	1,668	1,650
F. Other Liabilities	917	0	917	885
G. Total Intragovernmental Other Liabilities	\$ 917	\$ 1,668	\$ 2,585	\$ 2,535
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 4,850	\$ 0	\$ 4,850	\$ 4,576
B. Advances from Others	0	0	0	0
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	0	0	0	0
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	12,358	0	12,358	11,052
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	549	0	549	474
J. Total Nonfederal Other Liabilities	\$ 17,757	\$ 0	\$ 17,757	\$ 16,102
3. Total Other Liabilities	\$ 18,674	\$ 1,668	\$ 20,342	\$ 18,637

NOTE 10. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS

As of September 30	2007				2006
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
(Amounts in thousands)					
1. Pension and Health Actuarial Benefits					
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	\$ 0		\$ 0	\$ 0	\$ 0
2. Other Actuarial Benefits					
A. FECA	\$ 6,678		\$ 0	\$ 6,678	\$ 6,399
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	\$ 6,678		\$ 0	\$ 6,678	\$ 6,399
3. Other Federal Employment Benefits					
	\$ 0		\$ 0	\$ 0	\$ 0
4. Total Military Retirement and Other Federal Employment Benefits:					
	\$ 6,678		\$ 0	\$ 6,678	\$ 6,399

Federal Employees Compensation Act (FECA)

The actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DoD OIG 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	5.170%
Year 2 and thereafter	5.313%

To provide more specificity 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>
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

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.

NOTE 11. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Intragovernmental Costs and Exchange Revenue				
As of September 30	2007		2006	
(Amounts in thousands)				
1. Intragovernmental Costs	\$	50,610	\$	48,312
2. Public Costs		179,364		173,481
3. Total Costs	\$	229,974	\$	221,793
4. Intragovernmental Earned Revenue	\$	0	\$	0
5. Public Earned Revenue		65		40
6. Total Earned Revenue	\$	65	\$	40
7. Net Cost of Operations	\$	230,039	\$	221,833

Disclosures Related to the Statement of Net Cost

The Consolidated Statement of Net Cost (SNC) 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.

NOTE 12. DISCLOSURES RELATED TO THE STATEMENTS OF CHANGES IN NET POSITION

As of September 30	2007		2006	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	\$	0	\$	0
		\$		\$
		0		0
		\$		\$
		0		0

B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
C. Total Prior Period Adjustments	\$ 0	\$ 0	\$ 0	\$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	\$ 4,000	\$ 0	\$ 4,481	\$ 0
B. Civilian Health	6,753	0	6,259	0
C. Civilian Life Insurance	23	0	22	0
D. Judgment Fund	0	0	0	0
E. IntraEntity	0	0	0	0
F. Total Imputed Financing	\$ 10,776	\$ 0	\$ 10,762	\$ 0

Other Information: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 and 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.

NOTE 13. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30	2007	2006
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 14,539	\$ 18,106
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Apportionment Categories

(Amount in thousands)	
<u>Direct Obligations</u>	
Category A	\$224,405
Category B	<u>0</u>
Total Direct Obligations	\$224,405
Exempt from Apportionment	\$0
Reimbursable Obligations	<u>\$250</u>
Total Obligations	<u>\$224,655</u>

Information Related to the Statement of Budgetary Resources

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

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.

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:

The objective of the Statement of Financing is to reconcile the difference between budgetary obligations and the net cost of operations reported. The Office of Management and Budget Circular A-136 requires the Statement of Financing to be presented on a consolidated basis.

The following Statement of Financing lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

The Other line in Resources Used to Finance Activities consists of other gains and losses.

The Other line in Resources Used to Finance Items not Part of the Net Cost of Operations consists of other gains and losses.

The Other line in Components Requiring or Generating Resources in Future Period section consists of future funded expenses for unfunded leave.

The Other line in Components of the Net Cost of Operation that will not Require or Generate Resources in the Current Period consists of cost capitalization offset.

NOTE 15. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30	2007	2006
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	\$ 224,655	\$ 215,884
2. Less: Spending authority from offsetting collections and recoveries (-)	(10,723)	(13,745)
3. Obligations net of offsetting collections and recoveries	\$ 213,932	\$ 202,139
4. Less: Offsetting receipts (-)	0	0
5. Net obligations	\$ 213,932	\$ 202,139
Other Resources:		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	0	0
8. Imputed financing from costs absorbed by others	10,776	10,762
9. Other (+/-)	13	(13)
10. Net other resources used to finance activities	\$ 10,789	\$ 10,749
11. Total resources used to finance activities	\$ 224,721	\$ 212,888
Resources Used to Finance Items not Part of the Net		

Cost of Operations:			
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:			
12a. Undelivered Orders (-)	\$	3,567	\$ 6,039
12b. Unfilled Customer Orders		161	16
13. Resources that fund expenses recognized in prior Periods (-)		0	0
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		0	0
15. Resources that finance the acquisition of assets (-)		0	0
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:			
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)		0	0
16b. Other (+/-)		(13)	13
17. Total resources used to finance items not part of the Net Cost of Operations	\$	3,715	\$ 6,068
18. Total resources used to finance the Net Cost of Operations	\$	228,436	\$ 218,956
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:			
19. Increase in annual leave liability	\$	1,307	\$ 990
20. Increase in environmental and disposal liability		0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)		0	0
22. Increase in exchange revenue receivable from the public (-)		0	0
23. Other (+/-)		296	1,778
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$	1,603	\$ 2,768
Components not Requiring or Generating Resources:			
25. Depreciation and amortization	\$	0	\$ 109
26. Revaluation of assets or liabilities (+/-)		0	0
27. Other (+/-)			
27a. Trust Fund Exchange Revenue		0	0
27b. Cost of Goods Sold		0	0
27c. Operating Material and Supplies Used		0	0
27d. Other		0	0
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	\$	0	\$ 109
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$	1,603	\$ 2,877
30. Net Cost of Operations	\$	230,039	\$ 221,833

NOTE 16. OTHER DISCLOSURES

As of September 30	2007			
	Asset Category			
	Land and Buildings	Equipment	Other	Total

**1. ENTITY AS LESSEE-
Operating Leases**

Future Payments Due

Fiscal Year

2008	\$	14,405	\$	0	\$	0	\$	14,405
2009		11,933		0		0		11,933
2010		6,759		0		0		6,759
2011		2,726		0		0		2,726
2012		1,911		0		0		1,911
After 5 Years		3,549		0		0		3,549

**Total Future
Lease Payments
Due**

\$	41,283	\$	0	\$	0	\$	41,283
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Other Information – According to the FMR Volume 6B, Chapter 10, the Inspector General must disclose information relating to operating leases 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 FY08-FY12 and five years after. Our calculations were based on current expiration of lease agreements shown in the GSA website.

Office buildings in the amount of \$41.3 million represent office space rental. The lease periods are from three to ten years. There are no escalation clauses or contingent rental restrictions.

Appendix A – DoD OIG Management’s Comments On the Auditors’ Report



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

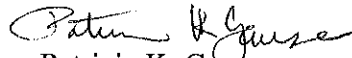
November 9, 2007

MEMORANDUM FOR ACUITY CONSULTING, INC

SUBJECT: Draft Report of the Office of the Inspector General, Department of Defense
FY 2007 Financial Statement Audit.

The Office of the Inspector General, Department of Defense is providing the attached general comments to the material weaknesses identified during the FY 2007 Financial Statement audit.

The point of contact is Mr. Marlon Moreira. Mr. Moreira can be reached at (703) 602-2226.


Patricia K. Gause
Comptroller

Attachment:
As stated

Auditor's Comment:

1.) The DoD OIG does not perform adequate managerial review of the information processed by DFAS.

In the prior year, we observed that the DoD OIG performed many activities that replicate the actions taken by their service provider. In some cases the activities are more akin to converting data from one format to another (i.e. PDF to Excel). In the current year, initial steps were taken to improve business processes in order to begin to independently validate the information being processed by the service provider. Additional progress needs to be made, in order to assure that data analysis of the financial reporting level is being performed.

Management Comments:

The DoD OIG concurs with this comment. However, as previously stated, many of DFAS's reports are in formats that are not user friendly (TXT, PDF). The DoD OIG initiated new procedures to improve business processes in order to begin to independently validate the information being processed by DFAS. The DoD OIG has several managerial reviews that are not fully documented. The Office of the Comptroller works together with DFAS Indianapolis to properly review transactions that may affect the DoD OIG's Financial Statements.

Auditor's Comment:

2.) The DoD OIG does not have a process in place to ensure the completeness of the quarterly or year-end financial statements.

Last year we reported, and the condition continues in need of remediation, that the DoD OIG in conjunction with their service provider has not fully documented the crosswalks used to develop the DD 1176 from the WAAS general ledger. The DD 1176 serves as an integral piece of the audit trail from the general ledger to the Statement of Budgetary Resources. The DoD OIG did, however, adopt an interim process using alternative procedures by which we were able to validate the DD 1176 and the statement of budgetary resources. Additional actions are necessary to fully remediate this condition.

Management Comments:

The DoD OIG concurs with this comment. We adopted an interim process using alternative procedures to properly reconcile and validate the DD 1176 report produced by DFAS. The DoD OIG will continue to work with DFAS Indianapolis to develop an Access database process to fully account for every reported amount in our DD 1176.

Auditor's Comment:

3.) The DoD OIG does not have fundamental processes in place to ensure that transactions initiated are appropriately reviewed and approved.

We continued to observe that the DoD OIG does not have fully implemented business practices to perform adequate management review of transactions recorded to their books. In the current year, we observed newly implemented business processes to review the validity of lease or facilities costs recorded; however, there continued to be limited progress on the development of policy and the refinement of processes to validate the amounts recorded for personnel and benefits costs. The DoD OIG needs to identify, develop and implement management review and validation techniques to enable them to fulfill their management stewardship responsibilities.

Management Comments:

The DoD OIG concurs in principle with this comment. The DoD OIG **does not have complete written** documentation to reflect the adequacy of the reviews that validate the transactions recorded in its books, but it **does** have processes in place to review the adequacy of the recorded amounts to include personnel and benefits. To be in compliance with last year's recommendations, the DoD OIG implemented business processes to review the validity of lease or facilities costs recorded. The OIG will continue to work with the key personnel to formally document policies and processes to validate the amounts recorded for personnel and benefits costs as well as implement an adequate independent validation process to improve our current analysis of information at the financial reporting level.