

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



**Financial Statement Audit
Fiscal Year 2009**

Submitted by



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Management Discussion and Analysis

I. Background

The Inspector General Act of 1978 established civilian Offices of Inspector 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 American Revolutionary War, the Department of Defense Office of Inspector General (DOD OIG) was not established until 1982, when Congress amended the Inspector General Act in the National Defense Authorization Act for Fiscal Year 1983 (Public Law. 97-252, 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 DOD IG 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.” Similarly, the Inspector General Act also requires the DOD OIG to give “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. Mission Statement

The mission of the DOD OIG is to “[p]romote integrity, accountability, and improvement of Department of Defense personnel, programs, and operations in order to support the Department’s mission and serve the public interest.”

III. Vision Statement

The DOD OIG’s vision is “[o]ne professional team strengthening the integrity, efficiency, and effectiveness of the Department of Defense.”

IV. Core Values

The values that represent the DOD OIG core priorities are accountability, integrity, and efficiency.

V. Organization

The DOD OIG audits, investigates, inspects, and evaluates DOD programs and operations and, as a result, recommends policies and process improvements that promote economy, efficiency, and effectiveness in DOD programs and operations. For the last 3 years, DOD OIG has achieved \$22.9 billion in savings and \$4.4 billion in monies recovered for the nation. The IG is the only DOD official authorized to issue opinions on the DOD financial statements.

The IG also:¹

- is the principal adviser to the Secretary of Defense for matters relating to the prevention and detection of fraud, waste, and abuse in the DOD programs and operations;
- provides policy direction for audits and investigations relating to fraud, waste, and abuse and program effectiveness;
- investigates fraud, waste, and abuse uncovered as a result of other contract and internal audits, as the IG considers appropriate;
- develops policy, evaluates program performance, and provides guidance on DOD activities relating to criminal investigation programs;
- monitors and evaluates the adherence of DOD auditors to internal audit, contract audit, and internal review principles, policies, and procedures;
- develops policy, evaluates program performance, and monitors actions of audits conducted by the Comptroller General of the United States;
- requests assistance as needed from other audit, inspection, and investigative units of the DOD, including Military Departments;
- gives particular regard to the activities of the internal audit, inspection, and investigative units of the Military Departments with a view toward avoiding duplication and ensuring effective coordination and cooperation; and
- reviews existing and proposed legislation and regulations relating to DOD programs and operations.

¹ IG Act, as amended,



Figure 1. DOD OIG's Organizational Structure as of September 30, 2009

The DOD OIG is focusing its resources and human capital in critical areas to assist DOD in improving its programs and operations. Independent oversight of the DOD is essential to ensure the public's confidence and protect the warfighters.

Auditing

Section 3 (d) of the Inspector General Act establishes the requirement for the audit function within the DOD OIG. The work of the Office of the Deputy Inspector General for Auditing (ODIG-AUD) results in recommendations for reducing costs; eliminating fraud, waste, and abuse; improving the 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 and other DOD leadership, Hotline allegations, congressional requests, and OIG risk analyses of DOD programs and also include areas of concern for contract pricing, services contracts, contractor overhead costs, and major weapon systems acquisitions.

To support the Overseas Contingency Operations (OCO), ODIG-AUD maintains staff in Iraq, Afghanistan, and Qatar and is establishing new field offices in Germany and Hawaii and expanded the Yorktown, Virginia; Philadelphia, Pennsylvania; and Tampa, Florida offices.

Since FY 2006, the DOD OIG has achieved an average of \$11.9 million per auditor in monetary benefits. The ODIG-AUD goal is for 95 percent of completed audits to provide at least one of the following five benefits: improve business operations, comply with statute or regulations, improve national security, identify potential monetary benefits, and improve effectiveness of the safety of Service members.

Investigations

The Office of the Deputy Inspector General for Investigations (ODIG-INV) includes the Defense Criminal Investigative Service (DCIS). DCIS is the DOD OIG criminal investigative arm. Its traditional areas of concentration are major procurement fraud, with emphasis on defective and substandard products; cyber crimes; health care fraud; public corruption; antiterrorism operations; and technology protection investigations (illegal transfer, theft, or diversion of DOD technologies and U.S. Munitions List items to proscribed nations and persons). Since admission into the Department of Justice (DOJ) Asset Forfeiture Fund in May 2007, DCIS has obtained court orders of final forfeiture in the amount of approximately \$148 million.

DCIS participates with the Federal Bureau of Investigation (FBI) on Joint Terrorism Task Forces at the FBI headquarters and at 45 locations across the United States. DCIS also works with U.S. Immigration and Customs Enforcement to stem the illegal diversion of DOD technology, weapon systems, and equipment through an intensive criminal investigative effort and awareness training, including tailored briefings designed to encourage DOD and contractor employees to report to DOD law enforcement agency crimes impacting DOD programs.

DCIS actively participates in the Law Enforcement/Counterintelligence Center, which is part of the Joint Task Force – Global Network Operations (JTF-GNO) established to protect the Global Information Grid. It is a key member of the DOJ International Contract Corruption Task Force, whose mission is to deploy criminal investigative and intelligence assets worldwide to detect, investigate, and prosecute corruption and contract fraud resulting primarily from OCO. Additionally, DCIS is an active member of the Defense Council on Integrity and Efficiency and is a mainstay on the DOJ National Procurement Fraud Task Force (NPFTF), which promotes the prevention, early detection, and prosecution of procurement fraud. NPFTF is chaired by the DOJ Assistant Attorney General for the Criminal Division and includes the Civil, Antitrust, and Tax Divisions as well as DCIS, FBI, the IG community, and Federal prosecutors across the country.

DCIS special agents have full law enforcement authority, make arrests, carry concealed weapons, execute search warrants, serve subpoenas, and testify in legal proceedings.

Administrative Investigations

The Office of the Deputy Inspector General for Administrative Investigations (ODIG-AI) was separated from the ODIG-INV midyear to bring higher visibility to DOD OIG administrative investigations that involve particularly sensitive matters concerning DOD senior civilian officials and military officers and allegations of reprisal against DOD Service members, civilians, and Defense contractors. The ODIG-AI offices include Investigations of Senior Officials, which ensures that ethical violation, abuses of authority, or misuses of public office do not undermine

the credibility of the national command structure; Military Reprisal Investigations, which conducts and oversees investigations of whistleblower reprisal under three Federal whistleblower protection statutes: section 1034, title 10, United States Code (10 U.S.C. § 1034) (military members), 10 U.S.C. § 1587 (nonappropriated fund employees), and 10 U.S.C. § 2409 (DOD contractor employees); and Civilian Reprisal Investigations, which reviews and investigates whistleblower reprisal allegations submitted to the DOD Hotline by DOD civilian appropriated fund employees.

Policy and Oversight

According to 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, inspections, evaluations, investigations, and hotline activities within DOD; provides analysis and comments on all proposed draft DOD policy issuances; and provides technical assessments to OIG organizations.

- The Audit Policy and Oversight (APO) Directorate provides audit policy direction, guidance, and oversight for the ODIG-AUD, the Military Departments audit organizations, the Defense Contract Audit Agency (DCAA), other Defense audit organizations, and public accounting firms under the Single Audit Act. APO provides guidance and oversight for more than 6,500 DOD auditors in 24 DOD audit organizations, which is nearly 40 percent of all auditors in Federal Inspector General audit organizations.
- The Investigative Policy and Oversight (IPO) Directorate evaluates performance and develops policy for the DOD criminal investigative and law enforcement community as well as the DOD noncriminal investigative offices. IPO also manages the Inspector General Subpoena Program for investigating fraud and other select criminal offenses, and it administers the DOD Voluntary Disclosure Program, which facilitates Defense contractors desiring to self-report potential fraud.
- The Inspections and Evaluations Directorate conducts objective and independent customer-focused management and program inspections and evaluations that address areas of interest to Congress, DOD, and the IG and provides timely findings and recommendations to improve DOD programs and operations.
- The Technical Assessment Division (TAD) provides a variety of engineering support functions for the OIG audit, investigation, and evaluation organizations and other DOD organizations as needed.

Intelligence

The Office of the Deputy Inspector General for Intelligence (ODIG-INTEL) audits, evaluates, monitors, and reviews the programs, policies, procedures, and functions of the DOD Intelligence Community, special access programs, the Defense nuclear program and operations, and other highly classified programs and functions within the DOD (hereafter collectively referred to as DOD Intelligence). ODIG-INTEL is the primary advisor to the DOD IG and through the DOD IG to the Secretary of Defense and other Office of the Secretary of Defense (OSD) leaders on intelligence audit and evaluation matters. ODIG-INTEL audits, reviews, and evaluates topics determined by law, requests from the Secretary of Defense and other DOD leadership, Hotline allegations, congressional requests, and internal analyses of risk in DOD Intelligence programs.

ODIG-INTEL also works closely with other Federal agency and organization Inspectors General, such as the Central Intelligence Agency, Director of National Intelligence, and DOJ, coordinating and collaborating on projects to ensure proper operation, performance, and results for national intelligence activities.

ODIG-INTEL personnel assist the Office of the Director of National Intelligence Inspector General (ODNI-IG) in administering, coordinating, and overseeing the functions of the Intelligence Community Inspectors General Forum, which promotes and improves information sharing among the Intelligence Community IGs. It also enables each IG to carry out the duties and responsibilities established under the Inspector General Act of 1978, as amended, to avoid duplication and ensure effective coordination and cooperation.

Special Plans and Operations

The Office for Special Plans and Operations (SPO) facilitates informed decision making by senior leaders of the DOD, U.S. Congress and other Government organizations by providing timely, high-value assessment reports on strategic challenges and issues, with a special emphasis on OCO funding issues and operations in Southwest Asia. Its work complements the efforts of the other DOD OIG components.

SPO's core staff includes civilian and military personnel who are deployable to the Southwest Asia Theater of Operations. Team members are drawn from the DOD OIG, other DOD, and interagency detailees that have the required evaluation and audit skill sets, and specific experience and knowledge of the issue areas being addressed.

Other Components, OIG

The Office of Communications and Congressional Liaison (OCCL) supports the DOD OIG by serving as the primary point of contact for external communications between DOD OIG and the public and Congress and as the public affairs office. OCCL includes the Defense Hotline, Freedom of Information Division, the DOD OIG Web Development Team, and digital media support. During the midyear, the Government Accountability (GAO) Liaison Office was realigned under OCCL and will serve as the DOD OIG liaison with GAO on all matters concerning GAO reports and reviews consistent with DOD Instruction (DODI) 7650.01 "General Accountability Office and Comptroller Access to Records" and DODI 7650.02 "General Accountability Office Reviews and Reports." GAO is the investigative arm of Congress, and thus, the realignment of GAO Liaison with OCCL offers potential for improved support to GAO and enhanced communications with congressional stakeholders.

The Office of General Counsel (OGC) provides independent and objective advice and legal counsel to the IG and DOD OIG. The scope of OGC advice and legal opinions includes criminal and administrative investigation, procurement, fiscal, personnel, ethics, international, and intelligence matters. The DOD OIG General Counsel serves as the DOD OIG Designated Agency Ethics Official and manages the DOD OIG Ethics Program.

The Office of Administration and Management (OA&M) provides mission-critical support for personnel, security, training, administration, logistics, financial management, and information

technology through its six Directorates: Human Capital Advisory Services; Office of Security; Training Services; Administration and Logistics Services; Office of the Comptroller; and Information Systems. OA&M supervises and provides mission-critical functions in support of the DOD OIG's day-to-day operations at headquarters and 74 field offices located throughout the world. OA&M also supports Combatant Command and Joint Inspector General Training and Doctrine development. In accordance with the Base Closure and Realignment Commission Recommendation #133, DOD OIG offices in the National Capital Region are scheduled to relocate in 2011, and OA&M is the principal coordinator for this effort.

VI. Budgetary and Financial Aspects

DOD OIG remains focused on accomplishing its goals of improving the economy, efficiency, and effectiveness of DOD personnel, programs, and operations as well as eliminating and preventing fraud, waste, and abuse in DOD programs and operations. In the years ahead, DOD OIG will maintain its focus to ensure that those sent to locations around the world are trained and have the support they need to provide proper oversight and to ensure good stewardship over all with which DOD OIG has been entrusted, especially the troops and those that support them.

Because of the size and complexity of its financial statements, DOD continues to face financial management challenges. These challenges make it difficult for DOD to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. Much has been done during the last few years to address these challenges, but DOD needs to continue to be vigilant in its efforts to provide accurate and usable financial information to its managers for decision-making purposes.

DOD OIG is working closely with the DOD to address long-standing financial management challenges and supports the DOD goal of achieving a favorable audit opinion for the DOD agency-wide financial statements and the major DOD Components. The Under Secretary of Defense (Comptroller)/Chief Financial Officer issued the DOD Financial Improvement and Audit Readiness Plan as part of an initiative to improve financial management within the DOD. DOD OIG supports the objective of the plan, which is to provide ongoing, cross-functional collaboration with DOD components to yield standardized accounting and financial management processes, business rules, and data that will provide a more effective environment to better support the warfighting mission. DOD OIG also supports DOD's ongoing efforts to target achievable, incremental change and to initiate the adjustments necessary for continual, sustainable improvement in financial management.

Financial Condition

Annually, DOD OIG assesses the most serious management and performance challenges DOD faces. It bases its assessment 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 2009 was \$271.8 million. DOD OIG also received \$75,000 for the employee drug testing program, \$9.5 million for OCO, \$5 million in

reimbursable authority, and \$15 million to provide oversight of DOD's execution of the American Reinvestment and Recovery Act (Recovery Act) funds. DOD Recovery Act appropriations are available for obligation through the end of FY 2011, and DOD OIG has until the end of FY2015 to disburse Recovery Act funds. The FY 2009 funding amount increased by \$50 million, including the \$15 million in the DOD Recovery Act, from FY 2008, to accomplish the DOD OIG goals of improving the economy, efficiency, and effectiveness of DOD personnel, programs, and operations as well as eliminate and prevent fraud, waste and abuse in DOD programs and operations. Funds will be used to increase auditor staff, expand field offices, and provide for essential operational costs. The additional funding will allow DOD OIG to establish offices in Germany and Hawaii and expand the Tampa, Florida, field office.

Limitations to the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the DOD OIG, as required by the Chief Financial Officers Act of 1990 and expanded by the Government Management Reform Act of 1994 and other legislation. The DOD OIG principal financial statements have been prepared to report the financial position and results of operations of an entity, pursuant to the requirements of 31 U.S.C. § 3515(b) and in accordance with the DOD Financial Management Regulation, OMB Circular A-136, "Financial Reporting Requirements," revised June 3, 2008, and U.S. Generally Accepted Accounting Principles (GAAP) for Federal entities. Although the statements have been prepared from the books and records of the entity in accordance with GAAP and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

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

VII. Systems, Controls, and Legal Compliance

DOD OIG Systems

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,
- Defense Departmental Reporting System,
- Headquarters Accounting and Reporting System, and
- CFO Loan and Reconciliation System.

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. The

Council oversees and provides guidance in the implementation of the Financial and Feeder Systems Compliance.

The complexity and number of systems DOD uses to process its financial transactions and prepare its financial statements increases the time it will take DOD to make its financial accounting systems 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, GAAP, and Statements of Federal Financial 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, 2009, in accordance with the guidance in OMB Circular No. A-123 (Revised), "Management's Responsibility for Internal Control," August 5, 2005, as implemented by DODI 5010.40, "Managers' Internal Control Program Procedures," January 4, 2006. The DOD OIG's senior management also performed an evaluation of whether the system of internal accounting and administrative control for the DOD OIG is in compliance with standards prescribed by the Comptroller General.

The objectives of the system of internal accounting and administrative control of the DOD 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 DOD OIG system of internal accounting and administrative control, in effect during the fiscal year ending September 30, 2009, provides reasonable assurance that management controls are in place, operating effectively, and being used.

VIII. Performance Goals and Objectives

Strategic Plan

The DOD OIG's Strategic Plan supports the DOD's mission, including priorities identified by the Secretary of Defense. The DOD OIG mission is to "[p]romote integrity, accountability and improvement of DOD personnel, programs, and operations to support the DOD's mission," including winning OCO and other Secretary of Defense top priorities, and addressing management challenges identified by DOD OIG and the GAO's High-Risk areas.

The DOD OIG Strategic Plan includes key objectives that provide independent, objective, and relevant information to the DOD, Congress, other Government agencies, and the public; promote ethics and integrity within DOD; prevent and detect fraud, waste, and abuse; ensure accountability for mission accomplishment and strategic human capital management and merit system principles; and improve the planning and use of DOD OIG resources to ensure relevant and timely information to senior-level decision makers on critical issues. To monitor performance against the plan, DOD OIG complies with the Government Performance and Results Act of 1993, as amended, and tracks goal attainment to measure progress and results to ensure a return on investment of taxpayer dollars. One of the key methods of monitoring performance is through the DOD OIG quarterly performance report that assesses each functional component in six categories: (1) timeliness of projects; (2) coverage of key areas, such as DOD Transformation Priorities and DOD OIG-identified management and performance challenges; (3) return on investment; (4) external engagement; (5) budget; and (6) personnel. In addition to the DOD OIG quarterly performance report, each component maintains its own system of monitoring performance.

Strategic Goals

DOD OIG has identified three strategic goals and key objectives corresponding to those goals that are pertinent to the implementation of its Strategic Plan.

Goal 1: Improve the economy, efficiency, and effectiveness of Department of Defense personnel, programs and operations.

Objectives:

- Provide independent and objective audits, evaluations, and investigations of DOD programs and operations and fully inform the Secretary of Defense and the Congress about potential problems and deficiencies.
- Identify and execute projects focused on improving efficiency and effectiveness in key strategic areas as identified by the Inspector General.
- Recommend solutions to resolve identified risks and weaknesses.
- Provide independent and objective information products to the DOD, Congress, other Government agencies, and the public.

Goal 2: Eliminate fraud, waste, and abuse in the programs and operations of the DOD.

Objectives:

- Improve the ability of the DOD to accomplish its mission by detecting and preventing fraud, waste, and abuse.
- Promote accountability, ethics and integrity within the DOD.
- Provide independent and objective information products to the DOD, Congress, other Government agencies, and the public.
- Promote public confidence in the DOD leadership and programs.

Goal 3: Ensure the efficiency and effectiveness of DOD OIG work products, processes, and operations.

Objectives:

- Establish short -and long-term priorities for the DOD OIG.
- Support the President’s Management Agenda.
- Ensure accountability for mission accomplishment.
- Ensure accountability for strategic human capital management and merit system principles.
- Improve the planning and use of DOD OIG resources to ensure that relevant and timely information is provided to senior-level decision makers on critical issues.
- Ensure that DOD OIG performance measures focus on outcomes and impacts.
- Improve component unique operations.
- Capitalize on opportunities to integrate efforts of DOD OIG components.
- Optimize jointness/coordination with other oversight agencies (leverage resources).
- Ensure DOD OIG personnel receive the training and education needed to develop their full potential.

IX. Results

Audit

In FY 2009, ODIG-AUD produced 117 reports, which claimed potential monetary benefits totaling \$826.4 million. During FY 2009, ODIG-AUD also achieved \$201.8 million in monetary benefits from reports issued in FY 2007 and earlier (i.e., funds were put to better use because of actions completed on audit recommendations). Numerous audits do not lend themselves to identification of specific monetary benefits. The ODIG-AUD goal is for 95 percent of completed audits to provide at least one of the following five benefits: improve business operations, comply with statutes or regulations, improve national security, identify potential monetary benefits, and improve effectiveness of the safety of Service members.

As a result of the additional funding provided in FY 2009, the ODIG-AUD created and filled new positions to provide increased oversight of high risk areas, such as Southwest Asia operations, as well as the Recovery Act funds.

DOD annually produces at least 65 individual financial statements, many of which are larger and more complex than the statements of most public corporations. DOD OIG is the sole DOD audit organization authorized to review those statements and issue opinions on them. With regard to the reliability of DOD financial statements, DOD OIG conducts audits that are consistent with Public Law 107-107, section 1008.² In FY 2009, DOD OIG limited its financial statement audit

² Section 1008(d) “Limitation on Inspector General Audits,” states that “[o]n each financial statement that an official asserts is unreliable . . . [t]he Inspector General of the Department of Defense shall only perform the audit procedures required by generally accepted government auditing standards consistent with any representation by management.” Complying with Section 1008(f), “Termination of the Applicability,” audits will be conducted “[if] the Secretary of Defense certifies to the Inspector General of the Department of Defense that the financial statement

work and redirected the Defense Business Operations staff to work on audits related to the Government Purchase Card Program and internal control and compliance reviews over systems and property. In addition, because of increased concerns over funding spent on OCO and in response to the FY 2008 National Defense Authorization Act, Section 842, “Investigation of Waste, Fraud, and Abuse in Wartime Contracts and Contracting Processes in Iraq and Afghanistan,” DOD OIG performed several financial audits to determine whether OCO funds were being used for their intended purpose.

Priority demands on audit resources include:

- section 842 of the FY 2008 National Defense Authorization Act, which requires DOD OIG to develop a comprehensive plan for a series of audits of Defense contracts, subcontracts, and task and delivery orders for the performance of security and reconstruction functions in Iraq and Afghanistan;
- the Chief Financial Officers Act of 1990, as amended by FFMIA;
- the Intelligence Authorization Act for FY 2002, which requires DOD 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 DOD OIG presence in Southwest Asia and increase coverage of OCO-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 that, although beneficial, do not result in reports that can be reflected in DOD OIG productivity statistics.

In 2009, the auditors issued disclaimers of opinion on the DOD Agency-wide FY 2008 financial statements and eight of the components’ statements that support the Agency-wide statements; a qualified opinion on the Medicare-Eligible Retiree Health Care Fund; an unqualified opinion on the Military Retirement Fund; and a unqualified opinion on the U.S. Army Corps of Engineers FY 2008 and FY 2007 financial statements. In addition, the auditors performed audits or provided contractor oversight on 5 financial systems audits and performed approximately 65 other audits on internal controls, compliance with laws and regulations, and other financial-related issues.

As OSD and Components identify segments of financial statements that are ready for review, DOD OIG audit staff announces audits or attestation engagements, as appropriate. For example, DOD OIG is overseeing an audit of the TRICARE Management Activity’s Contract Resource Management Balance Sheet. ODIG-AUD also continues to perform internal control and

for the Department of Defense or a financial statement for a Component of the Department of Defense, for a fiscal year is reliable”

compliance reviews over systems and property and attestation reviews of the DOD Counterdrug program, which is an annual requirement from The Office of National Drug Control Policy Reauthorization Act of 2006.

Investigations

DCIS uses several methods to evaluate performance, depending on the importance of the matter under investigation; for example, 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. In addition, DCIS has established an evaluation standard that 75 percent of investigations initiated must be in its priority areas of criminal activity. 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.

DCIS investigations resulted in 271 criminal indictments, 207 convictions, and more than \$1.5 billion in criminal, civil, and administrative recoveries (excluding headquarters and field managers, an average of \$5.24 million per agent for the year). Since its inception, DCIS has participated in cases that have resulted in more than \$14.8 billion in criminal, civil, and administrative recoveries. Further, DCIS supports crucial national defense priorities primarily by using its limited investigative resources effectively and efficiently and emphasizing investigations of terrorism, product substitution/defective parts, illegal technology transfer, and public corruption.

The Military Reprisal Investigations (MRI) office received 432 reprisal complaints and closed 405 complaints, of which 182 were investigated by Military Department Inspectors General under MRI oversight. Of the 405 complaints, 330 cases were closed after the preliminary inquiry stage. MRI currently has 455 open cases. MRI continues to implement policies and procedures to improve the timeliness in processing and resolving such allegations. The Directorate also conducts extensive outreach to the Military Components, the Combatant Commands, and other Defense agencies through mobile training teams and formal training workshops.

The Civilian Reprisal Investigations (CRI) office closed 32 cases and opened 42. CRI currently has 22 open matters and expects to increase its case closure rate in the future, giving highest priority to contractor fraud and abuse within the Defense Intelligence and counterintelligence communities. CRI has met, and exceeded, its established metric of allocating 25 percent of its resources to cases of congressional interest.

The Investigations of Senior Officials (ISO) office received 302 senior official cases and closed 367 cases, of which 46 (13 percent) contained substantiated allegations during FY 2009. ISO performed oversight on 178 investigations conducted by DOD components and evaluated the impact of those investigations on public confidence in DOD leaders and ultimately on national security. Investigative impact may be evaluated by the overall number of investigations conducted or overseen, the percentage of investigations that were of significance to DOD or congressional leaders, and the percentage of investigations that substantiated alleged misconduct.

Thirty percent of investigations conducted by ISO in FY 2009 had significant media, Secretary of Defense, or congressional interest, with results provided directly to the Secretary of Defense or Members of Congress and involved complicated issues of public interest and were human resource-intensive because of the extensive fieldwork required. Examples of ISO work products include investigations into alleged conflicts of interest on the part of senior DOD officials, alleged mismanagement of an aircraft procurement program, and reprisals. More than 13 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.

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, ISO conducted more than 10,000 name checks on DOD senior officials in the past year. The Senate Armed Services Committee relies exclusively on name checks completed by ISO before confirming military officer promotions.

Policy and Oversight

ODIG-P&O issued 21 reports and provided technical support to approximately 21 audit and investigative projects. ODIG-P&O managed the DOD OIG's policy coordination process for 330 draft DOD policy issuances and coordinated or published the following two DOD issuances: DODI 5100.86, "DOD Forensic Sciences Committee," November 20, 2008, and DOD 7600.07-M, "DOD Audit Manual," February 13, 2009.

Audit Policy and Oversight (APO) issued seven oversight reports, one hotline report, and one followup review report and reviewed and commented on 87 single audit reports and issued 107 memoranda for grant or contracting officer followup. APO commented on 13 exposure draft policy documents and reviewed 42 and commented on 5 Federal Acquisition Regulation and Defense Federal Acquisition changes.

Further, APO provided oversight of 2,089 open and closed contract audit reports with more than \$5.9 billion in potential savings and issued 67 recommendations, 63 (94 percent) of which were agreed upon or provided acceptable alternatives. APO monitored DCAA's assessment of all issues and conclusions on the quality of audit work in response to the GAO review of DCAA Western Region Audit Offices, completed a review of 1 DOD Hotline complaint, started reviews on 2 other DOD Hotline complaints concerning DOD audit operations, reviewed 4 unsatisfactory condition complaints from DCAA, and launched a fraud Web site that provides guidance and other resources for DOD and Federal auditors.

In addition, APO hosted the DOD OIG's first Fraud Prevention and Detection Conference, attended by more than 320 auditors, investigators, attorneys, and acquisition and contracting personnel from more than 60 organizations. APO also published DOD 7600.07-M "DOD Audit Manual," February 13, 2009, to assist the 24 DOD audit organizations with more than 6,500 auditors in complying with the auditing standards issued by the Comptroller General of the United States.

Investigative Policy and Oversight (IPO) established a new Contractor Disclosure Program to receive and effectively respond to disclosures by Defense contractors and subcontractors of procurement-related crimes, which is now mandated by the Federal Acquisition Regulation. In FY 2009, the Program coordinated 54 disclosures of potential crimes through Defense investigation, audit, and suspension or debarment authorities and the DOJ. At the same time, IPO worked to resolve 20-plus voluntary disclosures under the previous program. IPO worked diligently to promote the new program through presentations to private and Government organizations.

The Inspector General Subpoena Program managed by IPO, is on track to coordinate and issue approximately 360 subpoenas to Defense investigators this fiscal year. Subpoena cycle time has been held to under 15-days, the established performance metric. New subpoena initiatives include a feedback mechanism for subpoena recipients and the addition of a comprehensive subpoena reference guide to the program Web site. The Subpoena Program also provided training on 11 occasions to military criminal investigators at the Federal Law Enforcement Training Center and other venues. Oversight work was generally guided by strong congressional interest in a broad variety of investigative matters.

At the request of Congress, IPO initiated a review of a murder/suicide in Iraq to resolve long-standing concerns the Military Service had not effectively supported the soldier who was murdered. In a separate congressional matter, IPO initiated a review of a sailor who shot himself in the presence of several police officers. In a matter normally outside IPO's charter, the Inspector General tasked the IPO to assist in the review of another office's congressionally-directed report of allegations that conflicts of interest or inappropriate special access to DOD information spoiled a DOD public affairs program involving mostly retired military analysts.

The Inspections and Evaluations (I&E) Directorate issued six reports: one interagency report - DOD/DOS evaluation of the FY 2006 National Defense Authorization Act, Section 1206, "Global Train and Equip" Program for partner nations; Part I of a two-part, multifunctional review of electrocution deaths in Iraq; reviews of the voting assistance and accident reporting programs; and three safety survey reports summarizing personnel perceptions of the DOD safety program. I&E started four congressionally mandated projects and one project in response to a congressional request that will continue into FY 2010. These five projects are the (1) review of the Combating Trafficking in Persons Program, (2) evaluation of the DOD Federal voting assistance program, (3) inspection of the Armed Forces Retirement Home, (4) review of the after-Government advice repository program for senior DOD officials seeking employment with Defense contractors and (5) review of Army actions taken in response to potential chemical contamination of soldiers in Iraq.

The Technical Assessment Division (TAD) provided technical support for approximately 21 audits, investigations, and assessments, including such highly visible projects as the New Orleans Pumps and Iraqi electrocutions. The TAD engineers provided support in the Southwest Asia Theater. In Bahrain, they developed test plans and assessed information assurance for the Navy's One Net system. In Afghanistan, the engineers assessed mechanical and electrical issues associated with the New Kabul Compound. The engineers supported audits with technical assessments of weapon systems such as the Light Tactical Vehicle, Ground Penetrating Radar,

Mine Resistant Ambush Protected Vehicles, Ballistic Glass, and Laser Dazzler. The engineers provided information support expertise for audits of the Defense Information Systems Agency and the Defense Civilian Personnel System. Their support of investigation oversight resulted in the reopening of four electrocution cases. In addition, they conducted research into non-conforming microchips and aviation safety investigations.

Intelligence

ODIG-INTEL provided DOD leadership and Congress with 10 intelligence evaluation and audit reports on topics such as a “Review of Intelligence Resources at the Joint Intelligence Task Force Combating Terrorism and Special Operations Command in Support of Operation Enduring Freedom and Operation Iraqi Freedom,” “Audit of the Management of SIGINT Counter Terrorism Enterprise Analyst,” and “Audit of Issues Related to the Modification of the Joint Air-to-Surface Standoff Missile System.” Two projects of particular interest include the multi-IG review of Foreign Intelligence Surveillance Act (FISA) and oversight of numerous inspections of Minot and Barksdale Air Force Bases. The FISA report was mandated in the FISA Amendments Act of 2008 and examined the involvement of OSD in the establishment and implementation of the President’s program. The oversight of the nuclear surety inspections identified improvements in the inspection process, including the need for no-notice inspections.

FY 2009 was a year of identifying and improving internal processes and as such, ODIG INTEL introduced a new Annual Project Planning Process to improve its ability to target projects to support DOD focus areas. Similarly, ODIG-INTEL improved a project planning process to gain efficiencies in the execution of a project from start to finish. Additionally, new performance metrics were established to ensure goals were met effectively. Congressionally directed actions or requests, management requests, or DOD Hotline complaints account for 65 percent of ongoing projects. The other 35 percent came 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 DOD’s goals and the OIG Strategic Plan.

Office of Special Plans and Operations

In a followup mission to Iraq and Afghanistan, directed by the Secretary of Defense, an SPO team reviewed the DOD progress in implementing the observations findings, and recommendations in a classified report concerning munitions. Other issues assessed included the accountability and control of arms, ammunition, and explosives in Afghanistan, the responsiveness of U.S. Foreign Military Sales processes supporting the Afghan National Security Forces (ANSF) and Iraqi Security Forces (ISF), and the development of logistics sustainment capability for ANSF and ISF, including a related issue on building the Afghan and Iraqi military health care systems and its sustainment base. During the mission to Iraq, SPO identified the possibility that accountability and control of other sensitive equipment, specifically night-vision devices, might also be inadequate. Consequently, SPO deployed a team in early FY 2009, resulting in the publication of “Assessment of the Accountability of Night Vision Devices Provided to the Security Forces of Iraq.”

Anticipating that U.S. Forces in Afghanistan may be facing the risk of electrocutions similar to those incurred in Iraq, SPO launched a project and published a report to review the effectiveness of command efforts to ensure the electrical safety of DOD-occupied and -constructed facilities in Afghanistan.

In spring 2009, a SPO team deployed to Afghanistan to assess Commander, International Security – Assistance Force; Commander, U.S. Forces-Afghanistan; and Combined Security Transition Command-Afghanistan plans, milestones, and metrics to train, equip and mentor the Afghan National Army (ANA) and Afghan National Police (ANP); evaluate progress in training, equipping, and mentoring ANA and ANP according to established goals and objectives; identify process efficiencies and resources required to improve the quality and timing of training, mentoring and equipping; and assess coordination and cooperation between U.S. interagency, European Police, and other international contributors in providing training and other resources to ANP. Three reports that provide observations and recommendations resulting from the trip are scheduled to be published in September-October 2009.

At the request of the Commander, Multi-National Security Transition Command-Iraq (MNSTC-I), SPO deployed a senior IG advisor to Iraq to advise and mentor the IGs for the Iraqi Ministries of Defense and Interior. This effort was intended to support the MNSTC-I mission to build the ministerial capacity of the Iraqi Security Forces.

Other DOD OIG Components

OCCL opened 213 cases based on inquiries received from congressional offices. The Freedom of Information and Public Affairs Office received 290 requests for information and completed 253 requests in FY 2009. The DOD Hotline received, in FY 2009, 12,035 contacts (composed of telephone calls, letters, and email) and initiated 2,241 cases. In FY 2009, the GAO Liaison Office processed 232 GAO draft and final reports and 347 GAO surveys and reviews.

X. Events, Trends, and Risks

New Leadership

On July 10, 2009, the U.S. Senate confirmed, by unanimous consent, the nomination of the Honorable Gordon S. Heddell to be the Department of Defense Inspector General. He was appointed as the DOD Acting Inspector General on July 14, 2008. He was nominated by the President to be the DOD Inspector General on June 1, 2009, and was favorably reported by the Senate Armed Services Committee on June 18, 2009. In January 2001, Mr. Heddell was appointed as the Inspector General at the U.S. Department of Labor, and he continued to hold that position while serving as the DOD Acting Inspector General.

Overseas Contingency Operations

DOD is currently involved in two of the longest running military engagements in U.S. history, Operation Enduring Freedom (OEF) and Operation Iraqi Freedom (OIF). DOD OIG has positioned its resources and personnel to provide effective oversight of these operations in

Southwest Asia and continued directing its resources toward those areas of greatest risk within DOD.

DOD OIG has strategically positioned field offices in Afghanistan, Iraq, Qatar, and Kuwait to address critical needs in support of OEF and OIF. DOD OIG audits addressed challenges in the compilation and reporting of financial transactions for overseas contingency operations, acquisition processes for assets required to support the deployed warfighters, contract administration, contractor oversight, and accountability and control of sensitive items.

DCIS is actively investigating fraud, theft, and corruption in Afghanistan, Iraq, and Kuwait. DCIS recoveries related to OEF and OIF are identified through contract fraud, corrupt business practices, and theft of critical military equipment destined for Afghan National and Iraqi Security Forces.

DOD OIG Intelligence examined intelligence missions and resources at the Joint Intelligence Task Force Combating Terrorism and the Special Operations Command, evaluated the management of signals intelligence counterterrorism analysts, and reviewed the policies and procedures for conducting oversight of sensitive programs.

DOD OIG has deployed assessment teams to numerous locations, including Afghanistan, Iraq, and Pakistan. Their reports address challenges in the accountability and control of weapons, ammunition, and other sensitive equipment; security assistance processes that provide equipment to the security forces of Afghanistan, Iraq, and Pakistan; train and equip missions for the Afghan National and Iraqi Security Forces; and building logistics and medical sustainment capabilities for the security forces.

Management Challenges

DOD OIG addressed a variety of issues by conducting audits of programs, investigating criminal activity, and assessing key operations. Audits focused on management challenges related to the following programs:

- Financial Management,
- Acquisition Processes and Contract Management,
- Joint Warfighting and Readiness,
- Information Assurance, Security, and Privacy, and
- Health Care.

Investigations focused resources on the following areas of criminal activity:

- Corruption and Fraud, especially in Southwest Asia;
- Technology Protection;
- Cyber Security; and
- Terrorism.

In addition, DOD OIG focused attention on a broad array of challenging issues affecting the safety, health, and well-being of U.S. troops, such as body armor testing requirements and TRICARE controls. DOD OIG has conducted assessments and inspections to address issues of national and international significance, such as the review of electrocution deaths in Iraq and munitions accountability in Afghanistan. Finally, DOD OIG has responded to requests from Congress to review challenges to the Department and conducted work pursuant to several significant statutory mandates.

Providing Oversight of Critical Areas

Acquisition Processes and Contract Management

DOD has faced tremendous challenges providing oversight over large amounts of spending for many years and these challenges have grown in recent years because of large spending increases associated with the war effort. DOD contracting procurement fraud comprises over 60 percent of the DCIS case inventory. These crimes have a significant impact on DOD and the warfighter. DOD OIG continues to find problems with the oversight of large contracts for information systems and information technology services. Contracts for these services have been awarded for billions of dollars and are often decentralized and not closely managed.

Weapons and Equipment Accountability

DOD OIG has completed four assessments and has one ongoing assessment that include issues regarding accountability and control of munitions and sensitive items transferred or being transferred to the Afghan and Iraqi Security Forces. The four completed reports contained 69 observations and 206 recommendations regarding accountability issues. The primary issues in Afghanistan were the lack of written policies and procedures for munitions accountability at the U.S. Central Command and DOD organizations in Afghanistan. In Iraq, the chains-of-custody were not maintained, weapons were not properly inventoried, and serial numbers were not accurately recorded and reported at Iraqi warehouses. In addition, the Ministry of Defense's captured weapons policy was not fully implemented.

Technology Protection and Cyber Security

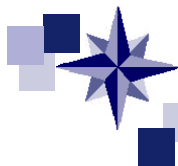
The U.S. technological advantages are constantly targeted by adversaries who seek to neutralize them or to divert them to their use and thereby place the men and women in uniform at greater risk. These attempts come in many forms, including illegal purchases of major aircraft parts, theft of night-vision technology and the compromise of networks and exploitation of protected software. DOD is continually challenged to maintain a cyber security barrier, not only for the defense of DOD's Global Information Grid but also for the protection of sensitive data on Defense contractor networks. Currently, there are no requirements compelling DOD contractors to report the loss of sensitive but unclassified Defense information. DOD has begun to form ad hoc agreements with contractors, asking that they voluntarily report intrusion and data loss. In exchange, DOD would share classified cyber threat data so contractors could better protect their networks. This ad hoc exchange is occurring on a case-by-case basis.

Common Access Card

A DOD OIG audit of the life cycle of the contractor Common Access Card found that weaknesses pose a potential national security risk that may result in unauthorized access to DOD resources, installations, and sensitive information worldwide.

Transparency and Accountability

Transparency, accountability, and urgency were key watchwords as the new administration transitioned to power. The American Recovery and Reinvestment Act allocated nearly \$800 billion to fund Government-run programs that promise to put Americans to work and stimulate the economy. While the influx of such a large amount of money will provide a significant challenge to many of the smaller Federal agencies, DOD continues to face challenges in improving and mitigating risks in financial and contract management of its annual appropriations, which amounted to about \$735 billion for FY 2009.



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INDEPENDENT AUDITORS' REPORT

TO: The Audit Advisory Committee of the Department of Defense, Office of the
Inspector General
The Inspector General, Department of Defense

Introduction

We have audited the balance sheet of the Department of Defense, Office of the Inspector General (the DOD OIG) as of September 30, 2009 and 2008, 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 the financial statements as of September 30, 2009. In connection with our audit, 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 years ended September 30, 2009 and 2008, 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 significant deficiencies under standards issued by the American Institute of Certified Public Accountants (AICPA) and Office of Management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*. Our testing of internal controls identified a significant deficiency 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 the Federal Financial Management Improvement Act (FFMIA).

The results of our tests of compliance with certain provisions of laws and regulations disclosed three instances of noncompliance that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States and 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 on the Financial Statements

We have audited the accompanying balance sheet of the DOD OIG as of September 30, 2009 and 2008, 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's management. Our responsibility is to express an opinion on the September 30, 2009, financial statements based on our audit.

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 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 material misstatement. An audit includes consideration of internal control 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 control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DOD OIG as of September 30, 2009 and 2008, and its net cost of operations, changes in net position, and budgetary resources, for the years ended September 30, 2009 and 2008, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying "Management's Discussion & Analysis" and "Other Accompanying Information," are not required parts of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America, OMB Circular A-136, Financial Reporting Requirements, and the Federal Accounting Standards Advisory Board. This supplementary information is the responsibility of the DOD OIG's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, such information has not been subjected to the auditing procedures applied in our audit of the basic financial statements and accordingly, we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have issued our report dated November 6, 2009, 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.

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

We have audited the financial statements of the DOD OIG as of and for the years ended September 30, 2009 and 2008, and have issued our report thereon dated November 6, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the requirements of OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the DOD OIG's internal control 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 control over financial reporting. Accordingly, we do not express an opinion on the DOD OIG's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented, or detected. This material weakness definition aligns with the same material weakness definition used by management to prepare an agency's FMFIA assurance statement.

A significant deficiency is a deficiency in internal control, or a combination of deficiencies, that adversely affects 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's financial statements that is more than inconsequential will not be prevented or detected. The term "significant deficiency" replaces the former term "reportable condition." This "significant deficiency" definition aligns with the "reportable condition" definition used by management to prepare an agency's FMFIA assurance statement.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described below that we consider being significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We considered the matters discussed in the following paragraphs to be significant deficiencies in financial reporting under the direct control of the DOD OIG. Additionally, we identified matters, related to Defense Finance and Accounting Service's (DFAS) financial management systems, used to record, process, summarize and report the DOD OIG activities and results that we consider to be significant deficiencies 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 DFAS 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 substantial progress toward improving their financial reporting processes. We believe additional effort will be necessary to fully remediate the conditions.

- In prior years 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 service provider is developing new financial information systems which they expect to remediate this condition. To remediate the condition in the interim, the DOD OIG adopted a process which uses alternative procedures by which we are able to validate the DD 1176 and the statement of budgetary resources. Continued use of the interim procedures is necessary to fully remediate this condition.
- Seized asset data is not always complete or properly valued. Data provided contained inaccurate counts of monetary instruments and used incorrect

conversion rates. The data originated from evidence logs maintained by field offices; however, because the process is informal, there are little or no controls for ensuring the reported data is recorded, reviewed and reported reliably.

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 significant deficiency in financial reporting.

DOD Systems

As reported in prior years, 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, DFAS 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 6, 2009.

Agency Comments

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

November 6, 2009

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)

	2009	2008
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 67,828	\$ 41,319
Accounts Receivable (Note 4)	0	1,096
Total Intragovernmental Assets	\$ 67,828	\$ 42,415
Accounts Receivable, Net (Note 4)	82	108
Cash and Other Monetary Assets (Note 5)	700	85
Other Assets (Note 6)	256	253
TOTAL ASSETS	\$ 68,866	\$ 42,861
LIABILITIES (Note 7)		
Intragovernmental:		
Accounts Payable (Note 8)	\$ 2,923	\$ 1,601
Other Liabilities (Note 10)	3,563	3,178
Total Intragovernmental Liabilities	\$ 6,486	\$ 4,779
Accounts Payable (Note 8)	\$ 924	\$ 1,780
Military Retirement and Other Federal Employment Benefits (Note 9)	8,317	7,463
Other Liabilities (Note 10)	26,256	21,624
TOTAL LIABILITIES	\$ 41,983	\$ 35,646
NET POSITION		
Unexpended Appropriations - Other Funds	53,740	16,350
Cumulative Results of Operations - Other Funds	(26,857)	(9,135)
TOTAL NET POSITION	\$ 26,883	\$ 7,215
TOTAL LIABILITIES AND NET POSITION	\$ 68,866	\$ 42,861

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)

	2009	2008
1. Program Costs		
A. Gross Costs	\$ 286,854	\$ 249,789
B. (Less: Earned Revenue)	(2,204)	1,128
C. Net Program Costs	\$ 284,650	\$ 248,661
2. Cost Not Assigned to Programs		0
3. (Less: Earned Revenue Not Attributable to Programs)		0
4. Net Cost of Operations	<u>\$ 284,650</u>	<u>\$ 248,661</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)

	2009	2008
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ (9,136)	\$ (6,232)
Budgetary Financing Sources:		
Appropriations used	256,061	236,274
Other Financing Sources:		
Imputed financing from costs absorbed by others	10,894	9,437
Other (+/-)	(26)	46
Total Financing Sources	<u>266,929</u>	<u>245,757</u>
Net Cost of Operations (+/-)	284,650	248,661
Net Change	(17,721)	(2,904)
Cumulative Results of Operations	<u>\$ (26,857)</u>	<u>\$ (9,135)</u>
UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$ 16,351	\$ 11,382
Budgetary Financing Sources:		
Appropriations received	296,396	246,389
Appropriations transferred-in/out	75	(3,752)
Other adjustments (rescissions)	(3,020)	(1,395)
Appropriations used	(256,061)	(236,274)
Total Budgetary Financing Sources	<u>37,389</u>	<u>4,968</u>
Unexpended Appropriations	<u>53,740</u>	<u>16,350</u>
Net Position	<u>\$ 26,883</u>	<u>\$ 7,215</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)

	2009	2008
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
Unobligated balance, brought forward, October 1	\$ 10,496	\$ 11,452
Recoveries of prior year unpaid obligations	10,681	3,964
Budget authority		
Appropriation	296,396	246,389
Spending authority from offsetting collections		
Earned		
Collected	3,300	32
Change in receivables from Federal sources	(1,096)	1,096
Change in unfilled customer orders		
Without advance from Federal sources	1,609	207
Subtotal	300,209	247,724
Nonexpenditure transfers, net, anticipated and actual	75	(3,752)
Permanently not available	(3,020)	(1,395)
Total Budgetary Resources	\$ 318,441	\$ 257,993

COMBINED STATEMENT OF BUDGETARY RESOURCES - Continued**For the Years Ended September 30**

(Amounts in thousands)

	2009	2008
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ 289,868	\$ 246,158
Reimbursable	1,289	1,340
Subtotal	<u>291,157</u>	<u>247,498</u>
Unobligated balance:		
Apportioned	19,821	3,052
Exempt from apportionment	0	0
Subtotal	<u>19,821</u>	<u>3,052</u>
Unobligated balance not available	7,463	7,443
Total status of budgetary resources	<u>\$ 318,441</u>	<u>\$ 257,993</u>
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	\$ 32,327	\$ 25,208
Less: Uncollected customer payments		
from Federal sources, brought forward, October 1	<u>(1,503)</u>	<u>(199)</u>
Total unpaid obligated balance	30,824	25,008
Obligations incurred net (+/-)	291,157	247,498
Less: Gross outlays	(270,242)	(236,415)
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	0	0
Less: Recoveries of prior year unpaid obligations, actual	(10,681)	(3,964)
Change in uncollected customer payments from Federal sources (+/-)	(513)	(1,303)
 Obligated balance, net, end of period		
Unpaid obligations	42,560	32,326
Less: Uncollected customer payments (+/-)		
from Federal sources (-)	<u>(2,016)</u>	<u>(1,503)</u>
Total, unpaid obligated balance, net, end of period	40,544	30,823
Net Outlays		
Net Outlays:		
Gross outlays	270,242	236,415
Less: Offsetting collections	(3,300)	(32)
Less: Distributed Offsetting receipts	0	0
Net Outlays	<u>\$ 266,942</u>	<u>\$ 236,383</u>

Notes to the Principal 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 Circular 136, *Financial Reporting Requirements*, and U.S. GAAP for Federal entities. 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 DOD IG (DOD Directive 5106.1), under the provisions set forth by Public Law 95-452, serves as an independent and objective official in the DOD who is responsible for conducting, supervising, monitoring, and initiating audits, investigations, and inspections relating to programs and operations of the DOD. The IG 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 IG is also responsible for keeping the Secretary of Defense and Congress fully informed about current 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, OCO BRAC and procurement accounts.

1.D. Basis of Accounting

The DFAS provides financial management services to the DOD OIG. 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 GAAP for Federal entities. 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 GAAP for Federal entities, 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 pensions 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 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 (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 occur 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. Other Assets

Other Assets are classified as assets which are not reported elsewhere on the Balance Sheet, such as military and civil service employee pay advances, travel advances, and certain contract financing payments.

Business is conducted with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor caused by long-term contracts, financing payments may be provided. Federal Acquisition Regulations, Part 32, defines contract financing payments as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress. It is DOD policy to record certain contract financing payments as Other Assets.

1.L 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.

Government property is provided to contractors to complete their work when it is in the best interest of the Government. The DOD OIG either owns or leases such property, or it is purchased directly by the contractor for the Government based on contract terms. When the value of contractor-procured General PP&E exceeds the DOD capitalization threshold, Federal accounting standards require that it be reported on the DOD OIG's Balance Sheet.

1.M. 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. N. 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.O. Contingencies and Other Liabilities

The SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the 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.P. Accrued Leave

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

1.Q. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the balances that result from subtracting expenses and losses, from financing sources including appropriations, revenue, and gains since the inception of the activity.

1.R. 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	2009	2008
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	\$ 0	\$ 0
B. Total Intragovernmental Assets	\$ 0	\$ 0
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	\$ 700	\$ 85
B. Total Nonfederal Assets	\$ 700	\$ 85
3. Total Nonentity Assets	\$ 700	\$ 85
4. Total Entity Assets	\$ 68,166	\$ 42,776
5. Total Assets	\$ 68,866	\$ 42,861

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.

Seized cash in the amount of \$700 thousand is reported. The cash resulted from DCIS operations and is held in evidence lockers pending court proceedings. Depending on the outcome of the trial, this money can either be returned to the original owner or deposited in the Treasury's accounts.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30	2009	2008
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	\$ 67,828	\$ 41,319
B. Total Fund Balances	\$ 68,828	\$ 41,319
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 70,848	\$ 42,714
B. Fund Balance per Agency	67,828	41,319
3. Reconciling Amount	\$ (3,020)	\$ (1,395)

DOD OIG uses Treasury Index 97. The Treasury reports fund balances at the appropriation basic symbol level. The DOD OIG funding is allotted at limit level.

The FY 2008 reconciling amount of \$1.4 million relates to two cancelled appropriations for the 4th Quarter, Operations and Maintenance FY 2003 closed with a balance of \$1.3 million and Procurement FY 2001 closed with a balance of \$.1 million

The FY 2009 reconciling amount of \$3.0 million relates to two cancelled appropriations for the 4th Quarter, Operations and Maintenance FY 2004 closed with a balance of \$2.9 million and Procurement FY 2002 closed with the remaining balance

STATUS OF FUND BALANCE WITH TREASURY

As of September 30	2009	2008
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	\$ 19,821	\$ 3,053
B. Unavailable	7,463	7,443
2. Obligated Balance not yet Disbursed	\$ 42,560	\$ 32,326
3. Non-Budgetary FBWT	\$ 0	\$ 0
4. Non-FBWT Budgetary Accounts	\$ (2,016)	\$ (1,503)
5. Total	\$ 67,828	\$ 41,319

The DOD OIG did not have any suspense or budget clearing accounts to report at September 30, 2009 and 2008.

NOTE 4. ACCOUNTS RECEIVABLE

As of September 30	2009			2008
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables	\$ 0	N/A	\$ 0	\$ 1,096
2. Nonfederal Receivables (From the Public)	\$ 82	\$	\$ 82	\$ 108
3. Total Accounts Receivable	\$ 82	\$	\$ 82	\$ 1,204

NOTE 5. CASH AND OTHER MONETARY ASSETS ³

As of September 30	2009	2008
(Amounts in thousands)		
1. Cash	\$ 657	\$ 85
2. Foreign Currency	\$ 13	0
3. Other Monetary Assets	\$ 30	0
2. Total Cash, Foreign Currency, & Other Monetary Assets	\$ 700	\$ 85

The \$700 and \$85 thousand represents cash seized as a result of DCIS operations for September 30, 2009 and 2008, respectively. This amount is currently being held pending court proceedings and can either be returned to the original owner or deposited in Treasury's accounts.

³ This note discloses restricted cash under the control of the reporting entity but unavailable for agency use (non-entity cash) and has not been transferred to the general fund.

NOTE 6. OTHER ASSETS

As of September 30	2009	2008
(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. Other Assets (With the Public)	256	253
B. Total Nonfederal Other Assets	\$ 256	\$ 253
3. Total Other Assets	\$ 256	\$ 253

NOTE 7. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	2009	2008
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	2,045	1,918
D. Total Intragovernmental Liabilities	\$ 2,045	\$ 1,918
2. Nonfederal Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Military Retirement and Other Federal Employment Benefits	8,317	7,463
C. Other Liabilities	17,193	14,363
D. Total Nonfederal Liabilities	\$ 25,510	\$ 21,826
3. Total Liabilities Not Covered by Budgetary Resources	\$ 27,555	\$ 23,744
4. Total Liabilities Covered by Budgetary Resources	\$ 14,428	\$ 11,902
5. Total Liabilities	\$ 41,983	\$ 35,646

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; and
- 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; and
- 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	2009			2008
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	\$ 2,923	\$ N/A	\$ 2,923	\$ 1,601
2. Nonfederal Payables (to the Public)	924		924	1,780
3. Total	\$ 3,847	\$	\$ 3,847	\$ 3,381

Intragovernmental accounts payable consist of amounts owed to other federal agencies for goods 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. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS

As of September 30	2009				2008
	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	\$ 8,317		\$ 0	\$ 8,317	\$ 7,463
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DOD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	\$ 8,317		\$ 0	\$ 8,317	\$ 7,463
3. Other Federal Employment Benefits	\$ 0		\$ 0	\$ 0	\$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	\$ 8,317		\$ 0	\$ 8,317	\$ 7,463

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 OMB economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Year 1	4.223%
Year 2 and thereafter	4.715%

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>
2010	0.47%	3.42%
2011	1.40%	3.29%
2012	1.50%	3.48%
2013	1.80%	3.71%
2014+	2.00%	3.71%

The model's resulting projections were critically analyzed to ensure 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 10. OTHER LIABILITIES

As of September 30	2009			2008
	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. FECA Reimbursement to the Department of Labor	779	1,266	2,045	1,918
D. Custodial Liabilities	1	0	1	0
E. Employer Contribution and Payroll Taxes Payable	1,517	0	1,517	1,260
F. Total Intragovernmental Other Liabilities	\$ 2,297	\$ 1,266	\$ 3,563	\$ 3,178
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 8,028	\$ 0	\$ 8,028	\$ 6,469
B. Accrued Unfunded Annual Leave	16,494	0	16,494	14,280
C. Capital Lease Liability	0	0	0	0
D. Other Liabilities	1,734	0	1,734	875
E. Total Nonfederal Other Liabilities	\$ 26,256	\$ 0	\$ 26,256	\$ 21,624
3. Total Other Liabilities	\$ 28,256	\$ 1,266	\$ 29,819	\$ 24,802

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

Intragovernmental Costs and Exchange Revenue		
As of September 30	2009	2008
(Amounts in thousands)		
1. Intragovernmental Costs	\$ 56,219	\$ 52,873
2. Public Costs	227,635	196,916
3. Total Costs	\$ 286,854	\$ 249,789
4. Intragovernmental Earned Revenue	\$ (2,204)	\$ (1,128)
5. Public Earned Revenue	0	0
6. Total Earned Revenue	\$ (2,204)	\$ (1,128)
7. Net Cost of Operations	\$ 284,650	\$ 248,661

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	2009		2008	
	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
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	\$ 3,472	\$ 0	\$ 3,083	\$ 0
B. Civilian Health	7,394	0	6,329	0
C. Civilian Life Insurance	28	0	25	0
D. IntraEntity	0	0	0	0
E. Total Imputed Financing	\$ 10,894	\$ 0	\$ 9,437	\$ 0

Other Information:**Imputed Financing**

The amounts remitted to the OPM by and for employees covered by the CSRS, FERS, Federal Employees Health Benefits (FEHB) Program and the Federal Employee Group Life Insurance (FEGLI) Program 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 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	2009	2008
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 28,389	\$ 20,678
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Apportionment Categories

(Amount in thousands)

Direct Obligations

Category A	\$287,194
Category B	0
Total Direct Obligations	\$287,194
Exempt from Apportionment	\$0
Reimbursable Obligations	<u>\$3,963</u>
Total Obligations	<u>\$291,157</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. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30	2009	2008
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	\$ 291,157	\$ 247,498
2. Less: Spending authority from offsetting collections and recoveries (-)	(14,495)	(5,300)
3. Obligations net of offsetting collections and recoveries	\$ 276,662	\$ 242,198
4. Less: Offsetting receipts (-)	0	0
5. Net obligations	\$ 276,662	\$ 242,198
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	10,894	9,437
9. Other (+/-)	(26)	46
10. Net other resources used to finance activities	\$ 10,868	\$ 9,483
11. Total resources used to finance activities	\$ 287,530	\$ 251,681
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 (-)	\$ (7,712)	\$ (6,139)
12b. Unfilled Customer Orders	1,610	208
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 (+/-)	26	(46)
17. Total resources used to finance items not part of the Net Cost of Operations	\$ (6,076)	\$ (5,977)
18. Total resources used to finance the Net Cost of Operations	\$ 281,454	\$ 245,704
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	\$	2,214	\$ 1,921
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 (+/-)		982	1,036
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$	3,196	\$ 2,957
25. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period			
	\$	3,196	\$ 2,957
26. Net Cost of Operations	\$	284,650	\$ 248,661

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 OMB Circular A-136 requires the Statement of Financing to be presented on a consolidated basis in the Reconciliation of Net Cost of Operations.

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. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

In accordance with the SFFAS No. 3, *Accounting for Inventory and Related Property*, and OMB Circular A-136, property seized with a total value of \$3.454 million is reported.

The reported assets consist of cash, hardware/software, military equipment, miscellaneous, and non-valued items seized during investigations of major procurement fraud, cyber crimes, healthcare fraud, public corruption, anti-terrorism operations, and technology protection investigations (illegal transfer, theft, or diversion of DOD technologies and U.S. Munitions List items to proscribed nations and persons).

Seized property is not considered an asset and is not reported as such in the financial statements. However, the DOD OIG has a stewardship responsibility until the disposition of the seized items are determined, i.e., judicially or administratively forfeited or returned to the entity from which it was seized. The values assigned to the seized property are determined by each DCIS agent and are based on fair market values for comparable property. A \$2,500 threshold was established to aggregate all activity for the year.

The following table describes the categories of seized assets and the respective value as of September 30, 2009:

Seized Property (Amounts in thousands)										
Fiscal Year Ended September 30, 2009										
Seized Category:	Beginning Balance		New Seizures		Remissions		Adjustments		Ending Balance	
	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value
Cash/Monetary Instruments										
Cash/U.S. Currency		\$84		\$573						\$657
Monetary Instruments	1	1	3	1					4	2
Foreign Currency		0		35						35
Subtotal		85		609					1	694
Personal Property - Government										
Hardware/software	53	\$47			39	3			14	44
Vehicles	6	980							6	980
Military Equipment	1,100	980	64	598					1,164	1,578
Miscellaneous	12	49			10	43			2	6
Subtotal	1,171	2,056	64	598	49	46			1,186	2,608
Personal Property - Non Government										
Jewelry	15	97			6	70			9	27
Computer/hardware	59	8			59	8			0	0
Miscellaneous	40	51			39	46			1	5
Parts			19	120					19	120
Subtotal	114	156	19	120	104	124			106	152
Non Valued Assets (in number of items)										
Firearms	551	0	5,090						5,641	
Documents (Papers, Logs, binders, files, etc)	2,417	0			54				2,363	
Media Storage (Disks, tapes, CDs, microfiche, etc)	2,414	0			2,145				269	
Boxes (Various Items)	136	0			8				128	
Electronics, Hardware	625	0	134						759	
Miscellaneous Items	178	0	452						630	
Jewelry			16						16	
Military Equipment			23						23	
Subtotal	6,321	\$0	5,715		2,207				9,829	
Grand Total									11.048	\$3,454

NOTE 16. OTHER DISCLOSURES

As of September 30	2009 Asset Category			
	Land and Buildings	Equipment	Other	Total

(Amounts in thousands)

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

Future Payments Due

Fiscal Year

2010	\$	18,787	\$	0	\$	0	\$	18,787
2011		16,987		0		0		16,987
2012		9,190		0		0		9,190
2013		3,314		0		0		3,314
2014		2,864		0		0		2,864
After 5 Years		6,395		0		0		6,395

**Total Future
Lease Payments
Due**

\$	57,537	\$	0	\$	0	\$	57,537
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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 FY10 to FY14 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 \$57.5 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 3, 2009

MEMORANDUM FOR ACUITY CONSULTING, INC

SUBJECT: Draft Report of the Office of the Inspector General,
Department of Defense FY 2009 Financial Statement Audit.

The Office of the Inspector General, Department of Defense is providing the attached general comments to the significant deficiencies identified during the FY 2009 Financial Statement audit.

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

A handwritten signature in black ink, appearing to read "W. M. Culbreth", is located above the typed name.

W. M. Culbreth
Comptroller

Attachment:
As stated

Auditor Comment: The DoD IG 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 substantial progress toward improving their financial reporting processes. We believe additional effort will be necessary to fully remediate the conditions.

Management Comments:

The DoD OIG concurs with this comment. The Office of the Comptroller will maintain and improve these processes, in order to assure that data analysis of the financial reporting level is performed. In addition, the Office of the Comptroller will continue to work with DFAS Indianapolis to properly review transactions that may affect the DoD OIG's Financial Statements.

Auditor Comment: The DoD OIG has not fully documented the crosswalks used to develop the DD 1176 from the WAAS general ledger.

In prior years 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 service provider is developing new financial information systems which they expect to remediate this condition. To remediate the condition in the interim, the DOD OIG adopted a process which uses alternative procedures by which we are able to validate the DD 1176 and the statement of budgetary resources. Continued use of the interim procedures is necessary to fully remediate this condition.

Management Comments:

The DoD OIG concurs with this comment. The Office of the Comptroller adopted an interim process using alternative procedures to properly reconcile and validate the DD 1176 report produced by DFAS. DFAS is currently developing the Indy Detailed Audit Retrieval & Research System (IDARRS). IDARRS will provide the necessary transaction details to fully account for every reported amount in our DD 1176.

Auditor Comment: Seized asset data is not always complete or properly valued.

Seized asset data is not always complete or properly valued. Data provided contained inaccurate counts of monetary instruments and used incorrect conversion rates. The data originated from evidence logs maintained by field offices; however, because the process is informal, there are little or no controls for ensuring the reported data is recorded, reviewed and reported reliably.

Management Comments:

The DoD OIG concurs with this comment. The Defense Criminal Investigative Service (DCIS) is currently developing the Case Reporting and Information Management System (CRIMS) which will include a seized asset reporting module. CRIMS will properly report complete and accurate seized asset information therefore, ending the need to manually collect, summarize and report seized assets from each DCIS field office. The Comptroller Office will continue to assist DCIS to accurately convert foreign currency into US dollar.