

***DEPARTMENT OF DEFENSE***

***AGENCY-WIDE  
FINANCIAL STATEMENTS  
AUDIT OPINION***

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INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-2885

February 16, 2000

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

SUBJECT: Independent Auditor's Report on the Department of Defense Agency-Wide  
Financial Statements for FY 1999 (Project No. OFI-2115)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General and prescribes the responsibilities of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. We attempted to audit the FY 1999 DoD Agency-Wide financial statements. As the Chief Financial Officer of DoD, the Under Secretary of Defense (Comptroller) is responsible for these financial statements, for establishing and maintaining internal controls, and for complying with laws and regulations applicable to DoD financial accounting and reporting. We did not audit the Army, Navy, and Air Force financial statements for FY 1999. The Military Department audit agencies attempted to audit those financial statements and issued disclaimers of opinion.

**Disclaimer of Opinion.** DoD did not provide us with the FY 1999 DoD Agency-Wide financial statements in time for us to perform all of the necessary audit work. Therefore, we did not verify the reported amounts. However, we identified deficiencies in internal controls and accounting systems related to General Property, Plant, and Equipment; Inventory; Environmental Liabilities; Military Retirement Health Benefits Liability; and material lines on the Statement of Budgetary Resources. Those deficiencies would have precluded an audit opinion. We also identified approximately \$2.3 trillion in adjustments to financial data used to prepare financial statements for the Army, Navy, and Air Force General Funds; the Army, Navy, and Air Force Working Capital Funds; Other Defense Organizations-General Funds; and Other Defense Organizations-Working Capital Funds. Those adjustments were not supported by adequate audit trails or by sufficient evidence to determine their validity.

The financial data reported on the FY 1999 financial statements for the Army, Navy, and Air Force General Funds and the Army, Navy, and Air Force Working Capital Funds were unauditable and represent a significant portion of the financial data reported on the DoD Agency-Wide financial statements for FY 1999.

Because the financial statements were not provided in a timely manner and internal control weaknesses, compilation problems, and financial management system deficiencies continued to exist, we were not able to perform adequate tests of the various line item amounts reported on the financial statements. As a result, we do not express an opinion on the DoD Agency-Wide financial statements for FY 1999. Except for the limitations on the scope of our work on the Principal Statements described above, we did our work in accordance with generally accepted Government auditing standards and the Office of Management and Budget (OMB) Bulletin, "Audit Requirements for Federal Financial Statements."

**Required Supplementary Stewardship Information.** The Stewardship Statement includes national defense property, plant, and equipment; heritage assets; stewardship land; non-Federal physical property; and research and development. This information is not required to be audited, and we did not audit and do not express an opinion on it. However, we applied limited procedures prescribed by professional standards that raised doubts that we were unable to resolve regarding whether material modifications should be made to the information for it to conform with generally accepted accounting principles.

**Required Supplementary Information for Deferred Maintenance.** The supplementary information for Deferred Maintenance is not a required part of the basic financial statements, and we did not audit and do not express an opinion on this information. We did not apply procedures prescribed by professional standards because the official accounting guidance regarding the measurement criteria and reporting placement of deferred maintenance on the financial statements was not fully developed.

**Internal Controls.** Internal controls consist of the following components: control environment, risk assessment, control activities, information and communication, and monitoring. Effective implementation of these controls provides reasonable assurance that accounting data are accumulated, recorded, and reported properly by management and that assets are safeguarded. Management is responsible for internal controls. We performed applicable tests of the internal controls to determine whether the controls were effective and working as designed. However, these tests did not provide sufficient evidence to support an opinion on internal controls; therefore, we do not express an opinion on DoD internal controls.

DoD internal controls were not adequate to ensure that resources were properly managed and accounted for, that DoD complied with applicable laws and regulations, and that the financial statements were free of material misstatements. DoD internal controls did not ensure that adjustments to financial data were fully supported and that assets and liabilities were properly accounted for and valued. The material weaknesses and reportable conditions we identified were also reported in the management representation letter for the FY 1999 DoD Agency-Wide financial statements, the FY 1999 DoD annual statement of assurance, and the DoD Financial Management Improvement Plan. A separate report discusses internal control weaknesses in further detail.

**Compliance With Laws and Regulations.** Our objective was to assess compliance with laws and regulations related to the FY 1999 DoD Agency-Wide financial statements and not to express an opinion. Therefore, we do not express an opinion on compliance with laws and regulations.

DoD did not fully comply with laws and regulations that had a direct and material effect on its ability to determine financial statement amounts. DoD had not evaluated all critical finance, accounting, and mixed systems included in the DoD Financial Management Improvement Plan, as required by section 3512, title 31, United States Code (formerly the Federal Managers' Financial Integrity Act of 1982). As a result, DoD did not disclose the full extent of remedies, resources, or intermediate target dates needed to correct financial management system deficiencies. In addition, DoD did not comply with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 7, 2000, and Statement of Federal Financial Accounting Standard No. 4, "Managerial Cost Accounting Standards," effective October 1, 1997, which require financial data to be reported consistent with DoD performance goals and measures.

The results of our tests also disclosed instances where DoD financial management systems did not substantially comply with the three requirements of the Federal Financial Management Improvement Act of 1996. For example, DoD financial management systems

were not integrated; did not maintain adequate audit trails; did not value and depreciate property, plant, and equipment in accordance with Statement of Federal Financial Accounting Standard No. 6, "Accounting for Property, Plant, and Equipment," November 30, 1995; and did not incorporate the U.S. Government Standard General Ledger at the transaction level. Our work would not necessarily disclose all material weaknesses. A separate report discusses compliance issues in further detail.

*David K. Steensma*

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for Auditing

