



United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-258750

December 16, 1994

The Honorable Earl Hutto
Chairman, Subcommittee on Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This letter responds to your request that we examine several issues regarding the National Defense Stockpile Transaction Fund. The National Defense Stockpile was established to maintain an inventory of essential commodities necessary for military, industrial, and civilian needs and to decrease reliance on foreign sources of supply in times of national emergency. In addition to the cash purchase of commodities, the Strategic and Critical Materials Stock Piling Act encourages the acquisition of commodities by noncash barter or exchange.¹ The Fund is also authorized by annual National Defense Authorization Acts to transfer certain amounts of funds to Department of Defense (DOD) operations and maintenance (O&M) accounts.

You requested that we review the propriety of the Fund's accounting for recent noncash transactions² and the reasonableness of the Fund's reported cash and obligated balances. You also asked us to assess whether the Fund had used \$215.8 million of appropriations made to the Fund prior to January 1, 1985, as directed by section 518 of Public Law 100-440, enacted September 22, 1988.

¹50 U.S.C. 98e(c)(2).

²Noncash transactions include (1) the exchange of like material, such as the rotation of quantities of old rubber for new rubber, (2) payment-in-kind, such as trading larger quantities of raw materials for smaller quantities of finished materials, or (3) payments in commodities, such as the delivery by contractors of needed materials with payment in stockpile commodities determined to be excess.

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RESULTS IN BRIEF

In the latest available reports, we found that noncash transactions were not separately identified and disclosed in the Fund's fiscal year 1993 financial statements or in its annual Strategic and Critical Materials Report to the Congress for fiscal year 1993. These noncash transactions were misclassified as obligations to be applied against available cash balances. This misclassification resulted in the unobligated fund balances--\$113.6 million as of September 30, 1993--being understated by \$109.2 million. This underreporting fails to disclose to the Congress the amounts available for transfer to DOD O&M accounts.

We also noted that the Fund's unaudited financial statements for fiscal year 1993 did not separately disclose all the amounts comprising the Fund's net position, as prescribed by the Office and Management and Budget (OMB). The Fund's invested capital balance was overstated by \$181.8 million because it included amounts for unobligated appropriations and undelivered cash and noncash orders, which should have been separately disclosed.

The Fund is working to correct these deficiencies for its fiscal year 1994 financial statement report and its annual Strategic and Critical Materials Report to the Congress. Because the statements were under year-end review and were not available for our examination, we were unable to report on the reasonableness of Fund balances and corrective actions as of September 30, 1994.

With regard to the requirement in Public Law 100-440, section 518, for the Fund to use an estimated \$215.8 million in appropriations authorized and appropriated before January 1, 1985, Fund officials told us that they could not find the documents to link detailed transactions to specific contracts, obligations, and cash payments that constituted use of that appropriation. Therefore, we did not have the detailed data to update our decision³ that the Fund was not in compliance with the requirement. Fund officials have agreed to maintain such necessary documentation in the future.

³B-223657.3, September 21, 1989.

BACKGROUND

The National Defense Stockpile Transaction Fund is a revolving fund that finances acquisition of commodities and receives funds from the sale of excess commodities. Effective July 3, 1988, management responsibility for the Fund was transferred from the General Services Administration (GSA) to DOD's Defense Logistics Agency (DLA).⁴ On January 20, 1991, the Defense Finance and Accounting Service (DFAS) became responsible for accounting for the Fund, although it primarily acts as a service bureau to process transactions. There are two general means available to the Fund for acquiring stockpile items: (1) the authority to exchange current stockpile items for new items and (2) purchasing items with appropriations. The National Defense Authorization Acts for 1993 and 1994 authorized the transfer to other DOD O&M accounts of not more than \$400 million for fiscal year 1993, and not more than \$500 million for fiscal year 1994, respectively.

Under the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576), the DOD Inspector General (IG) conducted an initial financial statement audit of the Fund for fiscal year 1992 but was unable to express an opinion on the fair presentation of the financial statements because adequate documentation was not available to support the acquisition cost of the Fund's \$4.1 billion commodity inventory. Since the same condition existed in fiscal years 1993 and 1994, the DOD IG did not attempt to conduct financial audits of the Fund for those years. The DOD IG is planning to conduct a fiscal year 1995 audit of the Fund.

SCOPE AND METHODOLOGY

We reviewed Fund accounting policies and practices involved with cash and noncash transactions and discussed these transactions with DNSC program and accounting officials. We also reviewed Fund accounting records, financial statements, annual reports to the Congress, and supporting documents, as well as other information. In addition, we interviewed responsible DOD and DFAS policy officials and determined whether cash balances agreed with U.S. Treasury reports. We conducted our fieldwork from June 1994 through

⁴GSA's National Defense Stockpile was transferred to DLA and renamed the Defense National Stockpile Center (DNSC).

November 1994 in accordance with generally accepted government auditing standards.

WEAKNESSES IN FUND POLICIES AND REPORTING

Neither the Fund's fiscal year 1993 financial statements nor its annual Strategic and Critical Materials Report to the Congress distinguished between cash and noncash transactions. The Fund recorded noncash transactions as obligations of the Fund's appropriation balances. These noncash transactions include payments-in-kind for the upgrade of large quantities of Ferro ores for smaller quantities of finished Ferro metals. However, as we stated in our letter B-223657.3, September 21, 1989 (discussed below), these transactions will not result in cash outlays. Treating these transactions as obligations of appropriated funds overstates obligation balances and understates amounts available for obligation. As a result, reported unobligated fund balances of \$113.6 million as of September 30, 1993, in both reports were understated by \$109.2 million.

While the Fund's cash balances of \$181.8 million as of September 30, 1993, agreed with U.S. Treasury reports, such underreporting does not disclose to the Congress the full amounts available to be transferred to DOD O&M appropriations under the annual National Defense Authorization Acts. Accurate reporting of noncash transactions would give the Congress more reliable information for determining the amount of funds that it could authorize to be transferred each year.

DNCS officials acknowledged that the Fund has not been adequately disclosing noncash transactions. DNCS officials attributed these shortcomings to a lack of guidance for reporting noncash transactions. DOD accounting policy officials told us that they were not aware of any DOD guidance covering such transactions, since DOD's Accounting Manual 7220.9-M does not mention either the Fund's accounting or treatment of noncash transactions. Although DLA issued guidance in June 1991 on Stockpile Fund accounting (DLA Manual 7000.1, Chapter 6), this document for the most part restated existing GSA guidance without augmenting it to address accounting for and reporting of noncash transactions. According to DFAS officials, DFAS has not issued guidance concerning Stockpile Fund transactions but plans to issue an accounting manual in June 1996 that will supersede the existing DLA manual.

DNCS officials told us that they will work with DFAS to develop detailed accounting guidance for the Fund, particularly accounting and reporting of noncash transactions to be included in DFAS' new accounting manual. DNCS officials stated that they are also in the process of revising the Fund's 1994 Strategic and Critical Materials Report to the Congress and fiscal year 1994 financial statements to provide additional disclosure of cash and noncash transactions. In addition, the Fund has broken out cash and noncash transactions for its fiscal year 1994 reports to OMB and the Department of the Treasury.⁵ We discussed these issues with DOD's IG representatives for further follow-up as part of their fiscal year 1995 financial audit of the Fund pursuant to the CFO Act.

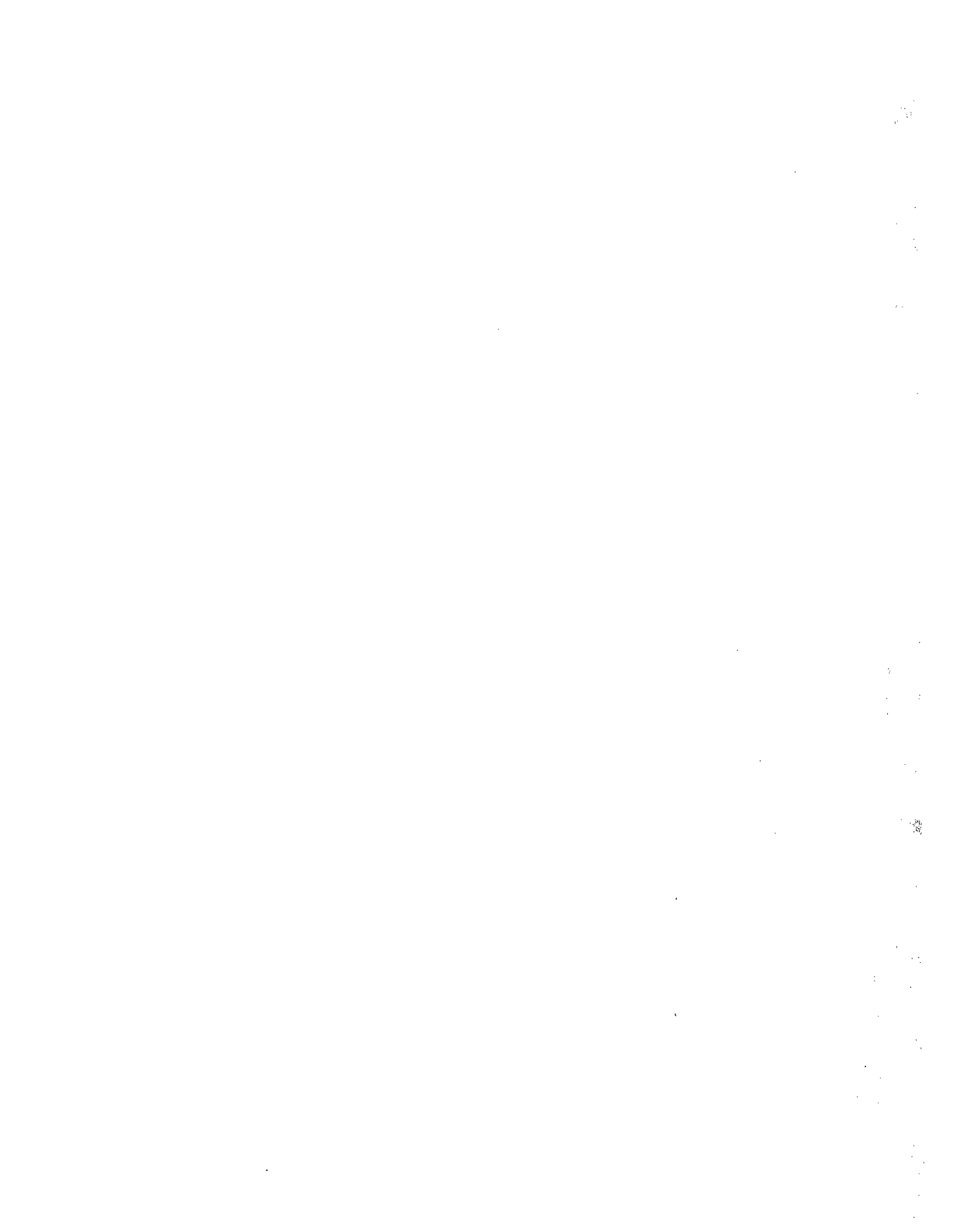
We also noted that the Fund's unaudited financial statements for fiscal year 1993 did not separately disclose all of the amounts comprising its net position as prescribed by OMB.⁶ Specifically, \$113.6 million of unobligated appropriations and \$68.2 million of cash and noncash undelivered orders were not disclosed. Instead, these amounts were included in invested capital (which should primarily represent the value of inventory) on the financial statements, thereby overstating that account by \$181.8 million. For fiscal year 1994, DNCS accounting personnel are working with DFAS personnel on a draft of the statements to correct these deficiencies and conform to the OMB Bulletin.

OBLIGATION AND SPENDING OF
APPROPRIATIONS UNDER SECTION 518

Section 518 of Public Law 100-440 (enacted September 22, 1988) required the Fund, by October 1, 1989, to use all funds authorized and appropriated to the Fund before January 1, 1985. These funds, estimated to be \$215.8 million, were to be used to evaluate, test, relocate, upgrade, or purchase stockpile materials to meet national defense stockpile goals and specifications in effect on October 1, 1984. In our letter B-223657.3, September 21, 1989, we stated that the Fund had not complied with the requirements of section 518. In response to section 518, the Fund had recorded contracts involving in-kind exchanges

⁵DOD Form 1176 and Treasury Form 2108.

⁶OMB Bulletins 93-02 and 94-1, "Form and Content of Agency Financial Statements," October 29, 1992, and November 16, 1993.



of current stockpile goods for new goods as uses of the \$215.8 million in appropriations. We disagreed with this action because the in-kind exchange contracts do not reduce unobligated Fund balances since there is no resulting expenditure of funds. Therefore, we concluded that the Fund was not in compliance with the requirement of section 518.

During our review, Fund officials told us that, subsequent to our decision, they modified certain contracts recorded against the \$215.8 million of appropriations to include making payments in cash for stockpile items. Further, Fund officials also said that the Fund maintained records separate from its accounting system to document their actions in response to this one-time requirement.

However, according to Fund officials, these records cannot be found now due to the passage of time and the retirement of an individual responsible for them. While the Fund has retained records of its detailed transactions, it could not find the documents to link these transactions to specific contracts, obligations, payments, and deobligations that comprise and support the \$215.8 million. Therefore, we could not update the conclusions reached in our September 21, 1989, letter. Fund officials told us that they would maintain such necessary documentation in the future.

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We are sending copies of this letter to Ranking Minority Member of your Subcommittee; the Director of the Defense Logistics Agency, who also serves as the Stockpile Manager; the Director of the Defense Finance and Accounting Service; the Administrator of the Defense National Stockpile Center; and other interested parties. Copies will be made available to others on request. Please contact me or Roger Stoltz, Assistant Director, at (202) 512-9095 if you or your staff have any questions concerning this report.

Sincerely yours,



David M. Connor
Director, Defense Financial Audits

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