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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548



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Dear Mr. Chairman:

In further response to your letter of January 26, 1970, we are reporting on our review of the management of selected nonappropriated funds at Headquarters, U. S. Army, Navy, Air Force, and Marine Corps.

Our review was directed toward an evaluation of the systems of accounting and internal control and the adequacy of audits of the funds. We examined accounting and auditing reports and records, performed cash tests, analyzed financial statements, reviewed applicable regulations, and held discussions with officials responsible for each fund.

Each military department has established nonappropriated funds at its headquarters to provide for services common to various types of command and installation nonappropriated fund activities. Our review included the following headquarters funds: (1) Army Central Welfare Fund and Army Central Mess Fund, (2) Navy Central Recreation Fund, (3) Air Force Central Welfare Fund and Air Force Central Mess Fund, (4) Marine Corps Central Recreation Fund and Marine Corps Mess Fund, and (5) the Army and Air Force Civilian Welfare Fund.

At the time of our fieldwork, the combined income reported by the funds for their most recent fiscal years was \$111 million. Combined assets at the end of the respective fiscal years totaled \$140 million, of which \$86 million was invested in Government securities. Financial statements prepared from data developed by personnel of the various funds are included as enclosures I through X for general information purposes only, since the scope of our work was not designed for the certification of financial statements.

ALLOCATION OF EXCHANGE PROFITS

The principal source of revenue for welfare and recreation fund operations in the military departments is the profits generated by the exchange services. The amount of exchange profits distributed to the

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funds during their most recent fiscal years follows.

<u>Department</u>	<u>Profits distributed</u>
Army	\$ 53,447,625
Air Force	31,552,375
Navy	38,666,000
Marine Corps	<u>6,148,619</u>
Total	<u>\$129,814,619</u>

A more detailed description of the receipt and distribution of funds is contained in enclosure XI.

MAJOR GRANTS AND LOANS

Grants and loans by the various funds are made primarily for construction and renovation projects to local clubs and messes and to recreation and welfare activities; in some cases grants are approved for special projects and educational assistance scholarships. Generally we found that grants and loans had been properly made. The following table shows the amount of grants and loans approved by the funds during their most recent (differing) fiscal years.

<u>Fund</u>	<u>Grants</u>	<u>Loans</u>
Army Central Welfare	\$ 686,900	\$ -
Army Central Mess	-	4,150,500
Navy Central Recreation	4,465,500	6,366,400
Air Force Central Mess	-	645,600
Marine Corps Central Recreation	232,200	346,500
Marine Corps Mess	<u>385,800</u>	<u>481,000</u>
Total	<u>\$5,770,400</u>	<u>\$11,990,000</u>

The Army and Air Force Civilian Welfare Fund approved \$349,300 in grants and loans during fiscal year 1969. The fund's personnel were unable to identify the amount in each category.

Although the Air Force Central Welfare Fund, at the time of our fieldwork, did not make loans, it previously had conducted a student loan program and had unpaid loans outstanding.

INVESTMENTS

We believe that the controls over investments and the physical controls over the securities are adequate for their protection. The various military regulations restrict investments to savings accounts, certificates of deposit, and U. S. Government securities. The following is a schedule of the funds' investments at the most recent balance sheet closing dates.

<u>Fund</u>	<u>U.S. Government securities</u>	<u>Certificates of deposit</u>	<u>Savings accounts</u>
Army Central Welfare	\$56,817,500	\$ -	\$ -
Navy Central Recreation	2,996,000	-	-
Air Force Central Welfare	18,059,100	-	-
Air Force Central Mess	6,023,100	-	-
Marine Corps Central Recreation	1,070,200	330,000	59,470
Marine Corps Mess	-	-	3,604,800
Army and Air Force Civilian Welfare	<u>1,005,200</u>	<u>-</u>	<u>-</u>
Total	<u>\$85,971,100</u>	<u>\$ 330,000</u>	<u>\$3,664,270</u>

The Army Central Mess Fund has no investment program. The Deputy Chief of Staff for Personnel, however, established a voluntary centralized investment program to maximize the use of funds in excess of current needs at open mess activities. These excess funds are invested, along with welfare funds, in the Army Central Welfare Fund investment program and are included in the above table.

ADEQUACY OF FINANCIAL REPORTING

The various funds prepare monthly, quarterly, and annual financial statements of operations which, in our opinion, present an informative financial picture.

We reviewed the system of financial reporting used in the operation of the welfare, recreation, and mess funds and found that extensive reviews and analyses were not performed at headquarters on financial data, submitted by major commands, of clubs, messes, and recreation activities. It appeared to us that generally little use was made of financial statements for management purposes in reviewing for any significant increases or decreases in accounts from one period to another. We were advised by fund personnel that in some cases there was not enough time to analyze, in depth, the financial condition or results of operations of individual activities or of composite activities within a command.

APPROPRIATED FUND SUPPORT

The headquarters funds do not maintain records of appropriated fund support provided to them. Although in most cases we were able to obtain estimates of some of the support provided, we recognize that some of these estimates exclude a number of items, such as assistance from Inspectors General, internal review and audit staffs, and engineering staffs.

The estimated appropriated fund support provided annually to various funds at headquarters follows.

<u>Fund</u>	<u>Estimated appropriated fund support</u>
Army Central Welfare and Central Mess	\$ 42,400
Navy Central Recreation	436,875
Air Force Central Welfare and Central Mess	84,378 ^a
Marine Corps Central Recreation and Mess	56,000
Army and Air Force Civilian Welfare	<u>(b)</u>
Total	<u>\$ 619,653</u>

^aAfter our review was completed, the military position of custodian was converted to a nonappropriated fund civilian position which decreased the value of annual appropriated fund support by \$19,500.

^bWe were unable to obtain an estimate of the appropriated fund support provided annually to the Army and Air Force Civilian Welfare Fund.

EVALUATION OF AUDITS

The funds we reviewed are subject to annual audit by central internal review groups (Army Audit Agency, Air Force Auditor General, Naval Audit Service, and Marine Corps Field Audit Service); Inspectors General; or by certified public accountants, as in the case of the Army Central Welfare Fund.

The Army Central Welfare Fund was the only one of these funds to be reviewed by certified public accountants. We believe that the agreements by fund management for work to be performed by certified public accountants gave too little emphasis to internal controls. While the fund receives certification, it does not receive in depth evaluations of management policies and controls. The brief letters commenting on internal controls provided by the certified public accountants with certified statements generally included only a few sentences on the procedures implementing management policies.

We reviewed the audit work performed at the funds by the central internal review groups and found that in most cases the work had not been comprehensive and that appropriate tests had not been made to evaluate the system of internal controls. Recent audit reports prepared by the Marine Corps area auditors failed to show the scope of the audits, and working papers were not adequate to show that the work indicated in the reports had been performed.

Our examination of the Air Force Auditor General resident auditor's working papers for the Air Force central funds showed that insufficient work had been performed by him to render an opinion on the overall fund operation. Subsequent discussions with the Air Force auditors disclosed that the lack of time and insufficient staffing had resulted in incomplete audits and that this inability to perform a complete audit was the result of the Air Force's de-emphasizing audits of nonappropriated fund activities.

Our review at the Army and Air Force Civilian Welfare Fund revealed that the Army audited post restaurants and civilian welfare funds at the installation level about once every 12 months but that the Air Force averaged 27.8 months between audits.

The joint regulation regarding the operation of civilian non-appropriated funds requires that the civilian funds at Army installations be audited annually, but the Air Force leaves the frequency of audit to the discretion of the Auditor General. The Army and Air Force Civilian

Welfare Board has been informed by the Auditor General that audit coverage of restaurants and civilian welfare funds should be limited and that a specific level of audit effort cannot be established.

CONCLUSIONS

We believe that in general, the officials responsible for the central funds have established adequate procedures for the receipt and distribution of funds and that adequate control to safeguard the resources of the funds is exercised over cash and investments.

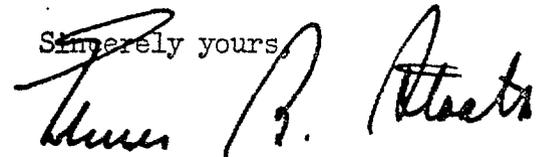
The problems in identifying appropriated fund support discussed in this report emphasize the need for new procedures in this area. As suggested in our earlier reports on nonappropriated fund activities of the Army, Navy, Air Force and Marine Corps, the Committee may wish to consider directing the military departments to establish systems for identifying the costs of all types of appropriated fund support provided to nonappropriated fund activities.

We have not discussed the results of our review with officials of Headquarters, U.S. Army, Navy, Air Force, and Marine Corps, or with officials of the Office of the Secretary of Defense, nor have we requested their formal comments.

We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

We trust that the results of our review at Headquarters, U.S. Army, Navy, Air Force, and Marine Corps are responsive to your request.

Sincerely yours,



Comptroller General
of the United States

Enclosures - 11

The Honorable George H. Mahon
Chairman, Committee on Appropriations
House of Representatives

DEPARTMENT OF THE ARMY
STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 1969 (note a)

BEST DOCUMENT AVAILABLE

	<u>Central Welfare Fund</u>	<u>Central Mess Fund</u>
ASSETS		
Cash	\$ 456,000	\$ 135,700
Loans receivable	3,078,300	4,994,000
Accounts receivable	7,300	66,100
Securities on loan	3,000,000	-
Investments	56,817,500	-
Nonappropriated fund group insurance and retirement premiums receivable	447,200	-
Decal inventory	-	4,400
Advanced allocation of exchange and motion picture dividends and other assets	<u>111,900</u>	<u>-</u>
Total assets	<u>\$63,918,200</u>	<u>\$5,200,200</u>
LIABILITIES AND NET WORTH		
Accounts payable	\$ -	\$ 6,300
Loans payable to Army Central Welfare Fund	-	2,768,200
Dividend and grant credits payable	37,957,200	1,500
Trust accounts	5,654,200	33,800
Accrued liabilities	14,800	-
Net worth	<u>20,292,000</u>	<u>2,390,400</u>
Total liabilities and net worth	<u>\$63,918,200</u>	<u>\$5,200,200</u>

^aCondensed from statements prepared by fund personnel.

DEPARTMENT OF THE ARMY
STATEMENT OF INCOME AND EXPENSE
YEAR ENDED DECEMBER 31, 1969 (note a)

REVENUE EQUIPMENT AVAILABLE

	<u>Central Welfare Fund</u>	<u>Central Mess Fund</u>
INCOME		
Exchange service dividend	\$ 46,998,000	\$ -
Motion picture service dividend	914,700	-
Open mess assessments	-	148,500
Residual assets of dissolved funds	43,000	98,100
Excess funds--U.S. Army, Vietnam	10,900,000	-
Profit on sale of decals	-	502,700
Interest on securities and loans	2,101,200	149,900
Accounting service fee	<u>16,700</u>	<u>-</u>
Total income	<u>60,973,600</u>	<u>899,200</u>
EXPENSE		
Distribution of exchange and motion picture dividends:		
CONUS (note b)	27,313,400	-
Overseas	31,173,000	-
Grant credit allocation	333,700	-
Student scholarship grants	353,200	-
Interest expense	2,000	92,000
Administrative expense	357,700	-
Accounting fee to Army Central		
Welfare Fund	-	8,500
Other expense	<u>20,800</u>	<u>3,300</u>
Total expense	<u>59,553,800</u>	<u>103,800</u>
Net profit	<u>\$ 1,419,800</u>	<u>\$ 795,400</u>

^aCondensed from financial statements prepared by fund personnel.

^bContinental United States

DEPARTMENT OF THE NAVY
CENTRAL RECREATION FUND
STATEMENT OF FINANCIAL CONDITION
DECEMBER 15, 1969 (note a)

	<u>General Account</u>	<u>Ships' Store Account</u>	<u>Officers' Me Account</u>
ASSETS			
Cash	\$ 5,446,800	\$ 458,700	\$ 1,723,800
Receivables	8,885,700	124,300	2,129,500
Investments	2,426,700	569,300	-
Decal inventory	-	-	5,300
	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$16,759,200</u>	<u>\$ 1,152,300</u>	<u>\$ 3,858,600</u>
LIABILITIES AND NET WORTH			
Current liabilities	\$ 1,517,000	\$ -	\$ 516,100
Net worth	<u>15,242,200</u>	<u>1,152,300</u>	<u>3,342,500</u>
	<u> </u>	<u> </u>	<u> </u>
Total liabilities and net worth	<u>\$16,759,200</u>	<u>\$ 1,152,300</u>	<u>\$ 3,858,600</u>

^a Condensed from financial statements prepared by fund personnel.

DEPARTMENT OF THE NAVY
CENTRAL RECREATION FUND
STATEMENT OF INCOME AND EXPENSE
YEAR ENDED DECEMBER 15, 1969 (note a)

	<u>General Account</u>	<u>Ships' Store Account</u>	<u>Officers' Mess Account</u>
INCOME			
Assessments	\$ 7,930,300	\$ 670,000	\$ 738,900
Slot machine income	1,779,100	-	494,100
Reimbursement--fleet movies	-	212,800	-
Interest income	1,997,200	68,200	80,700
Miscellaneous income	<u>38,900</u>	<u>24,800</u>	<u>46,000</u>
Total income	<u><u>11,745,500</u></u>	<u><u>975,800</u></u>	<u><u>1,359,700</u></u>
EXPENSE			
Motion picture service	4,003,100	1,000,000	-
Grants	3,895,000	241,600	329,000
Insurance	655,000	-	474,400
Nonappropriated Fund Accounting			
Unit and Bureau of Naval			
Personnel representatives	253,600	-	-
Mess management training facility	-	-	71,800
Sports program	176,500	-	-
Miscellaneous expenses	<u>426,300</u>	<u>36,400</u>	<u>27,500</u>
Total expense	<u><u>9,409,500</u></u>	<u><u>1,278,000</u></u>	<u><u>902,700</u></u>
Net profit or loss (-)	<u><u>\$ 2,336,000</u></u>	<u><u>\$- 302,200</u></u>	<u><u>\$ 457,000</u></u>

^a Condensed from financial statements prepared by fund personnel.

DEPARTMENT OF THE AIR FORCE
STATEMENT OF FINANCIAL CONDITION
JUNE 30, 1969 (note a)

	<u>Central Welfare Fund</u>	<u>Central Mess Fund</u>
ASSETS		
Cash	\$ 597,100	\$ 138,400
Investments	18,059,100	6,023,100
Loans receivable	789,200	1,717,900
Accounts receivable	18,700	3,800
Army and Air Force Exchange Service dividends receivable	<u>12,187,500</u>	<u>-</u>
Total assets	<u>\$31,651,600</u>	<u>\$ 7,883,200</u>
LIABILITIES AND NET WORTH		
Liabilities	\$20,560,500	\$ 900
Net worth	<u>11,091,100</u>	<u>7,882,300</u>
Total liabilities and net worth	<u>\$31,651,600</u>	<u>\$ 7,883,200</u>

^a Condensed from financial statements prepared by fund personnel.

DEPARTMENT OF THE AIR FORCE
STATEMENT OF INCOME AND EXPENSE
YEAR ENDED JUNE 30, 1969 (note a)

	<u>Central Welfare Fund</u>	<u>Central Mess Fund</u>
INCOME		
Exchange service dividend	\$29,051,900	\$ -
Motion picture service dividend	711,500	-
Assessments	-	1,562,000
Interest on investments	1,105,300	326,500
Other income	<u>15,200</u>	<u>2,200</u>
Total income	<u>30,883,900</u>	<u>1,890,700</u>
EXPENSE		
Claims	-	104,500
Allocations of exchange and motion picture dividends	27,175,500	-
Advances	545,900	-
Construction and other special projects	898,200	-
Other expenses	<u>505,300</u>	<u>29,200</u>
Total expense	<u>29,124,900</u>	<u>133,700</u>
Net profit	<u>\$ 1,759,000</u>	<u>\$ 1,757,000</u>

^a Condensed from financial statements prepared by fund personnel.

U.S. MARINE CORPS
STATEMENT OF FINANCIAL CONDITION (note a)

	Central Recreation Fund <u>January 31, 1970</u>	Mess Fund <u>November 30, 1969</u>
ASSETS		
Cash	\$ 551,700	\$ 3,729,000
Accounts receivable	18,500	18,500
Loans receivable	539,800	1,378,100
Advances	1,700	-
Investments	1,070,200	-
Other assets	<u>74,500</u>	<u>249,800</u>
Total assets	<u>\$ 2,256,400</u>	<u>\$ 5,375,400</u>
LIABILITIES AND NET WORTH		
Current liabilities	\$ 12,600	\$ -
Long term liability	74,500	249,800
Net worth	<u>2,169,300</u>	<u>5,125,600</u>
Total liabilities and net worth	<u>\$ 2,256,400</u>	<u>\$ 5,375,400</u>

^a Condensed from financial statements prepared by fund personnel.

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U.S. MARINE CORPS
STATEMENT OF INCOME AND EXPENSE (note a)

	Central Recreation Fund <u>January 31, 1970</u>	Mess Fund <u>November 30, 1969</u>
INCOME		
Exchange donation	\$ 500,000	\$ -
Assessments and loan payments	-	1,499,874
Interest on investments	53,300	161,431
Other income	<u>400</u>	<u>13,402</u>
Total income	<u>553,700</u>	<u>1,674,707</u>
EXPENSE		
Varsity sports and recreation	141,500	-
Loans and grants	-	913,639
Fund administration	-	81,016
Marine Corps Districts support	58,700	-
State Dept., security guards	16,100	-
Insurance and retirement programs	90,900	-
Other expense	<u>92,800</u>	<u>13,402</u>
Total expense	<u>400,000</u>	<u>1,008,057</u>
Net profit	<u>\$ 153,700</u>	<u>\$ 666,650</u>

^a Condensed from financial statements prepared by fund personnel.

ARMY AND AIR FORCE CIVILIAN WELFARE FUND
STATEMENT OF FINANCIAL CONDITION
JUNE 30, 1969 (note a)

ASSETS

Cash	\$ 82,200
Investments	1,005,200
Loans receivable	<u>413,900</u>
Total assets	\$ <u>1,501,300</u>

LIABILITIES AND NET WORTH

Liabilities	\$ 4,300
Net worth	<u>1,497,000</u>
Total liabilities and net worth	\$ <u>1,501,300</u>

^a Condensed from statements prepared by the Army and Air Force Civilian Welfare Fund.

ARMY AND AIR FORCE CIVILIAN WELFARE FUND
STATEMENT OF INCOME AND EXPENSE
YEAR ENDED JUNE 30, 1969 (note a)

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INCOME

Restaurant dividends	\$ 86,000
Interest on securities	42,700
Dissolved funds	27,200
Other income	<u>800</u>
Total income	<u>156,700</u>

EXPENSE

Grants	98,600
Salaries	24,500
Employer's share of taxes and insurance	7,100
Other expense	<u>200</u>
Total expense	<u>130,400</u>
Net profit	<u>\$ 26,300</u>

^a Condensed from statements prepared by the Army and Air Force Civilian Welfare Fund.

RECEIPT AND DISTRIBUTION OF FUNDS

The Army and Air Force Central Welfare Funds were established as central depositories of nonappropriated funds from which redistributions are made to help maintain welfare, recreation, and morale programs for military personnel.

The Board of Directors of the Army and Air Force Exchange and Motion Picture Services annually declares a dividend which is paid quarterly from the profits of the two services to the central funds on the basis of the respective military service personnel strengths. Because of an extensive rebuilding program, the motion picture service recently discontinued distributing profits to the central welfare funds. The dividends paid by the exchange service during its last 3 fiscal years were \$75 million in both 1968 and 1969 and \$85 million in 1970.

The Army welfare fund establishes rates at which resources will be allocated quarterly to major commands, central post funds, and unit funds on the basis of the expected dividend from the exchange service and personnel strengths. Commands and installations with greater strengths receive disproportionately lower per capita shares of the allocations than those with lesser strengths. The most recent quarterly command rates vary from \$1.45 a man for commands with less than 1,000 personnel to \$1 a man for those with 25,000 and over. Similarly, central post fund allocations vary from \$1 to \$0.55 a man. Unit funds receive \$0.50 a man, regardless of personnel strength.

The Air Force welfare fund allocates resources to all major commands quarterly on the basis of their average daily strength and a rate of \$6 a man. The major commands redistribute a portion of this allocation through applicable nonappropriated fund channels at not less than \$1.50 a man a quarter to central base funds and \$2.25 a man a quarter to isolated unit funds.

The Army and Air Force Central Mess Funds were established to provide financial assistance to open messes through the issuance of loans for the establishment and maintenance of adequate facilities. The Army mess fund also makes grants to open mess activities.

The Army mess fund's principal source of revenue is the profits generated from the sale of alcoholic-beverage-control decals to the open messes. Until March 31, 1969, it was the Army's policy to levy assessments on gross profits of messes within the continental United States. Since this assessment was not sufficient to provide operating resources for the fund, the cost of alcoholic-beverage-control decals was increased from \$2.05 a thousand to \$50 a thousand and the assessment on gross profit was discontinued.

The Air Force mess fund assesses major commands quarterly for one half of 1 percent of the gross income of all clubs and messes within the command.

The Navy Central Recreation Fund provides a means of supporting and equalizing the various recreation funds of the Navy. The fund consists of a General Account, a Ships' Stores Account, and an Officers' Mess Account. The Ships' Stores Account was established separately from the General Account so that ships' store profits would be used only for Navy personnel and not for other service personnel or for dependents of Navy personnel. The Officers' Mess Account was established to ensure that the funds used to support commissioned officers' messes are provided only by commissioned officers.

General Account income is derived from assessments of up to 40 percent of Navy exchange sales (depending on sales volume), 1.25 percent of gross sales of enlisted open messes, and 50 percent of slot machine profits of enlisted men's clubs and messes. The Officers' Mess Account receives the same type of income from officers' open messes. An assessment of from 1 to 2 percent of total sales of ship stores afloat (depending on ship personnel allowances) provides income to the Ships' Stores Account.

The Marine Corps Central Recreation and Mess Funds are monetary reserves which provide financial assistance to local recreation programs and to clubs and messes, respectively.

The primary source of income for the recreation fund is an annual donation, in varying amounts, from the Marine Corps Exchange Fund. The exchange fund donated \$450,000 in 1969 and \$500,000 in 1970. The recreation fund subsidizes local recreation activities if the local activity has no independent source of nonappropriated funds or if the local activity cannot bear the entire costs. The recreation fund also provides grants and loans for the construction and rehabilitation of recreation facilities.

The mess fund assesses clubs and messes at the rate of 3 percent of gross income on alcoholic beverage sales and 25 percent of net profit from slot machine operations. The mess fund provides individual clubs and messes with grants and interest-free loans.

The Army and Air Force Civilian Welfare Fund receives a 5-percent assessment from post and base restaurants and provides grants and loans for rehabilitation and expansion of restaurant facilities.