Audit Report

OFFICE OF THE INSPECTOR GENERAL

STATEMENT OF FINANCIAL POSITION FOR THE COMMISSARY SURCHARGE COLLECTIONS FUND, AS OF SEPTEMBER 30, 1994

Report No. 95-218 June 5, 1995

Department of Defense

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Acronyms

DeCA	Defense Commissary Agency
DFAS-CO	Defense Finance and Accounting Service-Columbus Center, Columbus, Ohio
DBMS	Defense Business Management System
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

June 5, 1995

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

SUBJECT: Audit Report on the Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994 (Report No. 95-218)

We are providing this report for your information and use and for use by the Congress. Financial statement audits are required by the Chief Financial Officers Act of 1990. Office of Management and Budget Bulletin No. 93-06 "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General, Department of Defense, to report on the adequacy of internal controls and compliance with laws and regulations and express an opinion on the fairness of financial statements. Comments from the Defense Commissary Agency and the Defense Finance and Accounting Service on a draft were considered in the preparation of this report.

We are unable to render an opinion on the Statement of Financial Position for the Commissary Surcharge Collections Fund because, despite some financial management improvements, an effective internal control structure over cash, capital equipment, construction in-progress, and accounts payable was not in place to provide reasonable assurance that material misstatements would be prevented or detected in a timely manner. We have included recommendations in the report which, if acted upon, will assist producing auditable financial statements. Our disclaimer of opinion is based on the Statement of Financial Position as of September 30, 1994, received by us in December 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request the Defense Commissary Agency to provide additional comments by August 4, 1995, on the recommendation that all construction in-progress costs be capitalized as required by the DoD Accounting Manual.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Robert J. Ryan, Audit Program Director, at (703) 604-9418 (DSN 664-9418) or Mr. Thomas D. Kelly, Audit Project Manager, at (215) 737-3886 (DSN 444-3886). The distribution of this report is in Appendix E. A list of audit team members is on the inside back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-218 **June 5, 1995**
(Project No. 4LA-2016)

Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994

Executive Summary

Introduction. The Commissary Surcharge Collections Fund receives cash primarily from a 5-percent surcharge that commissary patrons are assessed at checkout and disburses cash to pay for operating and constructing commissary stores. The Defense Commissary Agency (DeCA) manages the Commissary Surcharge Collections Fund while the Defense Finance and Accounting Service-Columbus Center, Columbus, Ohio (DFAS-CO), provides most accounting services. As of September 30, 1994, DeCA reported on the Statement of Financial Position that the Commissary Surcharge Collections Fund had $808 million in assets and $95.1 million in liabilities. We performed this audit in response to the Chief Financial Officers Act.

Objectives. Our objectives of the audit were to determine whether the September 30, 1994, Statement of Financial Position accounts present fairly the financial position of the Commissary Surcharge Collections Fund in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We evaluated the DeCA and the DFAS-CO internal control structure for ensuring that material misstatements were prevented or detected in asset and liability account balances as well as their compliance with applicable laws and regulations that have a direct and material effect on the financial statement.

Scope and Methodology. We examined the Statement of Financial Position and related notes for the Commissary Surcharge Collections Fund. Other principal statements and related notes prepared by DeCA, but not examined by us, include the Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. The Statement of Financial Position reflects the asset and liability general ledger account balances. For each of the general ledger account balances, we evaluated the internal control structure over transaction processing and recording at DeCA and DFAS-CO. We verified or attempted to verify balances to subsidiary records and supporting source documentation either generated by accounting systems or by related logistical systems. We reviewed computer-processed data from DeCA and DFAS organizations. We also independently verified the source data for selected transactions but not in sufficient quantities to draw conclusions on the overall reliability of the computer-processed data. The Statement of Financial Position upon which we made our review was submitted to us on December 30, 1994.

Disclaimer of Opinion. We are unable to render an opinion on the Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994, because an internal control structure over cash, capital equipment, construction in-progress, and accounts payable was not in place to provide reasonable assurance that material misstatements would be prevented or detected in a timely manner.

Findings on Internal Controls. The DeCA and DFAS-CO internal control structure for the Commissary Surcharge Collections Fund did not provide reasonable assurance that material misstatements would be prevented or detected in a timely manner.

o The internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate cash balance. As a result, the $406.7 million cash balance as of September 30, 1994, reflected $65.4 million less in collections and $91.7 million less in disbursements than the general ledger account balances and is probably materially misstated (Finding A).

o The internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of accurate capital equipment and related accumulated depreciation account balances. As a result, the $45.8 million net capital equipment balance as of September 30, 1994, contained overstatement errors of $6 million and is probably materially misstated (Finding B).

o The internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate construction in-progress account balance. As a result, the $327.7 million construction in-progress account balance as of September 30, 1994, was overstated by at least $248.1 million (Finding C).

o The internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate accounts payable balance. As a result, the $95.1 million accounts payable account balance as of September 30, 1994, contained overstatement errors of as much as $58.9 million and is probably materially misstated (Finding D).

DeCA has made significant improvements in its financial and accounting practices, and DFAS-CO has recognized the need for accounting system improvements. Implementation of the DeCA and DFAS-CO internal management control program also needs to be improved to ensure the effective processing and recording of assets and liabilities. A discussion of the controls assessed and the material internal control weaknesses identified is in Part II.A.

Findings on Compliance With Laws and Regulations. Our audit disclosed instances of noncompliance with laws and regulations that materially affected the reliability of the Statement of Financial Position for the Commissary Surcharge Collections Fund. Except for laws and regulations dealing with the form and content of financial

statements, all instances of material noncompliance and their effect on the Statement of Financial Position are discussed in Part II.A. Part II.B. contains our report on compliance with laws and regulations.

Summary of Recommendations. We recommend that DeCA and DFAS-CO amend, create, adhere to, and enforce procedures for processing and recording assets and liabilities of the Commissary Surcharge Collections Fund.

Management Comments. The Director, DeCA, agreed or partially agreed to all recommendations except for capitalizing in-house labor costs associated with constructing commissary stores. The Director, DFAS, fully agreed to two recommendations. A discussion of management comments on the recommendations and audit responses to those comments are in Part II.A. of this report. Other management comments and audit responses are in Appendix C. The complete text of management comments is in Part IV.

Audit Response. The DeCA comments on the recommendation concerning the capitalization of in-house labor costs are not fully responsive. The statutes cited by DeCA do not negate DoD accounting policy requiring the capitalization of in-house labor construction costs. Accordingly, we request that DeCA reconsider its position and provide additional comments on the unresolved recommendation by August 4, 1995.

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Part I - Disclaimer of Opinion

Disclaimer of Opinion

We are unable to render an opinion on the Statement of Financial Position and related notes for the Commissary Surcharge Collections Fund, as of September 30, 1994. Our disclaimer of opinion is based on the Statement of Financial Position and related notes submitted to us on December 30, 1994. Although the Defense Commissary Agency (DeCA) has made a major commitment to improving financial management of the Commissary Surcharge Collections Fund, a weak internal control structure prevented us from performing an audit of the general ledger balances.

o The internal control structure for processing and recording transactions in the cash general ledger accounts did not conform to key DoD accounting requirements, and the official U.S. Treasury cash balance of $406.7 million reported as of September 30, 1994, reflected $65.4 million less in collections and $91.7 million less in disbursements than the general ledger account balances and is probably materially misstated (Finding A).

o The internal control structure for processing and recording transactions in the capital equipment general ledger accounts did not conform to key DoD accounting requirements, and the net capital equipment balance of $45.8 million reported as of September 30, 1994, contained net overstatement errors of $6 million and is probably materially misstated (Finding B).

o The internal control structure for processing and recording transactions in the construction in-progress general ledger accounts did not conform to key DoD accounting requirements, and the construction in-progress balance of $327.7 million reported as of September 30, 1994, was materially overstated by at least $248.1 million (Finding C).

o The internal control structure for processing and recording transactions in accounts payable general ledger accounts did not conform to key DoD accounting requirements, and the accounts payable balance of $95.1 million reported as of September 30, 1994, contained overstatement errors of as much as $58.9 million and is probably materially misstated (Finding D).

It was not practical or efficient for us to perform, nor did we perform, other auditing tests to determine the validity of the reported balances. Because we were unable to determine the proper values of material asset and liability account balances, the scope of our work was not sufficient to enable us to express, therefore, we do not express, an opinion on the Statement of Financial Position and related notes.

Auditing Standards

We conducted our audit in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the principal statements are free of material misstatements. We relied on the guidelines suggested by the General Accounting Office and our professional judgment in assessing the materiality of matters impacting the fair presentation of the Statement of Financial Position and related internal control weaknesses.

Accounting Principles

Accounting principles and standards for the Federal Government remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General, who are principals of the Joint Financial Management Improvement Program. Specific standards agreed on by the three principals are issued by the Director, OMB, and the Comptroller General. Until accounting standards have been issued that will govern all aspects of financial statement reporting and constitute "generally accepted accounting principles for the Federal Government," agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. The hierarchy constitutes an "other comprehensive basis of accounting" to be used for preparing Federal agency financial statements. The hierarchy defined and approved by the Joint Financial Management Improvement Program principals is summarized as:

- standards agreed to and published by the Joint Financial Management Improvement Program principals,
- form and content requirements of OMB,
- accounting standards contained in agency accounting policy guidance, and
- accounting principles published by other authoritative sources.

To date, three accounting standards have been published by the Joint Financial Management Improvement Program principals, so most accounting standards for the DoD "other comprehensive basis of accounting" are contained in DoD accounting policy guidance. The DoD accounting guidance is primarily in DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983. During FY 1993, the then Comptroller of the DoD (presently the Under Secretary of Defense [Comptroller]) updated portions of the DoD Accounting Manual and incorporated those sections into a new regulation, DoD 7000.14-R, "DoD Financial Management Regulation," May 1993.

The DoD Financial Management Regulation will eventually serve as the single DoD-wide financial management regulation for use by all DoD Components for accounting, budgeting, finance, and financial management education and training. In the interim, unless superseded by published Federal accounting standards or requirements of OMB, the policy contained in the DoD Accounting Manual or in the DoD Financial Management Regulation, as applicable, is the authoritative basis for preparing financial statements in accordance with an "other comprehensive basis of accounting."

Part II - Audit Results

Audit Background

The Chief Financial Officers Act requires an annual audit of funds such as the Commissary Surcharge Collections Fund. The financial statements of the Commissary Surcharge Collections Fund are the responsibility of DeCA and were prepared by DeCA based on financial information provided by the Defense Finance and Accounting Service-Columbus Center, Columbus, Ohio (DFAS-CO), and the 9th Finance Group-Subsistence Finance and Accounting Office, Germany. The Statement of Financial Position essentially shows the worth of the Commissary Surcharge Collections Fund by comparing its assets and liabilities as of the end of a fiscal year. DeCA reported assets of $808 million and liabilities of $95.1 million on the Statement of Financial Position. The Fund's balances consisted of five major accounts:

Assets

- Cash, $406.7 million
- Accounts Receivable, $27.8 million
- Capital Equipment (less depreciation), $45.8 million
- Construction in-Progress, $327.7 million

Liabilities

- Accounts Payable, $95.1 million

Audit Objectives

Our primary objective was to determine whether the Statement of Financial Position accounts present fairly the financial position of the Commissary Surcharge Collections Fund in accordance with OMB Bulletin 94-01. We also evaluated the DeCA and the DFAS-CO internal control structure for ensuring that material misstatements were prevented or detected in asset and liability account balances as well as their compliance with applicable laws and regulations that have a direct and material effect on the financial statement.

Part II.A. - Review of Internal Controls

Introduction

We examined the internal control structure for the principal asset and liability accounts presented on the Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994. The statement upon which our examination was based was submitted to us on December 30, 1994. DeCA and DFAS-CO management are jointly responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control structure (United States Code, title 31) are to provide management with reasonable but not absolute assurance that the following are met.

o Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets.

o Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

o Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and any other laws and regulations that OMB, entity management, or the Inspector General, DoD, have identified as being significant for which compliance can be objectively measured and evaluated.

For the purpose of this report, we evaluated the significant internal controls over the following accounts: cash, accounts receivable, capital equipment, construction in-progress, and accounts payable.

Reportable Conditions. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure accurate and reliable financial information needed to manage and evaluate operational performance. A material weakness is a reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors would be in amounts that would be material to the statements being audited, or material to a performance measure or aggregation of related performance measures, and not be detected within a timely period by employees in the normal course of performing their functions. Material internal control weaknesses existed in the internal control structure at both DeCA and DFAS-CO.

DeCA. DeCA did not have effective internal controls to ensure that material misstatements were prevented or detected in the asset and liability account balances of the Statement of Financial Position. Also, DeCA did not fully implement its internal management control program as it relates to preventing or detecting material misstatements in the asset and liability account balances of the Statement of Financial Position. DeCA assessed the internal control risk of Commissary Surcharge Collections Fund accounting as high, based on our review of the Commissary Surcharge Collections Fund Financial Statements for FY 1992, but has not conducted any self-assessments of the controls over individual account balances. Checklists were published in August 1994 and self-assessments are planned for the FY 1995 and FY 1997 time frames. Because DeCA had not yet conducted self-assessments of individual accounts, the material weaknesses we identified were not surfaced and resolved.

DFAS-CO. DFAS-CO did not have a responsive accounting system for Surcharge Collections Fund transactions and recordings. DFAS-CO used the Defense Business Management System (DBMS) to account for Commissary Surcharge Collections Fund transactions and general ledger recordings. However, DBMS had significant shortcomings in meeting the accounting requirements of the Commissary Surcharge Collections Fund's asset accounts. Because of DBMS shortcomings, DeCA had to exercise accounting control of individual equipment and construction projects off line. DFAS-CO recognized the shortcomings of DBMS and discussed possible system improvements in its FY 1994 Annual Statement of Assurance. Until Commissary Surcharge Collections Fund accounting is integrated and automated, controls over asset and liability account balances will likely remain unreliable.

Reportable Conditions Not Noted. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions that are also considered to be material weaknesses.

Finding A. Cash

The internal control structure over transaction processing and general ledger recordings in the Commissary Surcharge Collections Fund did not provide reasonable assurance of an accurate cash balance. The condition occurred because the internal control structure did not provide for reconciling the official U.S. Treasury cash balance with general ledger account balances. As a result, the Statement of Financial Position reported cash balance of $406.7 million reflected $65.4 million less in collections and $91.7 million less in disbursements than the general ledger account balances and is probably materially misstated.

Background

Responsibility for Managing Cash Balances. DeCA is responsible for managing the Commissary Surcharge Collections Fund cash balance because general ledger accounting responsibility was split until the end of FY 1994. Specifically, the DeCA Resource Management Directorate was responsible for combining the general ledger account balances of DFAS-CO and the 9th Finance Group - Subsistence Finance and Accounting Office into the Commissary Surcharge Collections Fund's trial balance. As of September 30, 1994, the combined account balance for cash amounted to about $380.4 million. That amount was generated by $528.4 million in collection and disbursement transactions recorded in the general ledger of DBMS maintained by DFAS-CO and by $45 million in collection and disbursement transactions recorded in the general ledger of the Standard Finance System maintained by the 9th Finance Group. If DFAS-CO and the 9th Finance Group had collected and disbursed all Commissary Surcharge Collections Fund cash and accounted for the transactions accurately, their combined cash balance could be used reliably to report the Statement of Financial Position end of year cash balance.

"Transactions By and For Others." The combined DFAS-CO and the 9th Finance Group cash balances cannot be used to report the September 30, 1994, cash balance because transactions by and for others have inherent processing delays. Federal Government fiscal policy allows any finance and accounting office to collect and disburse cash for another finance and accounting office. That practice is termed "transactions by and for others." In the case of commissaries, those transactions mostly involve disbursements by finance and accounting offices at host installations for base services. Army Regulation 37-1, "Army Accounting and Fund Control," April 30, 1991, contains the following comments on transactions by and for others:

> The costliest, most time consuming, complicated, and error-prone segment of accounting for an installation's daily disbursing activity is making payments or collections for other U.S. Army fiscal stations, for other military services, or for other DoD agencies.

For FY 1994, transactions by and for others totaled about 61 percent of all transactions processed through DFAS-CO general ledger accounts. Because of those transactions, official cash balances for appropriations are maintained by the U.S. Treasury, and elaborate and complicated processing procedures and networks have been established to account for the balances. Simply put, all finance and accounting offices must send summary totals of collections and disbursements by appropriation to the U.S. Treasury and send detailed collection and disbursement documentation to the finance and accounting offices (DFAS-CO and the 9th Finance Group for the Commissary Surcharge Collections Fund) that maintain general ledger records for the appropriation. The U.S. Treasury also sends summary totals of collections and disbursements to the finance and accounting office having cash management responsibility (DeCA). The establishment of separate cash balances requires that reconciliations be performed and that differences be researched.

Account Balance

The internal control structure over transaction processing and general ledger recordings in the Commissary Surcharge Collections Fund did not provide reasonable assurance of an accurate cash account balance. As of September 30, 1994, the U.S. Treasury reported that the Commissary Surcharge Collections Fund had $406.7 million in cash. To determine the reasonableness of the U.S. Treasury's reported cash balance, we compared U.S. Treasury cash transactions to the DeCA combined general ledger cash transactions. The U.S. Treasury's cash balance should reflect more transactions than the DeCA cash balance, because summary totals can be processed much more quickly into appropriation accounts than can detailed transactions into general ledger accounts. However, the DeCA combined general ledger account balance reflected $65.4 million more in collections and $91.7 million more in disbursements than the U.S. Treasury's. Moreover, transaction histories for the U.S. Treasury showed that very little in collections ($7.8 million) and disbursements ($7.4 million) was recorded for the first 3 months of FY 1994. Such a situation could occur only if most commissary stores were closed.

Also, 43 percent of the U.S. Treasury balance consisted of reimbursements, another impossible situation considering that 97 percent of all surcharge collections funds come from a 5-percent surcharge added to commissary resales. We have intended only to show the direction of potential misstatements and to give some idea of their magnitude. Nevertheless, the Commissary Surcharge Collections Fund's September 30, 1994, cash balance, as recorded by the U.S. Treasury account, could be materially misstated because it does not include all transactions and contains numerous reimbursement misclassifications.

Internal Control Structure

Reconciliation of Account Balances. The Commissary Surcharge Collections Fund's internal control structure did not provide for reconciling the official U.S. Treasury cash balance with general ledger account balances. The DoD Accounting Manual provides for researching undistributed collections and disbursements, that is, the differences between those recorded in the official U.S. Treasury cash balance and those recorded in general ledger account balances. Those differences can be identified for research only by first reconciling amounts recorded in the U.S. Treasury's balance with amounts recorded in the DFAS-CO and the 9th Finance Group general ledgers. Transactions found in the U.S. Treasury's balance but not on general ledgers and vice versa should be adjusted if in error. However, most differences stem from processing delays and will adjust themselves. As the cash manager for the Commissary Surcharge Collections Fund, DeCA should have performed reconciliations and conducted research to verify the official cash balance maintained by the U.S. Treasury.

DeCA performed no reconciliations and research to verify the official cash balance. Foremost, the general ledger accounts needed to perform effective reconciliations and research were not on hand at DeCA but were at DFAS-CO and the 9th Finance Group. Additionally, DeCA was not staffed to perform detailed and time-consuming reconciliations. Based on monthly disbursement data, the undistributed disbursement balance as of September 30, 1994, represented more than 3.8 months of transactions. We attempted to reconcile just two transactions that were recorded on the U.S. Treasury's balance but not on the general ledger accounts. After 2 weeks of attempting to reconcile the transactions, we were unsuccessful. Some of the difficulties we encountered included: receipt documents were not maintained; payables were not established; disbursement vouchers were not available; and knowledgeable personnel were not available at remote finance and accounting offices.

Volume of Transactions and Complexity of Reconciliations. In addition to the difficulties we encountered, the volume of transactions and complexity of making reconciliations increase the possibility of erroneous and fraudulent charges against the Commissary Surcharge Collections Fund. Accordingly, cash reconciliations must be done. DeCA recognized the reconciliation work load that transactions by and for others has caused and has tried to minimize those transactions by attempting to have host installations send payment vouchers to DFAS-CO. Also, DFAS-CO has established a task force to reduce undistributed collections and disbursements. Additionally, the Under Secretary of Defense (Comptroller) has requested us to make an independent assessment of unmatched disbursements throughout DoD; this assessment is ongoing at DFAS-CO. In view of those actions and the fact that responsibility for cash management will switch to DFAS-CO in FY 1995, no recommendations are made in this report to improve the reconciliation process. However, unless DFAS-CO makes such reconciliations in FY 1995, we believe the Commissary Surcharge Collections Fund cash balance will likely remain inaccurate.

Materiality and Impact on the Surcharge Statement of Financial Position

The internal accounting controls over cash collections and disbursements were materially deficient. The DoD Financial Management Regulation includes guidance on what constitutes a material deficiency in an accounting system. The regulation provides 13 key accounting requirements that systems must reasonably comply with to meet standards established by the General Accounting Office, OMB, the U.S. Treasury, and DoD. The seventh key accounting requirement deals with system controls over funds and indicates that an accounting system must include good internal control procedures to prevent undistributed collections and disbursements. Also, the eighth key accounting requirement deals with audit trails and provides that an accounting system should allow for the detection and tracing of rejected or suspended transactions, such as unmatched disbursements, for ultimate systematic correction in a reasonable time frame.

According to the regulation, a departure from a key accounting requirement is considered a material deficiency if it could result in loss of control over 5 percent or more of the measurable resources for which the accounting system is responsible. From the standpoint of cash, the Commissary Surcharge Collections Fund's general ledger accounting system reported $380 million on hand as of September 30, 1994; applying the regulation's materiality criterion of 5 percent to the ending cash balance would mean that a material deficiency would occur if undistributed collections or disbursements exceeded $19 million. The undistributed collections and disbursements actually amounted to three and five times this amount, respectively, and were not reconciled and researched. Therefore, the internal accounting control structure is not only materially deficient, but the official cash balance of $406.7 million presented in the Statement of Financial Position reflected $65.4 million less in collections and $91.7 million less in disbursements than the general ledger account balances and could be materially misstated.

Management Comments on the Finding and Audit Response

DeCA commented on the finding. See Appendix C for specific DeCA comments and audit responses.

Finding B. Capital Equipment

The internal control structure over transaction processing and general ledger recordings in the Commissary Surcharge Collections Fund did not provide reasonable assurance of an accurate capital equipment account balance. The condition occurred because DFAS-CO did not have an effective general ledger accounting system for capital equipment and related accumulated depreciation, and DeCA did not effectively compensate for the inadequate DFAS-CO system. DeCA, which maintains subsidiary equipment records and directs changes to the DFAS-CO summary account balances, often did not conduct thorough physical inventories of equipment on hand or effectively reconcile its subsidiary records to the DFAS-CO general ledger balances. As a result, the Statement of Financial Position reported net capital equipment account balance of $45.8 million contains net overstatement errors of $6 million and is probably materially misstated.

Background

The DoD Accounting Manual requires that high-dollar-value equipment be capitalized when it has a useful life of at least 2 years. The then Comptroller of the DoD set the dollar value at $15,000 for items acquired on or after October 1, 1991, and increased it to $25,000 for items acquired on or after October 1, 1993. All capital equipment used in an entity's operation should be reported in the entity's annual financial statements. OMB and DoD guidance on the form and content of financial statements requires that capital equipment not in use be separately identified and reported.

The DoD Accounting Manual also provides standards that DoD organizations should follow in accounting for capital equipment. DoD organizations are to:

- identify and classify capital equipment;
- record all transactions for equipment acquisitions, dispositions, reevaluations, and transfers;
- maintain source document support for all entries in the accounting system so that subsidiary records can be reconciled with the accounting system general ledger;
- calculate depreciation in the accounting period in which benefits result from the use of the asset; and
- conduct periodic physical inventories to validate the subsidiary records and the general ledger account balance.

The Plant Property Accounting System (Property System) provides property accountability control over capital equipment at DeCA Headquarters and regions and serves as the subsidiary record for the DFAS-CO general ledger summary balances contained in DBMS. Both the Property System and DBMS provide summary balances for DeCA headquarters and its regions.

Account Balance

The internal control structure over transaction processing and general ledger recordings in the Commissary Surcharge Collections Fund did not provide reasonable assurance of accurate account balances for capital equipment and related accumulated depreciation. The Statement of Financial position reported $100.2 million in capital equipment and $54.4 million in accumulated depreciation, or a net capital equipment balance of $45.8 million. The $100.2 million comprised $88.3 million recorded in the general ledger of DBMS at DFAS-CO and $11.9 million recorded in the general ledger of the Standard Finance System at the 9th Finance Group - Subsistence Finance and Accounting Office.

To establish the reasonableness of the reported capital equipment and accumulated depreciation balances, we ascertained whether the summary totals in the Property System and DBMS agreed. As of September 30, 1994, the capital equipment balance was about $490,000 less in the Property System than DBMS, and total accumulated depreciation was about $2.2 million less in DBMS than the Property System. We also ascertained whether all monthly journal entries had been made to accumulate depreciation. The September 1994 depreciation expense of about $694,000 had not been entered in either the Property System or DBMS.

We also tested individual capital equipment records of the Property System to ascertain whether the equipment included in the Property System and represented in DBMS summary balances met prescribed capital equipment criteria as to dollar value and use as of September 30, 1994. Our interrogation of all 4,168 capital equipment records in the Property System disclosed the following discrepancies.

o Equipment valued at about $2 million (111 items), but costing less than $25,000 each, was represented in DBMS summary balances even though it was acquired after October 1, 1993. DeCA should have reported the equipment as an expense.

o Equipment valued at about $1.4 million was represented in DBMS summary balances even though it was located at sites of the Navy Exchange Service Command or the Army and Air Force Exchange System. DeCA had originally purchased the equipment, but left it for the exchanges to use after the exchanges were consolidated with commissaries. For financial reporting purposes, the equipment should be reported by the entities that receive benefit

from its use, that is, the appropriate exchange command. DeCA should have formally transferred the equipment to the exchanges because it had no intention of using the equipment again in commissary operations.

o Equipment valued at about $473,000 was represented in DBMS summary balances even though it was located in five stores closed before FY 1994. DeCA should have transferred or disposed of the equipment.

We have intended only to show the direction of potential misstatements and to give some idea of their magnitude. Nevertheless, the September 30, 1994, general ledger account balance for capital equipment may be materially misstated because it does not agree with subsidiary account balances, include all appropriate costs such as depreciation, represent valid capital equipment expenditures, and reflect proper equipment usage criteria.

Internal Control Structure at DFAS-CO

DFAS-CO did not have an effective accounting system for capital equipment and accumulated depreciation. Optimally, an accounting system should be automated and generate financial statement balances from an unbroken flow of source documents, journals, and ledgers. Such a system would likely have a low internal control risk. However, to account for transactions of the Commissary Surcharge Collections Fund and general ledger recordings, DFAS-CO used DBMS, a system unable to meet the accounting requirements of the Commissary Surcharge Collections Fund. DBMS is not integrated with the DeCA Property System and is thus not directly controlled by the subsidiary records for equipment and depreciation. DBMS can record only increases and decreases and produce summary totals. Thus, DeCA must exercise control of equipment in a separate system and provide journal vouchers to DFAS-CO for lump-sum adjustments to the capital equipment and accumulated depreciation accounts. DFAS-CO recognized DBMS shortcomings in its FY 1994 Annual Statement of Assurance. DFAS-CO has planned DBMS improvements that include an interface for property accounting systems. However, until the DBMS improvements are made and deemed compatible with the DeCA property accounting system, off-line control will be required and the internal control environment will remain at high risk of generating inaccurate account balances.

Internal Control Structure at DeCA

DeCA did not effectively compensate for the inability of DFAS-CO to adequately record and report capital equipment and accumulated depreciation. DeCA Directive 70-7, "Financial Management for Headquarters and Regions," August 31, 1994, provides procedures for processing and recording equipment transactions. DeCA Headquarters and regions are to update the Property System and DBMS. Within DeCA, logistics personnel are to update the

Property System, while resource management personnel are to update DBMS and reconcile it to the Property System at least once a month. DeCA Directive 40-2, "Equipment, Supplies and Services," July 17, 1992, requires commissary organizations in possession of equipment to conduct physical inventories annually. Inventories and reconciliations are necessary because front-end processing controls of equipment receipts into the Property System and DBMS have not been adequate and other transactions such as disposals, transfers, and depreciation cannot be entered directly in DBMS.

To determine the effectiveness of the DeCA internal control structure over capital equipment, we reviewed equipment inventories at 10 commissary stores and reconciliations at the stores' 2 regions in the continental United States. The stores and regions were selected judgmentally from the DeCA universe of 331 stores and 7 regions. The 10 stores varied in size and encompassed all classes of DeCA stores and military customers. The DeCA Property System for the 10 stores listed 141 items, costing $3.7 million (3.7 percent of total balance of reported capital equipment). We also obtained and analyzed FY 1994 capital equipment and accumulated depreciation transaction histories for the Commissary Surcharge Collections Fund from DBMS at DFAS-CO.

Physical Inventories. Not all commissary stores performed thorough annual physical inventories of capital equipment. Of the 10 stores we reviewed, 2 did not do any physical inventories during FY 1994, although required to by DeCA Directive 40-2. Five other stores performed inventories, but were not thorough. Our physical inventory at the 10 commissary stores disclosed the following discrepancies.

o Twenty-five items, costing $551,000, were not at the stores but were included in the Property System. The seven stores that did not conduct thorough physical inventories could not readily tell whether all the items were ever on hand or whether they had been disposed of before FY 1994. Thorough physical inventories would have disclosed that the 25 items were not on hand.

o Eight items, costing $155,000, were not included in the Property System but were physically on hand. Seven of the eight items were acquired before FY 1994 and, as such, would have been disclosed as on hand if thorough annual physical inventories had been conducted.

o Four items, costing about $97,500, were included in the Property System and on hand at three stores but were not in active use. The equipment had been inactive for years before our inventory. DeCA Directive 40-2 does provide for reviewing the status of equipment on hand. Accordingly, thorough physical inventories would have identified the four items as inactive for reporting purposes.

Our physical inventory also disclosed that several items of the same description and general dollar value were included or not included in the Property System, depending on their location. At four of five stores in one region, walk-in refrigerators and freezers were included in the Property System as capital equipment. At five stores in the other region, the same type of equipment was not included in the Property System as capital equipment. Similarly, at five

stores in one region, meat weighing, wrapping, and labeling equipment were combined as a system and included in the Property System as capital equipment. At five stores in the other region, the same equipment was in the process of being separated in the Property System and not included as capital equipment because the individual pieces of equipment did not meet the dollar threshold for capitalization. Different classifications for the same type of capital equipment could be widespread among regions. The average total value of capital equipment per store at one of the regions we reviewed was almost 70 percent more than the other region, although the region accounted for only about 19 percent more in sales. This apparent discrepancy was likely caused in part by not properly classifying equipment when received. Logistics personnel at DeCA Headquarters told us that walk-in freezers should be capitalized as part of the cost of a building if a building's exterior walls required structural change to house the freezers. We were also told that pieces of equipment within a system should be classified individually because that is how they are maintained and replaced. However, physical inventory procedures contained in DeCA Directive 40-2 do not include such specific equipment classification guidance or provide for reviewing the classification of equipment on hand.

Account Reconciliations. Not all regions performed thorough reconciliations of the DeCA subsidiary balances in the Property System to the DFAS-CO general ledger balances in DBMS. One of the two regions we reviewed performed monthly reconciliations and documented the results in accordance with DeCA Directive 70-7; that is, the adjustments were backed up with lists of equipment receipts, dispositions, or other transactions that had been recorded in the Property System but not DBMS. The other region made only 4 of 12 reconciliations during FY 1994 and provided no backup documentation to support the adjustments sent to DFAS-CO for entering into DBMS. It appeared to us the "reconciliations" simply involved making adjustments to bring the Property System and DBMS into balance. One of the reconciliations, for example, brought the accumulated depreciation balance in the Property System and DBMS into agreement even though DBMS included 1 additional month of depreciation ($123,712). DeCA Headquarters also initiated two unsupported accounting adjustments, totaling about $63 million, in August and September 1994, because regional reconciliations were not bringing the Property System and balances together; see Finding C, Construction In-Progress, for additional discussion under the paragraph subtitled "Unsubstantiated Amounts." Unless regions perform the required reconciliations monthly, the reliability of the Commissary Surcharge Collections Fund's Capital Equipment balance will remain in question.

Materiality and Impact on the Surcharge Statement of Financial Position

The internal accounting controls over capital equipment and related depreciation were materially deficient. The DoD Financial Management Regulation includes guidance on what constitutes a material deficiency in an accounting system. The regulation provides 13 key accounting requirements that systems must

reasonably comply with to meet standards established by the General Accounting Office, OMB, the U.S. Treasury, and DoD. The second key accounting requirement deals with system controls over property and specifies that an accounting system must include periodically taking physical inventories and reconciling subsidiary records to general ledger accounts. According to the regulation, a departure from a key accounting requirement is considered a material deficiency if it could result in loss of control over 5 percent or more of the measurable resources for which the accounting system is responsible. The Statement of Financial Position reported $45.8 million of capital equipment, net of accumulated depreciation, on hand; applying the regulation's materiality criteria of 5 percent to the net capital equipment balance would mean that a material deficiency would occur if net capital equipment was $2.3 million more or less than the reported amount. Based on our analyses and physical inventories, the reported net capital equipment balance contained net overstatement errors of $6 million. However, our analyses and physical inventories did not include all capital equipment and did not involve tests of detailed accounting transactions and, accordingly, could contain offsetting errors. Nevertheless, the internal control structure is materially deficient because the potential loss of control from not establishing an adequate general ledger/subsidiary ledger relationship and performing physical inventories and reconciliations well exceeds the $2.3 million criterion for materiality. As such, the net capital equipment balance of $45.8 million presented in the Statement of Financial Position cannot be relied upon and is probably materially overstated.

Management Comments on the Finding and Audit Response

DeCA commented on the finding. See Appendix C for specific DeCA comments and audit responses.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Commissary Agency:

1. Establish verification procedures to ensure that all organizations in possession of capital equipment perform comprehensive physical inventories at least once a year.

Management Comments. DeCA concurred and stated that verification procedures would be established in a local directive by September 30, 1995.

2. Revise Defense Commissary Agency Directive 40-2 to provide specific guidance on equipment classification and to require reviews of equipment classification during annual physical inventories.

Management Comments. DeCA concurred and stated that a new chapter on equipment accountability will be added to DeCA Directive 40-15 (instead of 40-2) by September 30, 1995.

3. Establish verification procedures to ensure that all regions perform monthly thorough and documented reconciliations of the DeCA subsidiary capital equipment and depreciation balances in the Plant Property and Accounting System to the general ledger balances in the Defense Business Management System.

Management Comments. DeCA concurred and stated that on August 31, 1994, a local directive was published with strengthened procedures for reconciling equipment and depreciation balances, and that an internal control checklist will be published by September 30, 1995, and scheduled for cyclical review.

Finding C. Construction In-Progress

The Commissary Surcharge Collections Fund's internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate construction in-progress account balance. The condition occurred because DFAS-CO did not establish a responsive general ledger accounting system for construction in-progress and DeCA did not effectively compensate for the inadequate DFAS-CO system. DeCA, in processing transactions to DFAS-CO or in attempting to establish detailed subsidiary accounts to support the DFAS-CO summary account balances, did not post all appropriate cost increases and decreases, subtract completed and transferred construction projects, and conduct effective monthly reconciliations to detect errors and omissions. As a result, the Statement of Financial Position reported construction in-progress account balance of $327.7 million was materially overstated by at least $248.1 million.

Background

In 1974, Congress authorized an increase in the Surcharge Collections rate charged commissary customers to generate funds for a new purpose: commissary construction. Congress authorized the use of surcharge collection funds for all phases of construction. United States Code, title 10, section 2685, states:

> (a) Notwithstanding any other provision of law, the Secretary of a Military Department, under regulation established by the Secretary of Defense, may, for the purpose of this section, provide for an adjustment of or surcharge on, sales prices of goods and services sold in the commissary store facilities.
>
> (b) The Secretary of a Military Department, under regulations established by him and approved by the Secretary of Defense, may use the proceeds from the adjustments or surcharges authorized by subsection (a) to acquire, construct, convert, expand, install, or otherwise improve commissary store facilities at defense installations *and for related environmental evaluation and construction cost, including surveys, administration, overhead, planning, and design.* [emphasis added]

In effect, the legislation made the Commissary Surcharge Collections Fund the primary construction appropriation for commissaries.

The DoD Accounting Manual provides the principles and standards that organizations should follow to account for construction. In short, all significant costs related to a construction project should be capitalized and accounted for as construction in-progress. Construction in-progress is a temporary asset account of the Commissary Surcharge Collections Fund that must be accumulated and controlled until the asset is transferred to the host installation. A summary

account should be established to accumulate all approved progress payments for projects meeting the prescribed criteria for capitalization, that is, real property constructed or altered for $25,000 or more and having a useful life of 2 years or more. Other progress payments and costs that should be capitalized include those for designing, administering, and managing projects and those for fixed or installed equipment. Because of the dollar significance as well as the fluctuating and temporary nature of the asset, construction in-progress payments must be controlled by detailed subsidiary accounts that support or provide a basis for:

- computing the summary account balance,
- making progress payments,
- meeting capitalization criteria,
- analyzing cash flow requirements, and
- determining the asset value to be transferred.

Completed construction that is transferred to host installations should be accounted for as reductions in the asset account "Construction In-Progress," and the equity of the Commissary Surcharge Collections Fund.

Account Balance

The Commissary Surcharge Collections Fund's internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate construction in-progress account balance. The Statement of Financial Position reported $327.7 million in construction in-progress. To determine the reasonableness of the balance, we performed a trend analysis and reviewed contracting records and management reports maintained by three organizations engaged to manage the DeCA major construction program: 3D/International, a commercial firm; the DeCA Design and Construction Division located in San Antonio, Texas; and the U.S. Air Force Air Education and Training Command's Contracting Squadron located in San Antonio, Texas. The balance for construction in-progress was substantially overstated. Normally, construction in-progress should remain fairly constant as a balance, because as a temporary asset, individual projects increase in value as work is performed; upon completion of work, they are decreased from the balance and transferred to host installations. However, the construction in-progress account actually increased by about $95 million (41 percent) since the end of FY 1993. Documentation available at organizations responsible for commissary construction could not substantiate such an increase. As Table 1 shows, the actual balance is likely some $248.1 million less than reported as of September 30, 1994.

Table 1. Comparison of Actual and Reported Balances for Construction In-Progress

Construction Activities	Balance Actual (millions)	Balance Reported (millions)
Reported Construction in Progress		$327.7
Design and Construction Division Projects (23)	$31.4	
3D/International Projects (11)	40.0	
Region Minor Construction Projects	8.2	
Total	**$79.6**	
Difference		**$248.1**

The above analysis represents actual ongoing projects according to management reports. To identify the major construction projects as of September 30, 1994, we used the October 1994 "Monthly Status Report" prepared by the DeCA Design and Construction Division. The gap between financial and construction management records evidences serious flaws in the internal control structure for processing and recording construction in-progress transactions.

Internal Control Structure at DFAS-CO

DFAS-CO did not establish a responsive accounting system for construction in-progress. Optimally, an accounting system should be automated and generate financial statement balances from an unbroken flow of source documents, journals, and ledgers. Such a system would likely have a low internal control risk. However, to account for Commissary Surcharge Collections Fund transactions and general ledger recordings, DFAS-CO used DBMS, a system with significant shortcomings when it comes to meeting the accounting requirements of the Commissary Surcharge Collections Fund and particularly construction in-progress. DBMS does not have cost accounting capability and does not have a general ledger account called "construction in-progress." As an alternative, DFAS-CO processes all construction in-progress transactions into an account called "Office Furniture and Equipment." This account can only record increases and decreases and produce summary totals; it is not controlled by subsidiary accounts for individual projects. Thus, DeCA must exercise control of individual projects off line. DFAS-CO recognized DBMS shortcomings in its FY 1994 Annual Statement of Assurance. DFAS-CO is considering system improvements, but off-line control of construction in-progress will continue to be required for some time. Until subsidiary control of construction in-progress is integrated and automated, the internal control environment will remain at high risk of generating inaccurate account balances.

Internal Control Structure at DeCA

DeCA was unable to compensate for the DFAS-CO inability to adequately report construction in-progress. During FY 1994, DeCA employed a "work around" system to capture construction in-progress by project to support the DFAS-CO summary totals. The initiative was formalized in a DeCA policy letter of June 11, 1993, "Recording Capital Construction in Progress in DeCA Financial Accounts," and subsequently as chapter 11 of DeCA Directive 70-7. Essentially, the initiative called for adapting and using the DeCA Property System as subsidiary accounts to record and control construction in-progress by project. Procedures have somewhat evolved or changed during the year but essentially still require the action of three organizations within DeCA: facilities, which is to obtain status reports on ongoing projects; logistics, which is to enter progress payment information into the Property System; and resource management, which is to enter the same financial information into DBMS and perform monthly reconciliations between DBMS and the Property System. Resource management is also to notify DFAS-CO of completed and transferred projects so that the construction in-progress account and the equity of the Commissary Surcharge Collections Fund can be reduced. Basically, the facilities, logistics, and resource management organizations at headquarters handle major construction, while their counterparts at regions are to perform the same duties for minor construction.

To determine the effectiveness of the DeCA internal control structure for construction in-progress, we reviewed ongoing projects to determine whether all appropriate charges and deletions were made to construction in-progress account balances. We also attempted to review monthly reconciliations to determine whether errors and omissions were detected in account balances. Our overall concern was to ascertain why the September 30, 1994, construction in-progress account balance appeared overstated by some $248.1 million.

Overall, the DeCA internal control structure was ineffective in processing and recording construction in-progress transactions. Foremost, DeCA did not fully implement its "work around" initiative by establishing project subsidiary accounts to control and support construction in-progress. Very few cost transactions were actually entered into the Property System. DeCA also did not follow its own initiative or the DoD Accounting Manual in recording costs and transfers in the official general ledger accounts and in performing reconciliations of construction in-progress. DeCA management needs to emphasize and monitor construction in-progress transaction processing and recording for any improvement to be realized in the accuracy of the account balance.

Costs. DeCA did not post all appropriate increases and decreases to construction in-progress account balances. According to the DoD Accounting Manual, the costs associated with the design, construction contracting, and construction phases should be capitalized. This includes costs for administration as well as fixed equipment. DeCA Directive 70-7 also provides that the contract cost of efforts associated with the design and construction phases of a project will be capitalized. However, DeCA did not capitalize all costs

associated with in-house project management, contract administration, and construction management services. Additionally, DeCA included the cost of noninstalled equipment and unsupported costs in construction in-progress.

In-House Project Management. DeCA did not capitalize and record in-house project management costs as construction in-progress. Within the Facilities Directorate of DeCA, the Design and Construction Division has nine functions including developing, coordinating, and executing DoD policy as it relates to the design and construction of commissary facilities. The division is authorized 24 employees, mostly engineers, and spends more than $1 million a year of operations funds for salaries, travel, and supplies. DeCA did not relate those costs to specific projects and capitalize them, because DeCA Directive 70-7 specifically prohibited it. Although the DoD Accounting Manual specifically provides for capitalizing all costs associated with construction, DeCA Directive 70-7 reads:

> All significant costs related to the construction or acquisition, other than the cost of salary and overhead for DeCA employees which shall be expensed, shall be recognized in capitalizing the costs of a project.

We did not attempt to relate and prorate the cost of in-house project management to individual projects; however, according to project status reports available at the Design and Construction Division, engineers were assigned to specific projects, evidencing a direct relationship for capitalization purposes. Nevertheless, the construction costs were expensed and paid for with operations funds.

Contract Administration. DeCA did not capitalize and record contract administration costs as construction in-progress. For FY 1994, DeCA sent the U.S. Air Force Air Education and Training Command's Contracting Squadron, an organization engaged by DeCA to award and administer construction contracts, about $0.6 million of operations funds for its services. At the contracting squadron, contracting officers were assigned to specific projects, evidencing a direct relationship for capitalization purposes. Nevertheless, the construction costs were expensed and paid for with operations funds.

Construction Management Services. DeCA did not capitalize and record management costs as construction in-progress. For FY 1994, DeCA engaged 3D/International, a commercial firm, to provide management services for commissary construction projects. The services included on-site inspection and acceptance of contractor work, evidencing a direct project relationship for capitalization purposes. Further, 3D/International status reports showed the cost of services by project. Recognizing the direct relationship, for FY 1994, we estimated that DeCA paid at least $0.7 million of Commissary Surcharge Collections Funds for the management services. Nevertheless, DeCA expensed all contract management services.

Fixed Equipment. DeCA did not limit construction in-progress recordings to equipment that would be installed and transferred upon completion of construction. DeCA Directive 70-7 distinguishes between fixed equipment and noninstalled capital equipment. The directive provides that only the cost of fixed equipment (such as cooling, heating, and electrical systems) will be

included in the cost of the facility being constructed. Noninstalled capital equipment (such as refrigerated display cases, scanning devices, and ovens) are not to be included in construction in-progress, because they will not be turned over to the host installation when construction is completed. However, DeCA did not follow those procedures and instead included noninstalled equipment in construction in-progress and added unsubstantiated dollar amounts as well.

Noninstalled Equipment. Our review of management reports and accounting records for six ongoing projects in FY 1994 showed that DeCA capitalized all noninstalled equipment as construction in-progress. For example, the construction contract for the Anderson Air Force Base commissary contained about $1.5 million to purchase equipment. All of the purchased equipment was recorded as construction in-progress. However, about $296,000 of the equipment was noninstalled equipment such as display shelving and checkout equipment. Misclassifications of equipment occurred because DeCA did not integrate budgetary and execution codes in the transaction and recording of equipment. Construction in-progress is recorded by function code: for equipment, there are three codes for distinguishing equipment to be capitalized and transferred, equipment to be capitalized but not transferred, and equipment to be expensed. However, approval documents used to record construction in-progress do not include the appropriate function codes but rather cite only accounting classifications. Since there was no crosswalk or other correlation between accounting classifications and function codes, DeCA often lumped and recorded equipment under one function code. Including noninstalled equipment in construction in-progress overstates the account and the amount to be transferred and understates capital equipment or expense accounts.

Unsubstantiated Amounts. Our review of DFAS-CO off-line journal entries to the construction in-progress account identified two large, unsubstantiated adjustments. On July 31 and September 30, 1994, DeCA sent general ledger adjustments of about $43.2 million and $22 million, respectively, to DFAS-CO. The main purpose of the two adjustments was to bring the DFAS-CO DBMS reported balance in line with the DeCA Property System capital equipment balance. The net of the two adjustments reduced (credited) the capital equipment account balance. However, DeCA did not document the need for increasing (debiting) the construction in-progress account balance by the same amount. DeCA maintained no details of the particular equipment to be added or the specific construction projects to be increased. DeCA Directive 70-7 does not discuss documenting off-line adjustments or assign approval responsibility. The fiscal reports branch initiated and approved both adjustments. In view of the inherent control weakness in the work-around system in place, off-line adjustments that affect a large percentage of an account balance should be elevated to at least division or directorate level.

Transfers. DeCA did not subtract completed and transferred construction projects from construction in-progress. Not deleting completed construction was undoubtedly the main reason for the DeCA construction in-progress account balance being overstated. According to DeCA Directive 70-7, facility organizations are to sign Transfer and Acceptance of Real Property forms (DD Forms 1354) prepared by contractors and forward them or similar documentation to logistics and resource management organizations to reduce the

DeCA subsidiary records and the DFAS-CO summary totals. However, the procedures were not followed for projects initiated by the Military Departments before DeCA was established or for projects initiated by DeCA.

Military Department Projects. DeCA did not reduce its construction in-progress account balance for commissary construction projects initiated by Military Departments and transferred to host installations. The September 30, 1994, account balance for construction in-progress contained about $152 million for projects initiated by the Military Departments and assigned to DeCA to manage in April 1992. The DFAS-CO journal voucher log shows that DeCA prepared just one voucher to reduce this account balance: the voucher was only for about $2.8 million on September 30, 1993, and did not identify the specific project. Millions of dollars worth of projects should have been reduced from the account, as shown in the following examples.

Camp Pendleton Commissary. Camp Pendleton accepted this commissary on March 1, 1993. However, the DeCA construction in-progress account as of September 30, 1994, still contained a balance of about $13 million for the commissary.

Fort Devens Commissary. Fort Devens accepted this commissary on September 1, 1991. However, the DeCA construction in-progress account as of September 30, 1994, still contained a balance of about $9 million for the commissary.

Fort Eustis Commissary. Fort Eustis accepted this commissary on February 4, 1992. However, the DeCA construction in-progress account as of September 30, 1994, still contained a balance of about $11 million for the commissary.

DeCA Projects. DeCA did not routinely reduce its construction in-progress account balance for commissary construction projects that it initiated. The DoD Accounting Manual and DeCA Directive 70-7 require that transfer documents be processed during the year as projects are completed. Although DeCA had established procedures for routinely processing transfer documents, they were not followed. For FY 1994, the DeCA Resource Management Directorate prepared one journal voucher for completed major construction projects. This occurred on September 30, 1994, and did not stem from a normal flow of DD Forms 1354. Rather, the reduction was the result of the DeCA Resource Management Directorate requesting the Facilities Directorate in September 1994 to provide DD Forms 1354 for projects completed in FY 1994. However, two of the DD Forms 1354 provided by the Facilities Directorate had not gone through a key step; specifically the forms for commissaries at Aberdeen Proving Ground and McChord Air Force Base had not been signed by the host installation as accepted although construction was virtually complete. Following the normal DD Form 1354 process or the established internal control structure would have ensured that the host installation accepted the property before DeCA reduced it from its construction in-progress account balance.

Reconciliations. DeCA did not conduct effective monthly reconciliations to detect errors and omissions in the construction in-progress account balances.

DeCA Directive 70-7 provides for resource management organizations to reconcile the DeCA subsidiary records to DFAS-CO summary totals. As of September 30, 1994, DFAS-CO and the 9th Finance Group reported trial balance totals for nine organization groups, as shown in Table 2.

Table 2. Reported Balances for Construction In-Progress

Organization Group	Balance
DeCA Headquarters	$167,729,893
Pre-DeCA (Military Departments)	151,791,477
Central Region	2,700,550
European Region	2,637,528
Midwest Region	515,773
Northeast Region	1,415,636
Northwest Region	709,724
Southern Region	170,345
Southwest Region	62,336
Total	**$327,733,262**

The reconciliations should essentially make sure that project balances shown in the Property System collectively agree with the official summary totals contained in DBMS. Only regional organization groups made any attempt to perform prescribed monthly reconciliations. Responsibility for reconciling the pre-DeCA construction balance was not even assigned, although the balance was the second largest and likely included many projects that were already completed. DeCA did not attempt to reconcile its two largest balances, because facility cost information was not entered into the Property System as prescribed. In effect, there was nothing to reconcile to the official summary totals. Resource management personnel at DeCA Headquarters told us that subsidiary balances were not developed in the Property System because of difficulty in gathering, identifying, and classifying cost information by project. In our opinion, this should have been foreseen and addressed in DeCA Directive 70-7. DeCA Directive 70-7 provides no detailed, step-by-step description of the transaction process needed to properly account for construction in-progress. Unless DeCA develops and maintains documented support for DFAS-CO summary totals by project, reconciliations will be precluded and the summary totals will remain unsubstantiated.

Materiality and Impact on the Surcharge Statement of Financial Position

The internal accounting controls over construction in-progress were materially deficient. The DoD Financial Management Regulation contains guidance on what constitutes a material deficiency in an accounting system. The regulation provides 13 key accounting requirements that systems must reasonably comply with to meet standards established by the General Accounting Office, OMB, the U.S. Treasury, and DoD. The second key accounting requirement deals with system controls over property and indicates that an accounting system must

include periodically taking physical inventories and reconciling subsidiary records to general ledger accounts. Also, the eighth key accounting requirement deals with audit trails and provides that a system should ensure that transactions are correctly classified, coded, and recorded in all affected accounts. According to the regulation, a departure from a key accounting requirement is considered a material deficiency if it could result in loss of control over 5 percent or more of the measurable resources for which the accounting system is responsible. The Statement of Financial Position reported a construction in-progress balance of $327.7 million as of September 30, 1994; applying the regulation's materiality criterion of 5 percent to the construction in-progress balance would mean that a material deficiency would occur if construction in-progress was $16.4 million more or less than the reported amount. Construction in-progress was at least $248.1 million less than the reported amount; therefore, the internal control structure of accounting for, and conducting inventories and reconciliations of, construction in-progress is materially deficient. Accordingly, the construction in-progress balance of $327.7 million presented in the Statement of Financial Position cannot be relied upon and is materially overstated.

Management Comments on the Finding and Audit Response

DeCA commented on the finding. See Appendix C for specific DeCA comments and audit responses.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Commissary Agency:

1. Amend Defense Commissary Agency Directive 70-7 to:

a. Provide a detailed, step-by-step description of the transaction process needed to properly account for and document construction in-progress costs.

Management Comments. DeCA partially concurred and stated that local procedures will be reviewed for adequacy and necessary changes will be made by August 31, 1995.

Audit Response. The DeCA comments are responsive.

b. Conform with the DoD Accounting Manual for capitalizing all construction in-progress costs, both in-house and solicited.

Management Comments. DeCA partially concurred and stated that construction services that are contracted for would be capitalized but that capitalizing in-house labor costs is prohibited by law.

Audit Response. The DeCA comments are partially responsive. However, we disagree with DeCA comments regarding capitalization of in-house labor costs. Existing statutes only prohibit capitalizing in-house labor costs associated with operating commissary stores--not with constructing them. Capitalizing in-house labor costs associated with construction would be consistent with the DoD Accounting Manual, which provides a subsidiary account, "Construction in Progress-In-House," for recording the cost of construction performed by DoD personnel. We request that DeCA reconsider its position and provide additional comments in its response to the final report.

c. Provide documentation and approval requirements for off-line journal entries for construction in-progress.

Management Comments. DeCA partially concurred and stated that local procedures will be reviewed for adequacy and that necessary changes would be made by August 31, 1995.

Audit Response. The DeCA comments are responsive.

2. Establish verification procedures to ensure that construction in-progress subsidiary ledgers are established and costs are posted in accordance with DeCA Directive 70-7.

Management Comments. DeCA partially concurred and stated that local procedures will be reviewed for adequacy and necessary changes would be made by August 31, 1995.

Audit Response. The DeCA comments are responsive.

3. Establish a crosswalk or extend the accounting classification codes so that equipment acquired can be easily correlated with the appropriate construction in-progress function code.

Management Comments. DeCA concurred and stated that a system change request was prepared for implementation by July 1995.

4. Establish verification procedures to ensure that construction in-progress recordings in subsidiary and general ledger accounts are appropriate and accounted for uniformly, completed construction is transferred, and reconciliations are performed.

Management Comments. DeCA partially concurred and stated that local procedures will be reviewed for adequacy and that necessary changes will be made by August 31, 1995.

Audit Response. The DeCA comments are responsive.

Finding D. Accounts Payable

The Commissary Surcharge Collections Fund's internal control structure over transaction processing and general ledger recordings did not provide reasonable assurance of an accurate accounts payable balance. The condition occurred because DeCA did not establish effective input controls over receipts and payables, and DFAS-CO did not establish an effective review process to ensure the integrity of the accounts payable balance. As a result, the $95.1 million accounts payable balance on the Statement of Financial Position contained overstatement errors of as much as $58.9 million and is probably materially overstated.

Background

The Commissary Surcharge Collections Fund accounts payable represent monies that DeCA owes military installations for commissary support (electricity, heating, and so forth) and commercial firms for construction in-progress, equipment, and supplies. The DoD Accounting Manual provides the principles and standards that organizations should follow to account for accounts payable. The recording of an accounts payable is the first transaction-level entry in the proprietary accounts. Until property or services are received, transactions are to be recorded in the budgetary accounts as undelivered orders. When an accounting station receives evidence that performance has occurred, the transaction is to be recorded simultaneously in the budgetary accounts as an accrued expenditure unpaid and in the proprietary accounts as an accounts payable. The basis for recording an accounts payable is a receiving report that clearly shows the property or services received and accepted.

The Statement of Financial Position reported $95.1 million in accounts payable. Of this amount, $80.7 million was recorded in the general ledger of the DBMS maintained by DFAS-CO. The remaining $14.4 million was recorded in the general ledger of the Standard Finance System maintained by the 9th Finance Group - Subsistence Finance and Accounting Office. Before August 1993, DFAS-CO posted commissary receipts and, in turn, accounts payable into DBMS based on documentation furnished by resource management offices at DeCA headquarters and regions. Subsequently, the DeCA resource management offices posted the information directly into DBMS through a communications network and sent copies of the receipt documents to DFAS-CO to be used in authorizing payments.

Account Balance

The Commissary Surcharge Collections Fund's internal control structure over transaction processing and general ledger recordings did not provide reasonable

assurance of an accurate accounts payable balance. To establish the reasonableness of the DeCA-reported balance as of September 30, 1994, we performed several trend and cross-sectional analyses of the DBMS general ledger maintained by DFAS-CO. Based on our analyses, the trial balance for accounts payable was substantially overstated.

Payment Analysis. The accounts payable balance was overstated in relation to the monthly obligation rate and payment practices. Accounts payable should be compatible with obligation rates under normal buying, receiving, and paying cycles. Also, payment incentives are usually sufficient to keep the accounts payable balance to 30 days or less. Contractors normally demand payment within 30 days and often provide discount terms to induce early payment. Further, the Prompt Pay Act requires payment within 30 days or a penalty must be paid. During FY 1994, DeCA obligated surcharge collections funds at a rate of $21.8 million a month outside Europe, so the ending balance of accounts payable should have approximated this monthly obligation rate. However, the accounts payable balance was actually $80.7 million, or $58.9 million (3.7 times) more than the monthly obligation rate. In the absence of any unusual buying activity or large payment penalties, the only explanation for the accounts payable balance is that it is overstated.

Activity Analysis. The accounts payable balance was overstated in relation to region expense profiles. Accounts payable should also be compatible with expense rates under normal buying, receiving, and paying cycles. All DeCA regions operate under the same accounting system and have about the same operational requirements. Assuming a 30-day payment cycle, the ending balance of accounts payable for expenses should approximate one-twelth, or 8 percent, of annual expenses. However, Table 3 shows that five of the six regions within the continental United States exceeded the 8-percent measurement by up to five times.

Table 3. Regional Expense Profile as of September 30, 1994

Region	Annual Expenses (millions)	Accounts Payable Balance (millions)	Accounts Payable Percentage
Central	$19.7	$5.6	28
Midwest	15.2	1.1	7
Northeast	23.9	10.2	43
Northwest	18.4	7.0	38
Southern	29.1	5.4	19
Southwest	27.2	11.6	43

In the absence of any unusual expenditure requirements, the only explanation for five of the regions' high accounts payable balances is that they are overstated.

Invoice Analysis. The accounts payable balance with non-Federal entities was overstated in relation to commercial invoices on hand. Invoices are the bills from the providers of property or services and are usually submitted when property or services are provided and accepted. As such, the balance of invoices on hand should approximate the accounts payable balance. The

DFAS-CO paying office for the Commissary Surcharge Collections Fund is consolidated with the Commissary Operations Fund and the Defense Logistics Agency's Depot Operations Fund. As of September 30, 1994, a consolidated listing of commercial invoices for the three funds amounted to about $5 million. In contrast, the commercial accounts payable balance for just the Commissary Surcharge Collections Fund amounted to about $22.5 million. In the absence of a large number of late billings, the only explanation for the accounts payable balance for commercial providers is that it is overstated.

Account Analysis. The accounts payable balance was overstated considering the date and type of account entries. We obtained from DFAS-CO a hard copy listing of Commissary Surcharge Collections Fund accounts payable as of September 30, 1994. The listing contained about 19,900 entries and a breakout by age. Of the $80.7 million reported balance, $41 million represented property and services ordered and likely received in FY 1992 or FY 1993. About 47 percent of the reported entries had not had any activity for at least 6 months and were likely invalid. Again, taking into account payment practices, the only explanation for an account balance made up largely of dated entries is that it is overstated. Further, the $80.7 million reported balance included about $17.4 million of negative entries, including one large single entry of $5.2 million that was generated by the Military Departments before DeCA and DFAS-CO were established. Negative entries are erroneous; they can come about only by not recording the receipt (payable), overpaying the invoice (payable), or not crediting the payment to the correct accounts payable. Negative entries can falsely decrease the accounts payable balance, if they are the result of not recording receipts or overpaying invoices. As such, the negative entries can have the effect of understating the overstated accounts payable balance.

Internal Control Structure

DeCA did not establish effective input controls over receipts and payables, and DFAS-CO did not establish an effective review process to ensure the integrity of the accounts payable balance. To establish the effectiveness of the DeCA internal control structure for accounts payable, we attempted to review transaction processing and general ledger recordings for 81 suspect accounts payable balances. We selected the 81 balances judgmentally from accounts generated by DeCA headquarters and two regions: Central and Northeast. The 81 balances amounted to $20.3 million, including $3.3 million stemming from negative entries. The 81 balances were equally distributed over the last 3 fiscal years and, in 27 cases, had no activity for at least 6 months. The change in input responsibility from DFAS-CO to DeCA, coupled with source documents often not being readily available, made our analysis very difficult. In fact, we were unable to draw a conclusion on 22 balances. Nevertheless, we concluded that 11 balances were supported and 48 balances, totaling about $6.2 million in absolute values, were erroneous. The erroneous balances were caused by processing and recording breakdowns at both DeCA and DFAS-CO.

DeCA. DeCA posted and generated inaccurate and unsupported accounts payable balances. The DoD Accounting Manual provides that liabilities will be posted to accounting records as they occur. Most of the erroneous balances occurred because DeCA did not abide by the precepts of accrual accounting. Of the 48 erroneous balances, DeCA posted payables for 25 not on the basis of receipts but on the basis of funding and obligation documents. Here are two examples of not following accrual precepts.

o As of September 30, 1994, DeCA had an erroneous accounts payable balance of $1,740,000 for communication services to European commissary stores. DeCA headquarters obligated the entire amount and posted the entire amount as received based on a financial plan. DeCA Headquarters had no evidence of the services actually being received, and DFAS-CO had no evidence of invoices or disbursements for the services.

o As of September 30, 1994, DeCA had an erroneous accounts payable balance of $68,616 for a scale and wrapper system at the Little Rock Air Force Base commissary. The Central Region purchased the system for $68,616 and posted a receipt for the same amount in September 1994. However, the commissary did not receive the system until November 1994.

The remaining 23 erroneous balances were caused by DeCA posting receipts against wrong document numbers or not posting receipts although the property or services had been received. In 16 cases, DeCA posted the receipts with the wrong function code; see Finding C, Construction In-Progress, for additional discussion under the paragraph titled "Noninstalled Equipment." In six cases, DeCA did not post the receipts because the receivers of property or services did not process receipt information. The following are examples of incorrect and late postings.

o As of September 30, 1994, DeCA had an erroneous negative accounts payable balance of $528,301 for fixed equipment at the Portsmouth Naval Shipyard commissary in New Hampshire. The commissary received the equipment in July 1994, but DeCA headquarters posted the receipt under an incorrect document number. When DFAS-CO paid the contractor in September, the correct payable could not be credited and a negative balance was generated.

o As of September 30, 1994, DeCA had an erroneous negative accounts payable balance of $118,560 for automatic data processing services at its headquarters. DeCA contracted for the services in October 1993 at a monthly rate of $19,760. As of September 30, 1994, DFAS-CO had paid invoices for 10 months of service, but DeCA headquarters had posted only 4 months of receipts. Because DeCA headquarters did not post 10 months of receipts, a negative accounts payable balance was generated by the DFAS-CO disbursements.

DFAS-CO. DFAS-CO did not conduct adequate periodic reviews and reconciliations of accounts payable balances. The DoD Accounting Manual provides that periodically, but at least annually, accounts payable balances shall be reconciled to supporting documentation and that differences shall be

researched and any necessary adjustments shall be fully documented. However, DFAS-CO did not identify any necessary adjustments for any of the 47 erroneous balances, even though many of the account balances went back at least 2 years without any activity. Periodic reviews are particularly needed at DFAS-CO because of its bill-paying process. DFAS-CO pays bills after matching invoices with receipts; it does not check accounts payable in the payment process. Responsible DFAS-CO personnel told us that the reason accounts payable are not checked is that the reported payables generated by DeCA are not reliable. Because accounts payable are not matched with receipts and invoices and play no control role in the payment process, DFAS-CO did not emphasize reviews and reconciliations, thus allowing negative and dated balances to perpetuate themselves. We believe accounts payable should be matched to invoices and receipts in the payment process to provide added control as well as to enhance the accuracy of account balances.

Materiality and Impact on the Surcharge Statement of Financial Position

The internal accounting controls over accounts payable were materially deficient. The DoD Financial Management Regulation contains guidance on what constitutes a material deficiency in an accounting system. The regulation provides 13 key accounting requirements that systems must reasonably comply with to meet standards established by the General Accounting Office, OMB, the U.S. Treasury, and DoD. The ninth key accounting requirement deals with accounts payable and specifies that payables should be recorded in the proper accounting period and that the liability reported in annual financial statements shall reflect amounts due for goods and services received. Also, the eighth key accounting requirement deals with audit trails and provides that a system should ensure that transactions are correctly classified, coded, and recorded in all affected accounts. According to the regulation, a departure from a key accounting requirement is considered a material deficiency if it could result in loss of control over 5 percent or more of the measurable resources for which the accounting system is responsible. The Statement of Financial Position reported an accounts payable balance of $95.1 million as of September 30, 1994. Applying the regulation's materiality criterion of 5 percent to the accounts payable balance would mean that a material deficiency would occur if accounts payable were $4.8 million more or less than the reported amount. Based on our analyses, the reported accounts payable balance contains overstatement errors of as much as $58.9 million. However, our analysis did not include all payables or test detailed accounting transactions and, accordingly, there could be offsetting errors. Nevertheless, the internal control structure is materially deficient, because the potential loss of control from not adhering to accrual precepts and making effective reviews well exceeds the $4.7 million criteria for materiality. As such, the accounts payable balance of $95.1 million presented in the Statement of Financial Position cannot be relied upon and could be materially misstated.

Management Comments on the Finding and Audit Response

DeCA commented on the finding. See Appendix C for specific DeCA comments and audit responses.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Commissary Agency:

a. Adhere to the DoD Accounting Manual by posting accounts payable as they occur to accounting ledgers.

Management Comments. DeCA concurred and stated that improved procedures were published in a local directive and that a management control checklist will be added by September 30, 1995, and scheduled for cyclical review.

b. Issue guidance to all organizations, emphasizing the importance of processing receipt information as property and services are received.

Management Comments. DeCA concurred and stated that procedures were reissued in a local directive and that a reminder to process receipt information timely will be sent to regions and commissaries by June 30, 1995.

2. We recommend that the Director, Defense Finance and Accounting Service-Columbus Center:

a. Match receipts and invoices to accounts payable balances in the payment process.

Management Comments. DFAS-CO concurred and stated that an Obligation Management Implementation Plan was completed and that a Front End Validation team began performing 100 percent validation of accounting information in March 1995.

b. Conform to the DoD Accounting Manual by making periodic reviews of accounts payable balances.

Management Comments. DFAS-CO concurred and stated that the Operational Review Embedded Program would be used to review DeCA accounts payable balances on an annual basis. The first audit is scheduled to be completed by July 1995.

Part II.B. - Review of Compliance with Laws and Regulations

Introduction

We evaluated the Commissary Surcharge Collections Fund for material instances of noncompliance with laws and regulations. The statement accounts on which we based our evaluation are presented in the Statement of Financial Position, as of September 30, 1994. The Statement of Financial Position was submitted to us on December 30, 1994. The Statement of Financial Position essentially shows the worth of the Commissary Surcharge Collections Fund by comparing its assets and liabilities as of the end of a fiscal year. DeCA reported assets of $808 million and liabilities of $95.1 million on the Statement of Financial Position. The Fund consists of five major account balances including cash, accounts receivable, capital equipment (less depreciation), construction in-progress, and accounts payable. DeCA has financial management responsibility for the Commissary Surcharge Collections Fund while DFAS-CO and the 9th Finance Group, Subsistence Finance and Accounting Office, Germany provide accounting services. Compliance with laws and regulations is the responsibility of the Fund managers.

As part of obtaining reasonable assurance on whether the Statement of Financial Position is free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statement and other laws and regulations designated by OMB and DoD. Such tests are required by the Chief Financial Officers Act of 1990. The laws and regulations used as a basis for our review were:

o United States Code, title 31, section 3512 (formerly the Federal Managers' Financial Integrity Act of 1982, Public Law 97-255);

o Chief Financial Officers Act of 1990, Public Law 101-576;

o OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993;

o DoD Regulation 1330.17-R, "Armed Services Commissary Regulation," April 1987;

o DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987;

o DoD Manual 7220.9-M, "DoD Accounting Manual," October 1993; and

o DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 1, "General Financial Management Information, Systems, and Requirements," May 1993.

We also obtained an understanding of the DeCA process for evaluating and reporting on internal control and accounting systems as required by United

States Code, title 31, section 3512. We compared the material weaknesses reported in the DeCA Annual Statement of Assurance for FY 1994 to the material weaknesses we found during our evaluation of the Commissary Surcharge Collections Fund's internal control structure and reported in Section II. A. of this report.

Reportable Conditions

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions in laws or regulations. Such failures or violations are those that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the principal statements or those whose sensitive nature would cause them to be perceived as significant. Our examination disclosed instances of noncompliance with laws and regulations that materially affected the reliability of the Statement of Financial Position. The instances of noncompliance were considered when forming our position not to render an opinion on the Statement of Financial Position. The results of our tests disclosed the following instances of noncompliance.

Cash. The DoD Accounting Manual and the DoD Financial Management Regulation were not fully complied with in processing and recording cash transactions. The DoD Accounting Manual requires that undistributed collections and disbursements of cash be researched as part of verifying the general ledger balance to the official cash balance maintained by the U.S. Treasury. The DoD Financial Management Regulation requires that an accounting system allow for the prompt detection and tracing of rejected or suspended transactions, such as unmatched disbursements. However, DeCA did not reconcile the general ledger account balance to the U.S. Treasury balance and the accounting system in place allowed undistributed collections and disbursements to reach unreasonable levels. Because applicable regulations were not complied with in accounting for cash, the official cash position presented in the Statement of Financial Position reflected $65.4 million less collections and $91.7 million less disbursements than the general ledger accounts and could be materially misstated.

Capital Equipment. The DoD Accounting Manual and the DoD Financial Management Regulation were not fully complied with in processing and recording capital equipment transactions. The DoD Accounting Manual provides capital equipment accounting standards to include establishing subsidiary records for reconciling with general ledger accounts and calculating depreciation in the period in which benefits result from the asset's use. The DoD Financial Management Regulation specifies that an accounting system must include periodically taking physical inventories and reconciling subsidiary records to general ledger accounts. However, DeCA did not perform required comprehensive physical inventories at all commissaries and reconcile subsidiary records to the DFAS-CO general ledger account balance. DeCA also did not record all accumulated depreciation. Because the applicable regulations were

not complied with in accounting for capital equipment, the net capital equipment balance of $45.8 million presented in the Statement of Financial Position can not be relied upon and could be materially misstated.

Construction In-Progress. The DoD Accounting Manual and the DoD Financial Management Regulation were not fully complied with in processing and recording construction in-progress transactions. The DoD Accounting Manual provides that all significant costs related to a construction project should be capitalized and accounted for as construction in-progress. The DoD Financial Management Regulation provides that an accounting system must include periodically taking physical inventories and reconciling subsidiary records to general ledger accounts and ensure that transactions are correctly classified, coded, and recorded in all affected accounts. However, DeCA did not capitalize all appropriate costs, maintain adequate subsidiary records, perform required reconciliations, and promptly remove completed projects from the general ledger balance. Because the applicable regulations were not complied with in accounting for construction in-progress, the construction in-progress balance of $327.7 million presented in the Statement of Financial Position cannot be relied upon and is materially overstated.

Accounts Payable. The DoD Accounting Manual and the DoD Financial Regulation were not fully complied with in processing and recording accounts payable. The DoD Accounting Manual provides that liabilities will be posted to accounting records as they occur. The DoD Financial Management Regulation provides that payables should be recorded in the proper accounting period and that the liability reported in the annual financial statements shall reflect amounts due for goods and services received. The DoD Financial Management Regulation also provides that an accounting system should ensure that transactions are correctly classified, coded, and recorded in all affected accounts. However, DeCA did adhere to prescribed accrual precepts, and DFAS-CO did not establish an effective review process for ensuring the integrity of accounts payable balances. Because the applicable regulations were not complied with in accounting for accounts payable, the accounts payable balance of $95.1 million presented in the Statement of Financial Position can not be relied upon and could be materially misstated.

Internal Control Program. United States Code, title 31, section 3512, and DoD Directive 5010.38 were not fully complied with in establishing and assessing internal controls. United States Code, title 31, section 3512, requires agencies to establish internal accounting and administrative controls in accordance with standards instituted by the Comptroller General. United States Code, title 31, section 3512, also requires agencies to establish a comprehensive system of internal control management to properly record and account for revenues and expenditures, prepare reliable financial and statistical reports, and maintain accountability over assets. DoD Directive 5010.38 provides the management system for achieving the objectives of United States Code, title 31, section 3512. In its FY 1994 Annual Statement Assurance, DeCA reported a material weakness in achieving the objectives of United States Code, title 31, section 3512. DeCA acknowledged in the statement that it had not complied with established financial procedures in managing the Commissary Surcharge Collections Fund. The source identifying the weaknesses was Inspector

General, DoD, audit reports. DeCA also did not implement an effective internal management control program that assessed the adequacy of internal controls over the assets and liabilities of the Commissary Surcharge Collections Fund. In April 1993, DeCA rated the Commissary Surcharge Collections Fund accounting as a highly vulnerable functional area in its Management Control Plan based on Inspector General, DoD, Report No. 93-145, "Defense Commissary Surcharge Collections Fund Financial Statements for FY 1992," June 30, 1993. However, no in-house management control reviews were performed during FY 1993 or FY 1994. Management control review checklists covering capital equipment, construction in-progress, and accounts payable were not published until August 31, 1994. Consequently, the material weaknesses we identified were not surfaced, reported in the annual statement required by United States Code, title 31, section 3512, or scheduled for corrective action.

Presentation. The DoD Accounting Manual and OMB Bulletin No. 94-01 were not fully complied with in accounting for and describing material differences in the cash balance of the U.S. Treasury, which maintains the official cash balance to be reported in financial statements, and the combined general ledger account balance maintained by DFAS-CO and the 9th Finance Group. Differences in the cash balances represent collections or disbursements that have been distributed (recorded) in either, but not both, the U.S Treasury account and the general ledger account. The DoD Accounting Manual provides that collections and disbursements that have not been fully distributed be recorded in the general ledger cash balance at yearend as well as adjusted against accounts receivable and accounts payable general ledger balances, respectively. Such action is to bring the general ledger cash balance in line with the U.S Treasury balance and to represent the likely positions of receivables and payables had all collections and disbursements been distributed; the adjustments are to be reversed at the start of the subsequent year. OMB Bulletin 94-01 provides for describing material cash balance differences in Note 2 to the financial statements. As of September 30, 1994, the U.S Treasury reported $406.7 million of cash on hand in the Commissary Surcharge Collections Fund, whereas the general ledger account balance amounted to $380.4 million, or $26.3 million less. The $26.3 million difference was made up of $65.4 million in undistributed collections and $91.7 million in undistributed disbursements. DeCA, however, did not explain the cash difference in terms of undistributed collections and disbursements and did not make the appropriate adjustments to the yearend accounts receivable and accounts payable general ledger balances. Instead, DeCA merely noted that the general ledger cash balance was $26.3 million less than the U.S. Treasury balance and posted that net amount to the accounts receivable general ledger balance, thereby mitigating the materiality of the actual difference in the cash balances and substantially misstating the accounts receivable and accounts payable balances.

Reportable Conditions Not Noted

Our evaluation of laws and regulations would not necessarily disclose all instances of noncompliance considered to be material and reportable. With

respect to items not tested, nothing came to our attention that caused us to believe that DeCA and DFAS-CO had not complied, in all material respects, with those laws and regulations identified above.

Management Comments on the Review of Compliance with Laws and Regulation.

DeCA commented on the Review of Compliance with Laws and Regulations. See Appendix C for specific DeCA comments and audit responses.

Part III - Additional Information

Appendix A. Scope and Methodology

We examined the Statement of Financial Position and related notes for the Commissary Surcharge Collections Fund, as of September 30, 1994. Other principal statements and related notes prepared by DeCA, but not examined by us, include the Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expense. The Statement of Financial Position essentially shows the worth of the Commissary Surcharge Collections Fund by comparing its assets and liabilities as of the end of a fiscal year. DeCA reported assets of $808 million and liabilities of $95.1 million on the Statement of Financial Position. The Statement of Financial Position includes five major account balances including cash, accounts receivable, capital equipment (less depreciation), construction in-progress, and accounts payable. DeCA has financial management responsibility for the Commissary Surcharge Collections Fund while DFAS-CO and the 9th Finance Group, Subsistence Finance and Accounting Office, Germany, provide accounting services. The Statement of Financial Position on which we made our examination was submitted to us on December 30, 1994.

Scope

We evaluated the DeCA internal control structure related to the Commissary Surcharge Collections Fund and compliance to directly related laws and regulations at DeCA Headquarters, 2 regions, and 10 commissary stores in the continental United States. We selected regions for evaluation because they process receipt information for assets and services other than major construction as well as maintain property accountability records. We selected stores for evaluation because they maintain actual equipment on hand and initiate much of the receipt documentation supporting asset balances and accounts payable. Our review covered the Statement of Financial Position and related general ledger account balances as of September 30, 1994. In making our review, we verified or attempted to verify balances to subsidiary records and supporting source documentation either generated by accounting systems or by related logistical systems. We judgmentally selected the particular regions and commissary stores for evaluation based on a mix of sales volume, Military Department customers, and extent of previous audit coverage.

We also evaluated the DFAS-CO internal control structure related to the Commissary Surcharge Collections Fund and compliance to directly related laws and regulations. DFAS-CO maintains DBMS, which operates the general ledger accounts for the Commissary Surcharge Collections Fund. Cash transaction histories were also reviewed at DFAS-Cleveland and DFAS-Indianapolis, which have roles in reconciling and reporting the cash balance of the Commissary Surcharge Collections Fund. Further, we reviewed management records maintained by the U.S. Air Force Air Education and Training Command's Contracting Squadron, which awards commissary

construction contracts, and 3D/International, a commercial contractor, which oversees construction projects in progress. Additionally, we reviewed property disposal records of commissary equipment from the Defense Reutilization and Marketing Service.

Methodology

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, including the accompanying notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement presentation. We developed a client profile for the Commissary Surcharge Collections Fund and developed a general risk analysis that assessed the internal control structure. We believe that our audit efforts provide a reasonable basis for our results.

Computer-Processed Information. We reviewed computer-processed data from DeCA and DFAS organizations. We independently verified the source data for selected transactions but not in sufficient quantities to draw conclusions on the overall reliability of the computer-processed data. We did not use statistical sampling procedures to conduct this audit.

Internal Management Control Program. Our internal control evaluation included implementation of the DeCA and the DFAS-CO internal management control program. The purposes of this evaluation were to:

o determine our auditing procedures for expressing an opinion on the Statement of Financial Position and

o determine whether the internal control structure was established to ensure that the statements were free of material misstatements.

That determination included obtaining an understanding of the internal control policies and procedures, as well as assessing the level of control risk relevant to all significant cycles, classes of transactions, and account balances. For those significant control policies and procedures that had been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed.

Time Period and Locations. This financial statement audit was made during the period July 20, 1994, through January 11, 1995. A complete list of the locations we visited and contacted is in Appendix C.

Appendix B. Summary of Prior Audits

During the last 3 years, the Inspector General, DoD, has issued two audit reports relating to the Chief Financial Officers Act and addressing the DeCA internal control program related to the Commissary Surcharge Collections Fund. The reported conditions, recommendations, and management comments are summarized below.

o Inspector General, DoD, Report No. 94-157, "Defense Commissary Agency Financial Management Improvement Program," June 30, 1994, stated that DeCA had made significant improvements in six Financial Management Improvement Program functional areas, two of which included asset and liability accounts of the Commissary Surcharge Collections Fund. DeCA had established procedures for recording expenses and accounts payable when incurred and had begun accounting for capital equipment and construction in-progress. The audit disclosed no material deficiencies in implementing the DeCA Financial Management Improvement Program. DeCA management agreed with the report.

o Inspector General, DoD, Report No. 93-145, "Defense Commissary Surcharge Collections Fund Financial Statements for FY 1992," June 30, 1993, stated that an internal control structure was not established to provide reasonable assurance that material misstatements would be prevented or detected in a prompt manner. Financial accounts were not developed and maintained in accordance with existing Federal laws and regulations governing trust fund financial accounting. Significant financial accounts were developed off line. DeCA used manually gathered and incomplete data to control and report financial transactions. The normal financial system of source documents, journals, and ledgers did not flow into the financial statements. DeCA management generally agreed with the report and indicated that corrective action would be or had been taken.

Appendix C. Other Management Comments and Audit Response

DeCA Comments on Cash and Accounts Payable Accounting Services. DeCA stated that accounting services for the European Region were not transferred to DFAS-CO after the end of FY 1994, as stated on pages 10 and 33 of the draft audit report.

Audit Response. We deleted mention of the planned transfer of services in the final audit report.

DeCA Comments on Cash Materiality and Impact (Finding A, page 13). DeCA stated that DFAS-CO and the 266 Theater Finance Command (changed October 1, 1994, from the 9th Finance Group) are responsible for processing, reconciling, and researching collection and disbursement transactions affecting DeCA cash.

Audit Response. As cash manager for the Surcharge Collections Fund, DeCA was required to reconcile its balance with the U.S. Treasury; however, as noted in the report, neither DeCA nor the servicing finance and accounting offices were in a position to perform effective cash reconciliations.

DeCA Comments on Capital Equipment Reconciliations (Finding B, page 18). DeCA stated that documentation for two adjustments totaling $63 million was available during the audit but was not requested for review by us.

Audit Response. We requested and reviewed all documentation on file in support of the two adjustments at both DeCA and DFAS-CO. Neither of the adjustments was supported by transaction listings of the particular equipment that needed to be added or reduced from financial records. Had the first adjustment been properly supported, there would have been no need for the second adjustment, which was made to offset about half the amount of the first adjustment and to bring the DFAS-CO financial balance in agreement with the DeCA equipment inventory balance.

DeCA Comments on In-House Project Management Costs (Finding C, page 25). DeCA stated that in-house labor cannot be capitalized in construction in-progress because of legal restrictions: statutory provisions of 10 United States Code, section 2484 (commissary operations costs which must be funded with surcharge collections), and 10 United States Code, section 2485 (authorized commissary construction costs to be funded with surcharge funds).

Audit Response. The statutes cited by DeCA only prohibit capitalizing in-house labor costs associated with operating commissary stores--not with constructing them. Not capitalizing in-house labor costs associated with construction is inconsistent with the DoD Accounting Manual, which requires capitalizing all costs associated with construction and even provides a subsidiary

account, "Construction in Progress-In-House," for recording the cost of construction performed by DoD personnel.

DeCA Comments on Accounts Payable Invoice Analysis (Finding D, page 32). DeCA did not agree with our using commercial invoices to measure the accuracy of the commercial accounts payable balance for commissary operations.

Audit Response. The use of commercial invoices to measure the accuracy of the commercial accounts payable balance was not the sole basis for concluding that accounts payable were overstated. Our conclusion was based on several trend and cross-sectional analyses, all of which indicated that accounts payable were overstated.

Management Comments on an Example of an Erroneous Accounts Payable Balance (Finding D, page 34). DeCA did not agree that a $1.74 million accounts payable balance for communication services in Europe was erroneous.

Audit Response. We considered the balance erroneous because there was no receipt documentation on file at DeCA headquarters or DFAS-CO to support an accrual balance throughout FY 1994. The services may have been provided, but the balance owed was supported solely by an annual funding document for communication services.

DeCA Comments on the Internal Control Program (Part II. B., Compliance with Laws and Regulations, page 40). DeCA noted that, although a self-assessment of surcharge collections controls had not been made, several other management initiatives had been made to improve financial controls. DeCA also noted that it has continued to disclose material financial weaknesses and work to correct them.

Audit Response. We cited the financial improvement initiatives made by DeCA in the report and recognize the effort of DeCA personnel to improve financial accounting and reporting of the Surcharge Collections Fund.

Appendix D. Organizations Visited or Contacted

Department of the Air Force

Air Education and Training Command, Contracting Squadron, Randolph Air Force Base, TX

Defense Agencies

Defense Commissary Agency, Fort Lee, VA
- Defense Commissary Agency, Central Region, Little Creek Naval Amphibious Base, VA
  - Fort Eustis Commissary, Newport News, VA
  - Fort Story Commissary, Virginia Beach, VA
  - Langley Air Force Base Commissary, Hampton, VA
  - Little Creek Naval Amphibious Base Commissary, Little Creek, VA
  - Portsmouth Naval Station Commissary, Portsmouth, VA
- Defense Commissary Agency, Northeast Region, Fort Meade, MD
  - Annapolis Naval Station Commissary, Annapolis, MD
  - Bolling Air Force Base Commissary, Washington, DC
  - McGuire Air Force Base Commissary, Pemberton, NJ
  - Philadelphia Naval Station Commissary, Philadelphia, PA
  - Quantico Marine Corps Base Commissary, Quantico, VA

Defense Finance and Accounting Service-Cleveland Center, Cleveland, OH
Defense Finance and Accounting Service-Columbus Center, Columbus, OH
Defense Finance and Accounting Service-Indianapolis Center, Indianapolis, IN
Defense Reutilization and Marketing Service, Battle Creek, MI

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Under Secretary of Defense (Comptroller/Management)
  Deputy Under Secretary of Defense (Comptroller/Program/Budget)
Under Secretary of Defense for Personnel and Readiness
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Defense Organizations

Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service - Columbus Center
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Central Imagery Office

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
U.S. General Accounting Office
- National Security and International Affairs Division, Technical Information Center
- National Security and International Affairs Division, Defense and National Aeronautics and Space Administration Management Issues
- National Security and International Affairs Division, Military Operations and Capabilities Issues

Chairman and Ranking Minority Members of Each of the Following Congressional Committees and Subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security
- House Panel on Morale, Welfare and Recreation, Committee on National Security

Part V - Management Comments

DeCA Comments

DEFENSE COMMISSARY AGENCY
HEADQUARTERS
FORT LEE, VIRGINIA 23801-6300

REPLY TO
ATTENTION OF

IR

MAY 11 1995

MEMORANDUM FOR INSPECTOR GENERAL, LOGISTICS SUPPORT DIRECTORATE, 400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Audit Report on the Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994 (Project No. 4LA-2016)

Reference: DoDIG Memorandum, dtd March 27, 1995, SAB.

Attached is the DeCA reply to the recommendations provided in subject report. If you have any questions, please contact Mr. Ben Mikell at (804) 734-8103.

RONALD P. McCOY
Colonel, USAF
Chief of Staff

Attachments:
As Stated

Final Repor
Reference

DEFENSE COMMISSARY AGENCY REPLY

SUBJECT: Draft Audit Report on the Statement of Financial Position for the Commissary Surcharge Collection Fund, as of September 30, 1994

Finding A. Cash

Additional Facts:

Background, page 10: The accounting services for the Europe Region were not transferred to DFAS-CO after the end of FY 1994 as stated in the report. Accounting support for the European Commissary Region is provided by the 266 Theater Finance Command (i.e., changed October 1, 1994 from the 9th Finance Group). DFAS-CO continues to provide accounting services for the DeCA Conus based regions.

Deleted

Materiality and Impact on the Surcharge Statement of Financial Position, page 13: The report states that DeCA performed no cash reconciliations and research to verify the official cash. DeCA has no visibility over the individual collection and disbursement transactions that were not processed by our servicing finance offices or transactions that have been rejected and impact our cash position. The responsibility for processing, reconciling and researching collection and disbursement transactions affecting DeCA's cash resides with the DFAS and 266 Theater Finance Command.

DFAS-CO has assigned the responsibility of maintaining the "cash book" for DeCA as well as other Defense Agencies to DFAS-IN. DFAS has recently started to provide DeCA with a summary status report of undistributed commissary collections and disbursements by fiscal station. Review of this type of data will enable DeCA to monitor cash at a summary level; however, it is DFAS and the 266 Theater Finance Command responsibility to process, reconcile and research the detail collection and disbursement transactions for general ledger accounting purposes.

Finding B. Capital Equipment

Additional Facts:

Background, Page 15: The reports states that the threshold for capitalization of assets was $15K in FY 1991, and $25K in FY 1993. This threshold was increased to $50K on October 1, 1994.

Account Reconciliations, Page 20: The report states that DeCA Headquarters initiated two unsupported accounting adjustments

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totaling $63 million, in August and September 1994. The two adjustments ($21,966,892.93, JV 94-9-3-00A and $43,266,117.10, JV 94-7-05-0, respectively) had a net affect on construction in-progress and capital equipment in the amount of $21,299,224.17. DeCA prepared the journal vouchers and the supporting documentation is on hand at DeCA Headquarters for review. Copies of documentation were not furnished to DFAS-CO to avoid unnecessary duplication of records. DeCA was not requested to provide the documentation in question during the audit.

Recommendation B-1. Establish verification procedures to ensure that all organizations in possession of capital equipment perform comprehensive physical inventories at least once a year.

Action Taken. Concur. Verification procedures will be established in DeCA Directive 40-15. The target date for publication of the revised directive is September 30, 1995.

Recommendation B-2. Revise Defense Commissary Agency Directive 40-2 to provide specific guidance on equipment classification and to require reviews of equipment classification during annual physical inventories.

Action Taken. Concur. Current plans are to remove the section concerning equipment accountability in DeCA Directive 40-2, and include it in DeCA Directive 40-15, Accounting & Reporting of Government Property Lost, Damaged or Destroyed. DeCA Directive 40-15 will be renamed "Managing, Accounting and Reporting of Government Property". A chapter will be added on the accountability of equipment through the Installation Equipment Management System (IEMS). In FY 1994, DeCA began converting accountability of equipment to this system. The target date for publication of the revised DeCA Directive 40-15 is September 30, 1995.

Recommendation B-3. Establish verification procedures to ensure that all regions perform monthly thorough and documented reconciliation of the DeCA subsidiary capital equipment and depreciation balances in the Plant Property and Accounting System to the general ledger balances in the Defense Business Management System.

Action Taken. Concur. DeCA Directive 70-7, August 31, 1994, titled, Financial Management for Headquarters and CONUS Regions, was published with strengthened procedures for the regions to reconcile and document equipment and depreciation balances. Additionally, an internal control checklist will be published by

September 30, 1995 and scheduled in the DeCA Internal Management Control Program for cyclical review.

Finding C. Construction In-Progress.

Additional Facts.

In-House Project Management Costs: DeCA inhouse labor cannot be capitalized in construction in progress because of legal restrictions. Statutory Provisions of 10 USC, Section 2484 (Commissary Operations costs which must be funded with surcharge collections) and 10 USC, Section 2685 (Authorized commissary construction costs to be funded with surcharge funds) provides for implementing regulations by the Secretary of Defense. DoD Directive 1330.17, Military Commissaries, March 13, 1987 states which funds will be used in support of commissaries. (Based on General Counsel's conclusion that personnel cost may not be paid with surcharge funds, February 25, 1993).

Recommendations C-1. Amend Defense Commissary Agency Directive 70-7 to:

a. Provide a detailed, step-by-step description of the transaction process needed to properly account for and document construction in-progress costs.

b. Conform with the DoD Accounting Manual for capitalizing all construction in-progress costs, both in-house and solicited.

c. Provide documentation and approval requirements for off-line journal entries for construction in-progress.

Action Taken: Partially Concur.

a. Procedures for recording capital construction in progress were republished in DeCA Directive 70-7, August 31, 1994 during the audit. Current procedures will be reviewed to determine if they adequately document the process and any changes will be included in the next update August 31, 1995.

b. DeCA is prohibited by statute from capitalizing inhouse labor in the Commissary Surcharge Collections Fund, construction in progress. These statutes are noted in the additional facts. Appropriate costs for contract services related to the commissary construction program will be capitalized.

c. Procedures for recording capital construction in progress were republished in DeCA Directive 70-7, August 31, 1994 during the

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Final Report Reference

audit. Current procedures will be reviewed to determine if they adequately provide for documentation and approval of offline journal entries for construction in progress and any changes will be included in the next update August 31, 1995.

Recommendation C-2. Establish verification procedures to ensure that construction in-progress subsidiary ledgers are established and costs are posted in accordance with DeCA Directive 70-7.

Action Taken: Partially Concur. Procedures for recording capital construction in progress were republished in DeCA Directive 70-7 during the audit. Current procedures will be reviewed to determine if controls are adequate for ensuring costs are posted accurately.

Recommendation C-3. Establish a crosswalk or extend the accounting classification codes so that equipment acquired can be easily correlated with the appropriate construction in-progress function code.

Action Taken. Concur. DFAS-HQ submitted a DBMS system change request (SCR) to DFAS-CO to correlate function codes with general ledger accounts for equipment which will facilitate correlation of postings to construction in progress. The SCR will be implemented with DBMS Release package 5.0 in July 1995.

Recommendation C-4. Establish verification procedures to ensure that construction in-progress recordings in subsidiary and general ledger accounts are appropriate and accounted for uniformly, completed construction is transferred, and reconciliations are performed.

Action Taken. Partially concur. Verification procedures for recording construction in progress were republished in DeCA Directive 70-7 during the audit. Current procedures will be reviewed to determine if adequate controls exist.

Finding D. Accounts Payable.

Additional Facts:

Deleted

The 266 Theater Finance Command provides accounting services to the European Commissary Region.

DeCA's policy requires the commissaries provide receipt documents to the DFAS-CO for payment. DFAS-CO was responsible for processing accrued expenses through July 31, 1993 when the function was transferred to the DeCA Conus based regions.

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Invoice Analysis: The report states that accounts payable should approximate invoices. We disagree. For annual contracts and reimbursable support, such as commissary base level support, one twelfth of the contract/reimbursable amount is accrued each month whether a receiving report is filed or not to more accurately relate expenses to the proper time period. In a decentralized environment with centralized accounting services, such as DeCA, it is impractical to expect all paperwork to be available at a central location before accounts are closed each month.

DeCA nonconcurs with the statement that an erroneous $1.740M accounts payable balance exists for communication services to the European commissaries. This is a valid accounts payable chargeable to Surcharge for communication services. The original payments were made out of the DBOF appropriation in error. The erroneous transactions were corrected and supporting documentation is available for review.

Recommendation D-1.a. Adhere to the DoD Accounting Manual by posting accounts payable as they occur to accounting ledgers.

Action Taken. Concur. Improved procedures were developed and published in the update in DeCA Directive 70-7, dated August 31, 1994. A management control checklist will be added September 30, 1995 and this area will be scheduled in the DeCA Internal Management Control Program for cyclical review.

Recommendation D-1.b. Issue guidance to all organizations, emphasizing the importance of processing receipt information as property and services are received.

Action Taken. Concur. Procedures for the processing of accrued expenditures were reissued in DeCA Directive 70-7, dated August 31, 1994. DeCA will issue a reminder to regions and commissaries of the importance of processing receipt information timely by June 30, 1995.

Part II.B. - Review of Compliance with Laws and Regulation.

Additional Facts: The report states that no self-assessment of Surcharge Collections controls have been made by DeCA. However, DeCA completed a Risk Assessment on Commissary Surcharge Collections in FY 1993 and determined it to be a high risk area. Additionally, a management control review checklist was developed and applied to Commissary Surcharge Collections in FY 1993 as required by OMB Circular A-123 (revised), Internal Control Systems, August 4, 1986, paragraph 8.b. Furthermore, a revised, more comprehensive internal control checklist was published in FY 1994.

This checklist is scheduled in the DeCA Internal Management Control Program to be applied in FY 1995 and FY 1997. This frequency of scheduled reviews, outlined in DeCA Directive 70-3 (C1), April 30, 1994, exceeds the requirements of OMB Circular A-123 and DoD Directive 5010.38, April 14, 1987, Subject: Internal Management Control Program, paragraph F.2.d.

DeCA disclosed a material weakness titled, Financial Management Procedural Noncompliance, in its first year of operation, FY 1992. We continued to disclose the Financial Management Procedural Noncompliance material weakness in the FY 1993 and FY 1994 FMFIA Annual Statements of Assurance, and have continued working to correct that weakness.

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DFAS Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

MAY 2 1995

DFAS-HQ/GC

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE
INSPECTOR GENERAL, DOD

SUBJECT: Management Comments on DoD IG Audit Report on the Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994 (Project No. 4LA-2016)

We have reviewed the subject report and are providing the attached management comments.

Any additional questions may be addressed to Mr. Charles McIntosh on (703) 607-1120.

Thomas F. McCarty
Deputy Director for General Accounting

Attachment
As Stated

SUBJECT: Management Comments on DoD IG Audit Report on the Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994 (Project No. 4LA-2016)

Recommendation 2.a: We recommend that the Director, Defense Finance and Accounting Service - Columbus Center (DFAS-CO): Match receipts and invoices to accounts payable balances in the payment process.

Management Comments: Concur. DFAS-CO has furnished Defense Finance and Accounting Service Headquarters with the Obligation Management Implementation Plan. This plan will ensure compliance with Public Law 103-335, Section 8137 (Prevalidation of Obligations to Disbursements).

The Financial Services Directorate has established a Front End Validation (FEV) team within the Commercial Payments Division, which is currently staffed with 24 employees. FEV currently performs 100 percent validation of accounting information.

Completion Date: March 1995

Recommendation 2.b: We recommend that the Director, Defense Finance and Accounting Service - Columbus Center: Conform to the DoD Accounting Manual by making periodic reviews of accounts payable balances.

Management Comments: Concur. DFAS-CO will use the Operational Review Embedded Program as a vehicle to review the Defense Commissary Agencies (DeCA) and serviced activities accounts payable balances on an annual schedule.

PLANNED MILESTONES:

Review DoD Accounting Manual requirements with Division and Branch Chiefs. Estimated Completion Date (ECD): May 1995

Complete an audit survey of DeCA accounts payable balances.
ECD: June 1995

Conduct an audit of DeCA accounts payable balances.
ECD: July 1995

Audit Team Members

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Shelton R. Young
Robert J. Ryan
Thomas D. Kelly
Lawerence L. Kutys
John B. Patterson
David Coyne
Glen B. Wolff
Laura A. Rainey
Frank M. Ponti