Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL STATEMENTS OF THE DEFENSE LOGISTICS AGENCY REUTILIZATION AND MARKETING SERVICE BUSINESS AREA OF THE DEFENSE BUSINESS OPERATIONS FUND FOR FY 1994

Report No. 95-220 June 5, 1995

Department of Defense

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Acronyms

ACRS	Appropriation Control and Reporting System
DAISY	DRMS Automated Inventory System
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DFAS-CO	DFAS Center, Columbus, Ohio
DLA	Defense Logistics Agency
DRMO	Defense Reutilization and Marketing Office
DRMS	Defense Reutilization and Marketing Service
IMCP	Internal Management Control Program
NSO	National Sales Office
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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June 5, 1995

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

SUBJECT: Audit Report on the Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994 (Report No. 95-220)

We are providing this report for your information and use and for use by 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 Logistics Agency were considered in the preparation of this report.

We are unable to render an opinion on the financial statements of the Defense Reutilization and Marketing Service, because account balances presented on the Statement of Financial Position and the Statement of Operations were based on unreliable financial data. In addition, the Defense Reutilization and Marketing Service implementation of the Internal Management Control Program was ineffective at reporting weaknesses related to the preparation of financial statements. Our disclaimer of opinion is based on the statements dated January 11, 1995.

DoD Directive 7650.3 requires all audit recommendations be resolved promptly. The Under Secretary of Defense (Comptroller) did not respond to the draft report and comments are requested. We also request that the Defense Logistics Agency reconsider its responses to Recommendations B.1.b. and B.2.b. and its position on the internal control weaknesses identified in the report. We request that comments be provided by August 4, 1995.

The courtesies extended to our staff are appreciated. Appendix C summarizes potential benefits resulting from the audit. If you have any questions about this report, please contact Mr. Charles Hoeger, Audit Program Director, at (215) 737-3881 (DSN 444-3881) or Mr. Stuart Dunnett, Audit Project Manager, at (614) 337-8009. The distribution of this report is in Appendix E. A list of our team members is on the inside back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-220 **June 5, 1995**
(Project No. 4LE-2008)

Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994

Executive Summary

Introduction. The Chief Financial Officers Act of 1990 requires DoD to prepare financial statements for revolving funds. The Reutilization and Marketing Service Business Area of the Defense Business Operations Fund is a revolving fund established to provide results of operations for the Defense Reutilization and Marketing Service (DRMS). DRMS is primarily responsible for disposing of excess, scrap, and hazardous DoD property. For FY 1994, DRMS reported $576.9 million in assets, $143.9 million in liabilities, $466.2 million in revenues and $367.3 million in expenses.

Objectives. The objectives of the audit were to determine whether the DRMS Statement of Financial Position, as of September 30, 1994, was presented fairly in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We also assessed controls over selected revenues and expenses presented on the DRMS Statement of Operations for FY 1994. We evaluated the internal control structure established for DRMS and assessed compliance with applicable laws and regulations that could have a material effect on the financial statements. Additionally, we followed up on audit issues identified in prior audit reports on financial statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund.

Scope and Methodology. We examined the DRMS Statement of Financial Position as of September 30, 1994, and selected revenue and expense accounts presented on the DRMS Statement of Operations for FY 1994. In addition, we examined the associated notes to those principal statements. The principal statements also include two statements that we did not examine, the Statement of Cash Flows and the Statement of Budget and Actual Expenses. The statements on which our disclaimer of opinion is based were dated January 11, 1995.

Disclaimer of Opinion. We are unable to render an opinion on the FY 1994 financial statements of the DRMS, because account balances presented on the Statement of Financial Position and Statement of Operations were based on unreliable financial data.

Findings on Internal Controls. The DRMS Statement of Financial Position for FY 1994 presented unreliable account balances. As a result, the Statement of Financial Position cannot be relied on in making decisions (Finding A).

The DRMS Statement of Operations for FY 1994 was unreliable. As a result, the excess of revenues over expenses (profit) was significantly overstated and performance measures were misleading (Finding B).

The DRMS implementation of the DoD Internal Management Control Program was ineffective at reporting weaknesses related to the preparation of financial statements. As a result, internal control weaknesses affecting the ability of the DRMS to prepare financial statements have not been corrected or reported to higher command levels. (Finding C).

Issues from prior year audits were not corrected and are discussed in Findings A, B, and C.

We identified DRMS budget authority of $208.3 million that should be suspended. We also identified $3.4 million in funds on unreconciled contracts that were unnecessarily held in suspense accounts. Internal controls over and the relevance of the DRMS financial information should also be improved.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) suspend the DRMS FY 1995 budget authority, and reconvene the DRMS Unit Cost Working Group to develop a fee structure for DRMS services. We recommend that the Director, Defense Logistics Agency, transfer all accounting responsibilities and related resources for national sales from the National Sales Office to the Defense Finance and Accounting Service, make the necessary changes to account for the hazardous program on an accrual basis, and establish relevant performance measures for the DRMS.

We recommend that the Commander, DRMS, establish procedures that require reconciliations to Defense Finance and Accounting Service records; implement controls over accounts receivable and accounts payable; establish accrual accounting procedures for reporting revenues and expenses; include in future annual assurance reports, the material weaknesses in the areas of financial statement presentation, operating systems interface problems, and inventory controls; and include in the inventory of assessable units, the major DRMS functions related to the preparation of financial statements.

Management Comments. The Office of the Under Secretary of Defense (Comptroller) did not respond to the draft report. The Director, Defense Logistics Agency, responded to all recommendations directed to the agency and DRMS.

The Defense Logistics Agency agreed to establish the necessary controls and procedures to ensure that the reported financial information more accurately reflects the operations of the DRMS. Action is either planned or underway and the Defense Logistics Agency has agreed to provide the results of its studies and copies of implementing guidance to us when it has completed its work. However, the Defense Logistics Agency stated that penalties for defaulted local sales contracts were unnecessary, and that performance measures for DRMS should not be developed by disposal program. The Defense Logistics Agency disagreed that the identified internal control weaknesses were material.

Audit Response. We request that the Under Secretary of Defense (Comptroller) provide a response to the final report. Additionally, we request that the Defense Logistics Agency reconsider its position on the establishment of penalties for defaulted local sales, the development of performance measures by disposal program, and the materiality of the internal control weakness. Comments are requested by August 4, 1995.

Table of Contents

Executive Summary i

Part I - Disclaimer of Opinion

Disclaimer of Opinion 2
Auditing Standards 2
Accounting Principles 2
Overview 3
Concurrent Audits 4

Part II - Audit Results

Audit Background 6
Audit Objectives 6
Scope and Methodology 7

Part II.A. - Review of Internal Controls

Introduction 10
Finding A. Statement of Financial Position 11
Finding B. Statement of Operations 21
Finding C. Internal Management Control Program 32

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

Introduction 38
Results of Audit 38

Part III - Additional Information

Appendix A. Summary of Prior Audits and Other Reviews 42
Appendix B. Laws and Regulations Reviewed 46
Appendix C. Summary of Potential Benefits Resulting From Audit 47
Appendix D. Organizations Visited or Contacted 48
Appendix E. Report Distribution 50

Part IV - Management Comments

Defense Logistics Agency Comments 54

Part I - Disclaimer of Opinion

Disclaimer of Opinion

We are unable to render an opinion on the financial statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund (DBOF) for FY 1994. The financial statements provide the results of operations for the Defense Reutilization and Marketing Service (DRMS). The DRMS financial statements include a Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. Also included are the footnotes, overview, and supplemental information. We limited our review to the Statement of Financial Position, Statement of Operations and related overview and notes to the statements. Our disclaimer of opinion is based on the financial statements dated January 11, 1995. We are issuing a disclaimer because account balances presented in the Statement of Financial Position and Statement of Operations were based on unreliable data.

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 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 financial statements and related internal control weaknesses. The financial statements are the responsibility of DRMS and DLA and we are responsible for expressing an opinion on the financial statements based on our audit.

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 that will govern all aspects of financial statement reporting have been issued, which will 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:

o standards agreed to and published by the Joint Financial Management Improvement Program principals,

o form and content requirements of OMB,

o accounting standards contained in agency accounting policy guidance, and

o 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 the DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983. During FY 1993 and FY 1994, the then Comptroller of the DoD, (Comptroller, DoD), 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."

Overview

The overview of the DRMS financial statements was presented to inform the reader of significant management practices and measurements of performance. We completed a limited review of the financial performance measures presented in the overview and the results of our review are presented in Finding B of this report. We did not review any of the other information presented in the overview, and therefore, we are not expressing an opinion on it.

Concurrent Audits

This audit was performed in conjunction with financial statement audits of the Defense Logistics Agency (DLA) Supply Management Business Area (Project No. 4LD-2006) and the Distribution Depot Business Area (Project No. 4LD-2007). The results of each audit will be provided in separate audit reports.

Part II - Audit Results

Audit Background

Defense Business Operations Fund. DoD established DBOF in FY 1992 to provide a financial structure for support organizations. DBOF is a revolving fund through which organizations are required to charge fees sufficient to cover all costs of providing goods and services. The DoD overall goals for establishing DBOF were to improve the support provided to the DoD Components (Military Departments and Defense agencies) and to reduce the costs of DoD support organizations through consolidation of like functions, increased cost visibility, and better business practices. DBOF organizations are required by the Chief Financial Officers Act of 1990 (Public Law 101-576) to prepare comprehensive financial statements that fully disclose their financial position, the results of operations, and other pertinent information that would allow Congress, agency managers, and others to assess the performance of the DBOF.

Chief Financial Officers Act of 1990. The Chief Financial Officers Act of 1990 requires annual audits of revolving funds. The Reutilization and Marketing Service Business Area of the DBOF is a revolving fund established to provide results of operations for DRMS.

Defense Reutilization and Marketing Service. The DRMS is responsible for reutilizing, selling, and disposing of excess and surplus personal property generated by DoD organizations. Personal property includes all types of usable, scrap, and waste material other than land and buildings. During FY 1994, DRMS reported $576.9 million in assets, $143.9 million in liabilities, $466.2 million in revenues and $367.3 million in expenses.

Defense Finance and Accounting Service. The Defense Finance and Accounting Service (DFAS) is responsible for providing accounting support for DBOF organizations. DFAS has consolidated the DRMS accounting functions, with the exception of accounting for sales transactions and overseas transactions, at the DFAS Center, Columbus, Ohio (DFAS-CO). Personnel at DFAS-CO were responsible for compiling the financial statements from the trial balances and other financial data. The Comptrollers of DRMS and DLA are jointly responsible for reviewing the compiled data and incorporating the overview and footnotes into the financial statements.

Audit Objectives

The objectives of the audit were to determine whether the DRMS Statement of Financial Position, as of September 30, 1994, was presented fairly in accordance with OMB Bulletin No. 94-01. We also assessed controls over

selected revenues and expenses presented on the DRMS Statement of Operations. We evaluated the internal control structure established for the DRMS business area and assessed compliance with applicable laws and regulations that could have a material effect on the financial statements. In addition, we followed up on conditions noted in our previous audits of the DLA Business Areas of the DBOF financial statements.

Scope and Methodology

We examined the internal control structure of the DRMS business area as related to the Statement of Financial Position and selected revenue and expense accounts presented on the Statement of Operations. In addition, we examined the associated notes to those principal statements. The principal statements also include two statements that we did not examine, the Statement of Cash Flows and the Statement of Budget and Actual Expenses. The statements were dated January 11, 1995.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the audited 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 financial statement presentation.

In planning and performing our audit of the DRMS business area for the year ended September 30, 1994, we evaluated the internal control structure of DRMS including the DRMS implementation of the DoD Internal Management Control Program (see Finding C). The purposes of this evaluation were to determine:

o the extent of auditing procedures and testing required for expressing an opinion on the financial statements.

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

The evaluation included obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to significant cycles, classes of transactions, and account balances. For those significant internal control policies and procedures, we performed sufficient tests to provide reasonable assurance whether the controls were effective and working as designed.

Computer-Processed Information. We did not review the general and application controls of the computer systems used by management to control DRMS financial transactions. Instead, we tested transactions to determine whether the accounting entries were made in accordance with generally accepted accounting standards for Federal agencies. Weaknesses in data reliability are discussed in the findings.

Time Period and Locations. This financial audit was made during the period May 1994 through February 1995. A complete list of the locations we visited and contacted is in Appendix D.

Part II.A. - Review of Internal Controls

Introduction

We examined the internal control structure for principal asset and liability accounts and selected revenue and expense accounts of the financial statements for the DRMS business area for the year ended September 30, 1994. The statements on which we based our evaluation were dated January 11, 1995. DFAS and DRMS management are jointly responsible for establishing and maintaining an internal control structure for financial data. In fulfilling that responsibility, management's estimates and judgments are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control review (United States Code, title 31, section 3512) 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 loss, misappropriation, unauthorized use, and waste.

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 the OMB, entity management, or the Inspector General, DoD, have identified as being significant for which compliance can be objectively measured and evaluated.

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 ability of DRMS 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 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 source of performing those functions.

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

Finding A. Statement of Financial Position

The DRMS Statement of Financial Position for FY 1994 presented unreliable account balances. The condition occurred because:

o DoD guidance required DRMS to use Appropriation Control and Reporting System data in the statement, creating unreconcilable adjustments, and

o DRMS had not established adequate accounting controls over collections, disbursements, accounts receivable, and accounts payable.

As a result, the accuracy of the Statement of Financial Position cannot be relied on.

Background

Statement of Financial Position. Data for account balances in the DRMS Statement of Financial Position are provided by the DRMS accounting system (the Defense Business Management System), the Appropriation Control and Reporting System (ACRS), and the Base Operating Supply System. In addition, the DRMS inventory value is based on operational data from the DRMS Automated Inventory System (DAISY). The inventory was reduced to net-realizable-value and classified as "Other Entity Assets." Manually compiled data from the NSO and summary data from the ACRS were also used to adjust accounts receivable and accounts payable balances.

Accounting for Collections and Disbursements. DFAS-CO makes accounting entries for DRMS into the Defense Business Management System. However, cash collections and disbursements from sales of excess material to the public are not entered into the DRMS accounting system by the individual posting of collections and disbursements to the accounting system. Instead, DRMS instructs DFAS-CO to post journal entries based on summary data entered in the ACRS from information maintained by the financial network (DFAS organizations plus accounting organizations overseas). During FY 1994, DRMS reported $602.4 million of collections and $375.7 million of disbursements on the Statement of Financial Position. DRMS also reported a cash balance of $13 million in its suspense accounts based on data from DFAS-CO.

DRMS Review Procedures. DRMS Manual 4160.14, "Property Disposal Procedures for Defense Reutilization and Marketing Offices," June 1993, requires the DRMOs to review contracts within 30 days of the final removal of material on the applicable sale. DRMS Handbook 4160.3, "Disposal Operating Procedures," March 1993, requires the NSO to review contracts within 90 days of the final removal of material on the applicable sale. The procedures require

DRMO and NSO personnel to complete the contract review based on cash collection and disbursement vouchers that have been verified by DFAS organizations. The procedures do not require personnel to verify that the cash transactions were made to the correct appropriation.

Verification Responsibilities. The DRMS Comptroller is the Chief Financial Officer for the business area. The DRMS Comptroller is responsible for verifying the completeness and reliability of financial data presented in the financial statements. In addition, the DRMS Comptroller prescribes regulations for resource analysts who are assigned to large DRMOs and to the NSO to verify the validity of financial transactions.

Hazardous Disposal Program. The General Services Administration delegated to the Secretary of Defense the responsibility for the disposition of excess and surplus property generated by DoD. DLA was designated the responsible agency within the DoD for worldwide disposal of hazardous material. DoD Manual 4160.21, "Defense Reutilization and Marketing Manual," March 1990, implements policy relating to the hazardous program. DRMS has been delegated the responsibility to dispose of hazardous property. DRMS manages contracts for the disposal of hazardous material and waste generated by DoD organizations. Although DRMS sells some hazardous property through the public sales program, most hazardous property is disposed of through disposal contracts. The DRMS uses the Base Operating Supply System to process collections, revenues, and disbursements for hazardous disposal contracts. The system does not report accounts payable balances for hazardous disposal contracts.

Reliability of Account Balances

The DRMS Statement of Financial Position for FY 1994 presented the following unreliable account balances:

Entity Assets	Balance (million)
Funds collected	$602.4
Funds disbursed	(375.7)
Net Fund Balance With Treasury	$226.7
Accounts Receivable, net - Federal	74.5
Accounts Receivable, net - Non-Federal	11.3
Non-Entity Assets	
Fund Balance With Treasury	$ 13.0
Total	**$325.5**

The above unreliable account balances represent 56.3 percent of the reported DRMS assets ($325.5 million of $576.9 million).

Liabilities Covered by Budgetary Resources	
Account Payable, net - Federal	$ 42.0
Accounts Payable, net - Non-Federal	54.1
Liabilities not Covered by Budgetary Resources	
Accounts Payable - suspense account	$ 13.0
Total	**$109.1**

The above unreliable account balances represent 75.7 percent of the reported DRMS liabilities ($109.1 million of $143.9 million).

The account balances presented in the Statement of Financial Position were based on incomplete and unreconciled data. The condition occurred because the then Comptroller, DoD, guidance required management to use ACRS data in the statement. In addition, DRMS had not established adequate accounting controls over collections, disbursements, accounts receivable, and accounts payable.

DFAS and DRMS have joint responsibility to ensure that the financial data are properly posted to DRMS financial records.

DoD Reporting Procedures

On May 12, 1993, the then Comptroller, DoD, issued a policy memorandum, "Defense Business Operations Fund Equity Adjustments and Centralized Control of Cash," that provided FY 1994 guidance to the business areas on the adjustment of accounts receivable, accounts payable, and equity accounts. Business areas were instructed to use collection and disbursement data generated by the financial network and compiled by the ACRS. The memorandum also required the business areas to adjust accounts receivable and accounts payable based on undistributed collections and disbursements. Undistributed collection and disbursement amounts are the net unreconciled differences between ACRS data and the accounting records of the business area.

On January 30, 1995, the Under Secretary of Defense (Comptroller) provided a policy memorandum, "Posting of Undistributed Disbursements and Collections," related to the posting of unreconciled differences to accounts receivable and accounts payable. The guidance was issued to avoid reporting negative balances in Accounts Receivable, Non-Federal and Accounts Payable, Non-Federal that were caused by existing guidance in the DoD Accounting Manual. The guidance allows business areas to prorate adjustments to Federal and Non-Federal accounts receivable and accounts payable. The proration must be supported by a documented analysis.

The DRMS complied with DoD Comptroller guidance and used ACRS data instead of its accounting records as the basis for "Funds Collected," and "Funds Disbursed," presented on the Statement of Financial Position for FY 1994. As a result, DRMS made adjustments to net-Federal accounts receivable and net-Federal accounts payable that were not reconciled to the DRMS accounting records.

Appropriation Control and Reporting System Data. The DRMS made adjustments to "Accounts Receivable, net - Federal" and to "Accounts Payable, net - Federal" based on summary collections and disbursements compiled by the ACRS. DLA requested permission to use its accounting records for funds collected and funds disbursed instead of the ACRS data, but the Under Secretary of Defense (Comptroller) denied the DLA request. Footnote 2 to the Statement of Financial Position discusses the impact of the unreconcilable ACRS data on the Federal accounts receivable and accounts payable balances as follows:

> Cash collections and disbursements data for the financial statements is obtained from the finance network/ACRS cash report and Service listings. The difference between cash collections in the ACRS cash report and the general ledger account amounted to ($40,187,538). This amount is reported as an increase to accounts receivable. The difference between cash disbursements in the ACRS cash report and the general ledger amounted to $34,828,045. This amount is reported as a decrease in accounts payable.

We reported the same weaknesses related to the use of the ACRS in Inspector General, DoD, Report No. 94-159, "Fund Balances with the Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund," June 30, 1994. As a result of our audit, DLA reported fund balances with Treasury accounts as a material weakness in its FY 1994 Annual Statement of Assurance. In addition, the Under Secretary of Defense (Comptroller) has returned the responsibility for management of cash back to the Military Departments and DLA for FY 1995. Accordingly, we are not making a recommendation on this issue.

Controls Over Collections and Disbursements

The DRMS did not have adequate accounting controls over collections and disbursements. The Chief Financial Officer of DRMS is responsible for requesting support from the DoD financial network to maintain an integrated

accounting and financial management system. However, DRMS did not request the DoD financial network to provide accounting support over transactions made to DRMS account 97X4930.5N54. In addition, DRMS did not verify the accuracy of collections and disbursements during contract reviews. As a result, we could not verify:

- o funds collected
- o funds disbursed
- o fund balance with Treasury
- o accounts payable - suspense account

Accounting Support. The DoD financial network provides accounting support for DRMS organizations. However, since the inception of DBOF in FY 1992, DRMS and DLA allowed DRMS account 97X4930.5N54 to be controlled as an open allotment by the financial network. An open allotment is an account that does not need to be reconciled to accounting records by the financial network. In addition, any DoD activity can process transactions to and from an open allotment. According to the ACRS, $236.7 million of the $602.4 million in collections and none of the $375.7 million in disbursements reported on the Statement of Financial Position were made to and from the open allotment. DRMS could not verify the accuracy of the reported amounts, because the open allotment information was incomplete.

We completed an analysis of collections and disbursements made to and from account 97X4930.5N54 at DFAS-CO by at least six DRMOs, the NSO, and an unknown number of other DoD organizations during FY 1994. DFAS-CO data showed that $119.3 million of the $236.7 million of collections made to account 97X4930.5N54 were processed at DFAS-CO. In addition, DFAS-CO data showed that $13.3 million of disbursements were processed out of the DRMS account (DFAS-CO called the disbursements "negative collections"). The ACRS reported only the net collection amount of $106 million ($119.3 million minus $13.3 million) even though $132.6 million ($119.3 million plus $13.3 million) of transactions had been processed through the open allotment.

The DRMS and DFAS-CO are in the process of implementing controls over collections and disbursements made to the account 97X4930.5N54 for all DRMS organizations. In addition, DRMS has requested a system change request that is designed to provide visibility over all collections and disbursements made to the DRMS account 97X4930.5N54. The change is scheduled for implementation in FY 1996. However, the change does not establish procedures to identify and correct existing errors as discussed below. In addition, milestones have not been established in the system change request for the NSO and overseas DRMS organizations.

Accuracy of Collections and Disbursements. The DRMOs and NSO did not verify the accuracy of collections and disbursements during the contract reviews (close-out of sales contracts). Our review of selected contracts identified $3.4 million that should have been transferred from suspense accounts. DRMS

procedures do not require DRMS personnel to reconcile collections and disbursements to records maintained by the financial network. As a result, two account balances that offset each other on the Statement of Financial Position, "Fund Balance with Treasury" and "Accounts Payable - Suspense Account," were not reliable.

DRMO Contract Close-out Reviews. During our audit tests, we identified $1.7 million in DRMS funds controlled by DRMO-Alameda that had been erroneously deposited by the local DFAS activity into a suspense account. During the close-out review of the sales contracts, DRMO-Alameda did not verify that the deposits had been made to the proper account. As a result of our audit, the $1.7 million was transferred from a suspense account into DRMS account 97X4930.5N54. This amount should have been reported in "Fund Balance with Treasury" and "Accounts Payable - Suspense Account." DRMO-Alameda took corrective action to ensure that deposits would be verified in the future. In addition, the Director of the local DFAS organization took action to ensure that deposits would be posted to the correct account in the future.

We also identified an additional $1.2 million in collections in a suspense account at DFAS-CO that were transferred to account 97X4930.5N54 as a result of audit. None of the contracts related to the $1.2 million at DFAS-CO or the $1.7 million at DFAS-Alameda were closed within the required 30 days.

We identified the same internal control weaknesses in Inspector General, DoD, Report No. 94-158 "Cash Management Within the Defense Reutilization and Marketing Service," June 30, 1994. DRMS Headquarters, Battle Creek, Michigan, directed the DRMOs to reduce suspense account balances to zero and DRMS records showed that $11.6 million was transferred from suspense accounts to account 97X4930.5N54 during FY 1994 from prior years sales. However, DRMS Headquarters did not provide adequate procedures to the DRMOs for the reconciliation of account balances to DFAS records.

NSO Contract Close-out Reviews. Contract close-out procedures were also inadequate at the NSO. We analyzed cash transactions from 120 sales contracts that had been closed by the NSO during FY 1994. When a contract is closed by NSO personnel, cash transactions are certified as being complete. However, we identified a total of $478,000 in collections on 29 of those 120 sales contracts that were still in a suspense account. The NSO took quick action to transfer the funds from the suspense account. As a result of our audit, NSO incorporated new closeout procedures on August 12, 1994, that require verification to DFAS records. However, the 120 contracts had not been reviewed within the required 90 days.

We completed our nonstatistical review of collections and disbursements at NSO and at 16 of the 19 DMROs visited. We could not project the scope of the problem for all of DRMS. Fraud investigations were initiated related to cash controls over public sales proceeds at two of the DRMOs visited during audit. Fraud indicators were discovered in both instances during the reconciliation of DRMS records to DFAS records. One investigation was initiated by DRMS management, and the other investigation was a result of our audit.

Controls Over Accounts Receivable and Accounts Payable

The DRMS did not have adequate controls over accounts receivable and accounts payable because DRMS did not:

o correct accounting problems at the NSO.

o review the validity of accounts receivable and accounts payable processed in the Defense Reutilization and Marketing Region-Europe, Wiesbaden, Germany.

o recognize accounts payable on hazardous disposal contracts.

Accounting Problems on National Sales. Accounting problems at the NSO continued during FY 1994. We followed up on adverse conditions at the NSO that were reported in Inspector General, DoD, Report No. 94-164, "Financial Statements of the Defense Reutilization and Marketing Service," June 10, 1994, and Inspector General, DoD, Report No. 94-158.

In response to recommendations in Report No. 94-164, we were informed that the NSO module to the DAISY system would solve the accounting problems with national sales during FY 1994. However, when we completed our audit tests in November 1994, NSO controls over collections, disbursements, accounts receivable, and accounts payable remained inadequate. The automated system related to accounts receivable and accounts payable was not functioning, and it was being used concurrently with manual and nonstandard data systems. We tested the reliability of the FY 1994 account balances reported by the NSO for collections, disbursements, accounts receivable, and accounts payable. The new system was producing unreliable financial data and manual processes were being applied inconsistently. We concluded that the data at the NSO were unreliable, because the necessary accounting systems and internal controls had not been established.

The national sales accounting function should be transferred to DFAS-CO. The DRMS spent about $2.4 million through FY 1994 to implement the DAISY national sales program. However, the DAISY national sales program is not integrated with the DRMS standard accounting system. In addition, NSO has been identified for possible relocation to DRMS Headquarters due to the FY 1995 Defense Base Realignment and Closure. The accounting for DRMS will be done at DFAS-CO for the foreseeable future. Accordingly, we concluded that because of the failure of DRMS to implement controls necessary to provide reliable accounting data to DFAS-CO, the accounting function at the NSO should be transferred to DFAS-CO during the relocation of the NSO.

Validity of Accounts Receivable and Accounts Payable in Europe. The DRMS did not review the validity of accounts receivable and accounts payable balances in the European region. We performed limited reviews of accounts receivable and accounts payable related to the DRMS European region, and identified $4.3 million of unbilled receivables in Europe for FY 1994 hazardous disposal contracts. We also reviewed the validity of $12.5 million of reported

FY 1994 accounts payable. Payment had already been made on $5.3 million of the accounts payable. DRMS did not have procedures established with the financial network to identify and correct accounts receivable and eliminate invalid accounts payable balances from the Statement of Financial Position.

Accounts Payable on Hazardous Disposal Contracts. The DRMS did not establish accounts payable for hazardous disposal contracts for FY 1992 through FY 1994. As a result, the Statement of Financial Position understated accounts payable by $80.8 million. In addition, the DRMS disclosure related to this issue in footnote 17 is inadequate.

The DRMS administers hazardous disposal contracts for DoD organizations and installations. The DoD customer submits a funded requisition to DRMS, and DRMS establishes a delivery order contract for the removal of the hazardous material or waste. DRMS recognizes the collections on its accounting records when interfund billings are processed shortly after the award of the delivery orders. However, the Base Operating Supply System does not create an accounts payable at the time of the collection, even though all collections are scheduled to be paid out to contractors at a later date.

For FYs 1992 through 1994, DRMS records showed collections of $386.1 million on hazardous disposal contracts. During that same period, only $305.3 million in payments were made to contractors. However, DRMS did not direct DFAS to post a journal entry to recognize the $80.8 million accounts payable, even though the problem had been identified and a system change request had been initiated to correct the accounting problem.

The system change request, however, did not adequately address the accounts payable problem for hazardous disposal contracts. The system change request recommends establishing an accounts payable at the time the contractor picks up the hazardous material. We believe the payable should be established at the time collection is recognized.

The DRMS disclosed the understated accounts payable in footnote 17 to the Statement of Financial Position. The footnote refers to a potential liability of $50 million to $90 million. Because a reasonable estimate can be made, DRMS should change the footnote disclosure to present information about the weakness in the accounting systems and post the $80.8 million liability to the Statement of Financial Position.

Inventory

As a result of Inspector General, DoD, Report No. 94-164, DRMS restated inventory values for FYs 1993 and 1994. The FY 1994 Statement of Financial Position reported the DRMS inventory at net-realizable-value on line 1.m., "Other Entity Assets." DRMS reduced the $5.1 billion originally reported for

FY 1993 to $158.8 million and reported $168 million for FY 1994. That represented a significant improvement over the valuation presented in the DRMS FY 1993 financial statements.

Property, Plant, and Equipment

Property, plant and equipment general ledger and subsidiary records were not reliable. DRMS and DLA initiated corrective action during FY 1994 in response to Inspector General, DoD, Report No. 94-149, "Property, Plant and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994. Accurate reporting of DRMS property, plant, and equipment and the related depreciation is not anticipated until the end of FY 1995.

Management Comments on the Finding

The DLA comments included responses to recommendations directed to DLA and its subordinate command, DRMS. DLA concurred with the finding; however, DLA did not consider the internal management control weaknesses to be material. We consider those weaknesses to be material because they contributed to our disclaimer of opinion. See Part IV for the complete text of the DLA comments.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Commander, Defense Reutilization and Marketing Service:

a. provide milestones in the system change request for the correction of accounting controls over collections and disbursements at the National Sales Office and overseas organizations.

Management Comments. The DLA concurred and stated that a system is under development to improve the control over collections and disbursements. DLA is developing functional specifications and the estimated completion date for the action is February 29, 1996.

b. establish controls that provide for timely closing of sales contracts and reconciliation of collections and disbursements to financial network records.

Management Comments. The DLA concurred and stated that procedures for the timely closing of sales contracts have been established. Copies of the procedures will be provided. In addition, DLA is working with DFAS-CO to reconcile suspense account data. The estimated completion date for the action is February 29, 1996.

Audit Response. The DLA actions to establish procedures for timely closing of contract files and to reconcile existing balances meet the intent of our recommendation. We will review the procedures to determine whether they meet the full intent of the recommendation.

c. establish procedures to review the validity of accounts receivable and accounts payable in the Defense Reutilization and Marketing Region-Europe.

Management Comments. The DLA concurred and stated that procedures for reviewing the validity of accounts receivable and accounts payable have been developed for the Defense Reutilization and Marketing Region-Europe. Copies of the procedures will be provided.

Audit Response. The DLA actions to develop procedures to validate accounts receivable and accounts payable data meet the intent of the recommendation. We will review the procedures to determine whether they meet the full intent of the recommendation.

d. establish an Accounts Payable Non-Federal of $80.8 million for hazardous disposal contracts and modify the existing system change request to record accounts payable at the same time the collection is recognized.

Management Comments. DLA concurred and stated that the current variance between hazardous accounts receivable and accounts payable for FY 1992 through FY 1994 will be corrected. In addition, DLA stated that a system change request will be implemented to establish a payable when each delivery order is obligated so that the accounts payable and collections coincide. The estimated completion date for the action is June 30, 1996.

2. We recommend that the Director, Defense Logistics Agency, transfer all accounting responsibilities and related resources for national sales from the National Sales Office to the Defense Finance and Accounting Service.

Management Comments. DLA partially concurred with the recommendation and stated that a review of the functions and responsibilities at the National Sales Office is in process. When completed, DLA will provide a copy of the results of its review.

Audit Response. The DLA proposed action meets the intent of our recommendation. We will review the results as a part of our audit followup process or during future audits.

Finding B. Statement of Operations

The DRMS Statement of Operations for FY 1994 was unreliable. The condition occurred because DRMS accounting policies, systems, and internal controls were not adequate to account for public sales proceeds, reduce buyer defaults, and to account for the hazardous disposal program on an accrual basis. In addition, major expense categories were not adequately supported and performance measures were not consistent with financial data. As a result, the excess of revenues over expenses (profit) was significantly overstated, performance measures were misleading, and the Statement of Operations cannot be relied on for making decisions or assessing performance.

Background

Statement of Operations The DRMS Statement of Operations for FY 1994 showed a profit of about $98.9 million on revenues of $466.2 million and expenses of $367.3 million. DRMS included as revenue cash proceeds from public sales and the funded requisitions they received from the Military Components (no surcharge) to pay hazardous disposal contractors. Additionally, the Comptroller, DoD, authorized DRMS to bill the Military Components (component level billings) about $523.3 million from FY 1992 through FY 1995 to recoup unreimbursed program expenses. Component level billings were included as revenue in the FY 1992 and FY 1994 Statements of Operation (no billings were approved for FY 1993). Major expense categories included contract services, depreciation, and payroll.

Accrual Accounting. Under accrual accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. In contrast, under a cash basis of accounting, revenues are recognized when cash is received and expenses are recognized when cash is disbursed. Accrual accounting is the generally accepted accounting principle for Federal organizations because it matches revenues and expenses to the appropriate accounting period and shows whether current year revenues were sufficient to pay for current year services.

Disposal Programs. Under the direction of DLA, DRMS is responsible for reutilizing, selling, and disposing of excess, scrap, and hazardous material generated by DoD organizations. The two largest DRMS disposal programs are public sales and hazardous disposal.

Public Sales Program. The DRMS sold about 89 percent of all the usable and scrap material disposed of through the public sales, reutilization, transfer, and donation programs. DRMS deposited the cash proceeds from sales into either the DBOF account or a suspense account. The $458.3 million that DRMS deposited into the DBOF account from FY 1992 through FY 1994 was used to offset DRMS operating costs and to reduce the required amount of

component level billings collected during the period. Starting in FY 1996, DRMS plans to discontinue component level billings and use only DBOF sales deposits to cover all operating costs. Deposits into suspense accounts were reimbursed to organizations such as military installations, with qualified recycling programs.

The DRMS sold material to the public either nationally or locally. The NSO and the Defense Reutilization and Marketing Region-Europe accounted for national sales contracts, while the individual DRMOs accounted for local sales contracts. DRMS policy requires that bid deposits be collected only on national sales contracts. DRMS policy does not establish penalties for successful bidders who default on local sales contracts.

Hazardous Disposal Program. The DRMS managed contracts for the disposal of hazardous material and waste generated by DoD organizations. DRMS collected funded requisitions from DoD organizations only for the actual costs (no surcharge) paid to outside contractors. Thus, the hazardous disposal program should have a neutral effect on the Statement of Operations (that is, revenues should equal expenses). The estimated $60.2 million in operating costs that DRMS incurred in FY 1994 to manage the hazardous disposal program were covered by sales proceeds and component level billings.

Reliability of Account Balances

The DRMS Statement of Operations for FY 1994 presented the following unreliable account balances:

Revenues and Financing Sources	Balance (million)
Revenues from sales - to the public	$213.0
Revenues from sales - intragovernmental	253.2
Total	**$466.2**

The $466.2 million represents 100 percent of DRMS reported revenues.

Expenses	Balance (million)
Program or Operating Expenses	$346.9
Depreciation and Amortization	10.3
Total	**$357.2**

The $357.2 million represents 97.3 percent of the DRMS total expenses of $367.3 million.

The account balances in the Statement of Operations were based on incomplete and unreconciled data. This condition occurred because DRMS did not:

o establish the accounting policies, systems, and internal controls over $213 million in public sales proceeds needed to define the point of sale and reduce buyer defaults, reconcile accounting records, and support adjusting entries;

o account for the hazardous disposal program on an accrual basis of accounting;

o apply FY 1994 Military Component level billings against $73.6 million of prior year expenses;

o have the DoD accounting systems and internal controls needed to support reported expenses; and

o report performance measures that were meaningful and consistent with reported financial information.

Accounting for Public Sales Proceeds

The DRMS did not establish, as required, the accounting policies, systems, and internal controls over public sales proceeds needed to define the point of sale and reduce buyer defaults, reconcile accounting records, and support adjusting entries. The DRMS Statement of Operations for FY 1994 included about $213 million of public sales revenues. Footnote 1D disclosed that DRMS had an inadequate accounting system and inadequate internal controls over sales proceeds. However, the footnote did not disclose that DRMS lacked adequate accounting policies; and it did not disclose the adverse effect that the problems had on preparing accurate FY 1994 financial statements.

Establishment of Accounting Policies. The DRMS did not establish accounting policies and related accounting systems and internal controls needed to define the point of sale and to reduce buyer defaults.

Point of Sale. The point of sale can be defined as either the time a sales contract is signed or when the buyer removes property. Both definitions have merit and either could be established as an accounting policy as long as the definition chosen is consistently applied. Each definition requires different procedures for accounting for defaults. DRMS recorded sales transactions when the cash was deposited by DFAS in the DBOF account without regard to when contracts were signed or material delivered. Establishing an accounting policy to provide a consistent definition for point of sale is the first step needed to convert from cash procedures to accrual procedures. Subsequent steps needed to convert to an accrual basis would include the modification of the DRMS accounting system to record the accrual transactions, and to establish the controls necessary to ensure compliance with the new policy.

Buyer Defaults. The DRMS did not establish a policy that provided for either a nonrefundable deposit or a penalty for buyer defaults on local sales contracts. A defaulted contract occurs when a successful bidder does not remove the awarded material from the DRMO. Current DRMO policy allows the DRMO to refund any advance payments made by a bidder on a defaulted contract. Using DRMS data, we compared default rates at 17 of the 19 DRMOs visited (default information was not available at two DRMOs). The default rate ranged from about 1.5 percent to 29 percent. We noticed an abnormally high default rate at the 5 DRMOs we visited in Europe (19 percent) as compared to the 12 DRMOs we visited in the United States (7 percent). According to DRMO personnel in the Defense Reutilization and Marketing Region-Europe, the high default rate occurred because some regular buyers defaulted on local sales contracts for certain items (such as military vehicles) when competition from nonregular buyers drove prices too high. Regular buyers would outbid competitors and default on the sales contracts without penalty. The regular buyers did so because DRMS did not have a policy providing for a nonrefundable deposit or default penalty, and they could rebid on the items on a later sale.

The DRMS will need to establish accrual accounting procedures for recording sales and assessment of penalties on defaulted contracts after it makes a decision related to establishing a consistent point of sale. DRMS will also need to modify its accounting system and establish internal controls to ensure compliance.

Reconciliation of Accounting Records. The DRMS did not establish the systems and internal controls needed to reconcile DRMS financial records to ACRS information. DRMS is responsible for the accuracy of financial records provided to DFAS for entry into ACRS. To ensure reliable ACRS summary totals, DRMS personnel need to close sales contract files timely and to periodically reconcile the contract files and related financial records with ACRS information. However, our audit showed that contract files were not closed timely and existing DRMS procedures did not require that DRMS contract files and financial records be reconciled to ACRS information. The required procedures would be similar to a bank reconciliation.

We were able to reconcile or partially reconcile contract files and related financial records to ACRS information at 15 DRMOs (we did not perform reconciliations at four DRMOs). Our reconciliations showed:

o theft and potential theft of sales proceeds at two DRMOs (fraud investigations have been initiated at the two sites).

o cash collection vouchers worth $457,438 were submitted to DFAS and not recorded in ACRS. Because those vouchers were not recorded in ACRS, sales revenue was understated by about $0.5 million.

o bid deposits for national term sales contracts and reimbursable sales proceeds were deposited into the DBOF account. Those deposits represented a DRMS liability, not revenue. The bid deposits for national term sales represent unearned revenue (a liability) since the proceeds act as a security deposit and are

not earned until the final months of the contract. We could not quantify the amount of bid deposits and reimbursable sales that were still in the DBOF summary total as of September 30, 1994.

The ACRS summary data also were not consistent, accurate, or timely. For example, about $19.6 million in cash deposits that DFAS collected in FY 1992 was not reported as DRMS revenue until FY 1994. Without reconciliations, the ACRS sales summary information was unreliable for use in preparing DRMS financial statements.

Adjustments from Cash to Accrual Accounting. The adjusting entries made to convert ACRS summary information from a cash to an accrual basis of accounting were not supported by DRMS subsidiary records. Instead, a net adjustment of $2.5 million was made to increase the ACRS data based on accounts receivable and accounts payable balances reported by the NSO. In addition, the DRMOs and NSO completed reviews to identify $28.3 million in prior year transactions that needed to be subtracted from the ACRS data. As a result, DLA subtracted $25.8 million ($28.3 million minus $2.5 million) from the $236.7 million in collections reported by the ACRS for account 97X4930.5N54. Our review of the $25.8 million in net adjustments is discussed below.

Accounts Receivable and Accounts Payable. The DRMS added $12 million of accounts receivable to and subtracted $9.5 million of accounts payable from the ACRS total. Those figures were derived from reports prepared by NSO. Our review of the accounting systems and internal controls used by NSO to prepare the reports showed that the adjustments were unreliable (see Finding A). In addition, no adjustments were made to reflect accounts receivable from the Defense Reutilization and Marketing Region-Europe national sales or for local sales contracts.

Prior Year Sales Proceeds. The DRMS removed about $28.3 million of prior year sales proceeds from the ACRS summary total in response to Inspector General, DoD, Report No. 94-158. The DRMOs and NSO completed reviews of prior year transactions and identified $28.3 million that had been transferred from DFAS suspense accounts to the DBOF account during FY 1994. NSO processed vouchers for $16.7 million in national sales and local DRMOs processed the remaining $11.6 million. Because of inadequate accounting systems, we were unable to adequately test for completeness the $16.7 million reported by NSO. We do know that the $16.7 million did not include national sales conducted in Europe. We reviewed the completeness of $2.2 million of the $11.6 million adjustment that was based on data from the DRMOs, and found that it was understated by about $2 million.

Although the DRMS has initiated actions to address the problems (developing a unique accounting system over public sales that is separate from existing DFAS accounting system), the problems have not been corrected. In Finding A, we recommended that DLA transfer the accounting responsibilities of DRMS over national sales to DFAS. We also recommended that DRMS provide for the timely closing of sales contracts and the reconciliation of collections and disbursements to financial network records.

Accounting for Hazardous Disposal

The DRMS accounted for the hazardous disposal program on a cash basis instead of the required accrual method. Using a cash basis of accounting, a timing difference resulted from the time DRMS collected the funded requisitions from the Military Components and when the funds were actually disbursed to pay contractors. DRMS recorded the timing difference in the Statement of Operations as either a profit or a loss. The timing difference in FY 1994 caused hazardous disposal expenses (reported as $126.4 million) to be understated and total profits to be overstated by approximately $7.2 million. Under accrual accounting, no timing difference would have existed because expenses would have matched the $133.6 million collected from the Military Components during FY 1994 and reported as revenue. Footnote 1E disclosed the existence of the timing problem; however, DLA elected not to correct the DRMS Statement of Operations for FY 1994.

Under accrual accounting, prior year revenues and expenses should also have been matched to the appropriate accounting period and expenses that have not yet been disbursed should have been reported as a liability. The cumulative results of operations reported in the DRMS financial statements for FYs 1992 through 1994 included $386.1 million of revenue and $305.3 million of expenses from the hazardous disposal program. Of the $80.8 million difference, $7.2 million was attributed to FY 1994 and the remaining $73.6 million related to years before FY 1994. DRMS did not account for the $80.8 million in total unpaid expenses as a liability in the FY 1994 Statement of Financial Position (see Finding A).

FY 1994 Component Level Billings. The DRMS did not apply $73.6 million in prior year expenses against FY 1994 component level billings that were provided for that purpose. In FY 1994, DRMS billed the Military Components $207 million to recoup cumulative losses (that is, expenses exceeded revenues) from operations for FY 1992 through FY 1994. In determining that $99.2 million of the $207 million was to be recorded as current year revenue, DRMS applied cumulative losses of $107.8 million. However, the $107.8 million in cumulative losses did not include the $73.6 million of prior year hazardous disposal program expenses. Had the $73.6 million in expenses been included, the cumulative losses would have been $181.4 million and the current year revenue would have included only $25.6 million of the $207 million in FY 1994 component level billings.

Other Expenses

Problems in the DoD accounting systems and internal controls have prevented DRMS from adequately supporting major expense categories. The problems were reported in the DFAS and DLA Annual Statements of Assurance for FY 1994. Major problem areas affecting the DRMS Statement of Operations for FY 1994 included:

o Reported expenses by object class were estimated based on the amounts obligated.

o Significant time lags existed between the time expenses (obligated amounts), and actual disbursements were posted. Consequently, many of the reported expenses in the Statement of Operations were at the obligated or estimated amounts.

o Budget documents used to record expenses could not be easily matched to payment vouchers processed by DFAS. As a result, many of the allocations to expenses either could not be matched to obligations or were matched arbitrarily.

o As noted in the footnotes, capital equipment accounts were materially understated in the FY 1994 financial statements. Accordingly, depreciation expenses were understated.

o The DLA did not establish a reasonable methodology to assign overhead (the problem was disclosed in the footnotes). The portion of DLA overhead attributed to the DRMS was included in the supply management business area.

As a result, we could not determine whether $357.3 million of the $367.3 million in expenses was fairly stated. However, because the problems were mostly outside of DRMS control and were being addressed during the audit, we are making no recommendations at this time.

Performance Measures

The performance measures reflected in the overview section of the FY 1994 financial statements are misleading because the data used to compute them were not consistent with the financial information presented in the Statement of Operations. The "DoD Guidance on Form and Content of Financial Statements for FY 1994 and FY 1995 Financial Activity," October 20, 1994, requires that DRMS report "the cost of disposing of material through reutilization, transfer, donation, or sales of these methods as compared to any revenues realized."

In Inspector General, DoD, Report No. 94-164, we recommended that DLA provide information about the revenues and costs associated with DRMS disposal programs. We believe the information would assist users of the financial statements in evaluating DRMS efforts, costs and accomplishment; and the manner in which those efforts and accomplishments have been financed. Because we believe the two performance measures provided with the FY 1994 financial statements can be misleading, we have provided additional information.

Cost per Dollar of Disposal Through Reutilization, Transfer, Donation, and Public Sales Programs. The DRMS reported that the cost per dollar of disposal through reutilization, transfer, donation, and public sales programs was $0.45. This figure is meaningless to a user of the financial statements because it is based on budget, rather than financial data. The measure was computed by dividing $185 million of program costs into budget revenues of about $409 million. The budget revenue was significantly higher than the $210.9 million reported as revenue from sales proceeds in the Statement of Operations, because it included $198 million of budget authority for reutilization, transfer, donation, and reimbursable sales programs. DRMS does not charge a fee for those services and therefore, receives no revenue.

Cost per Line Item of Hazardous Disposals. The DRMS reported a cost per line item of hazardous disposals of $197.82. The measure was computed by dividing the DRMS program costs of about $60.2 million by 304,183 line items. It excluded approximately $133.6 million (about $439 per line item) in funded requisitions that DRMS received from the Military Components to pay the disposal contractors. If all applicable costs from the Statement of Operations were included, the actual cost per line item of hazardous disposal would be about $637. The $197.82 per item represents the cost that DRMS needs to obtain from other finance sources, such as public sales proceeds.

Operating Results

Because some accounting practices used to develop the Statement of Operations did not conform with generally accepted accounting principles and other practices lacked the accounting systems and controls needed to support the reported balances, we are unable to render an opinion on the FY 1994 financial statements for DRMS. We caution any user of the DRMS Statement of Operations for FY 1994 not to rely on the reported results of operation.

The DRMS was unable to provide complete accounting records for us to select a statistical sample of accounting transactions. Consequently, we reviewed the validity of a judgmental sample of accounting transactions. We found that for the items reviewed, the $98.9 million reported as profit in the FY 1994 Statement of Operations was significantly overstated. As indicated above, profits were overstated by at least $82.3 million because revenues were overstated by $75.6 million ($2 million in prior year proceeds and $73.6 million in prior year expenses not applied against component level billings), revenue was understated by the $0.5 million that was not included in ACRS, and expenses were understated by at least $7.2 million in hazardous disposal expenses.

In addition, although DRMS was allocated $14.1 million of DLA overhead expense for budget purposes, that expense was charged to the supply management business area in FY 1994. Based on the reconstructed data from our review, including the $14.1 million in allocated overhead expense and excluding the $25.6 million in residual component level billings, DRMS would have reported a loss in FY 1994 of $23.1 million. Since the accounting transactions we reviewed were not statistically selected, the actual profit or loss may be materially different from the loss of $23.1 million that we computed.

Funding of Operating Costs

Since becoming a DBOF business area in FY 1992, DRMS has not established a fee structure to recoup operating costs. To make up for the revenue shortfalls, the Comptroller, DoD, authorized DRMS to bill at the Military Component level, on an interim basis, and to retain public sales proceeds in its DBOF account. However, in Inspector General, DoD, Report No. 94-164, we concluded that DRMS should establish a fee structure based on costs of the individual services rendered to DoD customers.

Fee Structure. The establishment of an appropriate fee structure is a fundamental principle of the DBOF as promulgated by Comptroller, DoD, guidance, "Defense Business Operations Fund Implementation Plan," January 1993. The guidance requires all business areas to set prices so that individual customers can make prudent decisions. In Report No. 94-164, we recommended that the Comptroller, DoD, establish a fee structure for DRMS that is based on relevant operating costs of DRMS services. The Comptroller, DoD, concurred with our recommendation and stated that the DRMS Unit Cost Working Group would address the DRMS fee structure. In a January 20, 1995, memorandum, the Under Secretary of Defense (Comptroller) suspended the working group and determined that, based on DRMS projected revenues from public sales proceeds, no basis existed to establish a fee structure at least through FY 1997. However, the Under Secretary of Defense (Comptroller) did not address the $208.3 million that was previously authorized for DRMS FY 1995 component level billings to meet FY 1995 revenue shortfalls. We continue to believe that the DRMS needs to comply with the DBOF principle on establishing fee structures. Accordingly, we believe that the Under Secretary of Defense (Comptroller) should suspend the $208.3 million in budget authority for DRMS, reconsider its decision not to pursue a fee structure at this time, and reestablish the DRMS Unit Cost Working Group to develop a fee structure for DRMS services.

Management Comments on the Finding and Audit Response

The Under Secretary of Defense (Comptroller) did not comment on the draft report. DLA comments included responses to recommendations directed to DLA and its subordinate command, DRMS. DLA partially concurred with the finding; however, DLA did not consider the internal management control weaknesses to be material. The DLA response was concerned about the content and consistency of our presentation related to the operating results. We modified the Operating Results paragraphs on pages 28 and 29 of the report to clarify that the lack of adequate accounting systems and records precluded a more precise determination of profit or loss. We consider the internal control weaknesses to be material, since they contributed to our disclaimer of opinion.

Recommendations, Management Comments, and Audit Response

Changes to the Finding and Recommendation 3.a. We modified the Finding and Recommendation 3.a. based on the results of a legal opinion provided by the Office of General Counsel, DoD, that was pending at the time the draft report was issued.

1. We recommend that the Commander, Defense Reutilization and Marketing Service, establish the necessary accounting policies, systems, and internal controls to:

a. define the point of sale on an accrual basis of accounting, and apply that definition consistently throughout the Defense Reutilization and Marketing Service. Incorporate the definition into all relevant accounting systems and related procedures used to account for the public sales program including transactions on defaulted contracts.

Management Comments. The DLA concurred and stated that a process action team will define the point of sale by type of sale and implement accounting for sales on an accrual basis. Action is ongoing and is estimated to be completed by October 31, 1995.

Audit Response. The DLA actions meet the intent of our recommendation. A copy of the implementing procedures should be provided to us when DLA completes its review.

b. establish a policy that requires either a nonrefundable deposit on local sales contracts or a penalty for buyer defaults on local sales contracts.

Management Comments. The DLA partially concurred and stated that recent policy changes have eliminated local sales, except those held on a cash and carry basis.

Audit Response. The DLA comments are not fully responsive. Local sales have been replaced by "zone sales" that operate under the same guidelines as local sales. No official guidance related to reducing buyer defaults was included in the guidelines for zone sales. We request that DLA reconsider its response and provide additional comments in response to the final report.

2. We recommend that the Director, Defense Logistics Agency:

a. change, as necessary, the accounting systems and procedures used to account for the hazardous disposal program on an accrual basis of accounting.

Management Comments. DLA concurred and will change the Hazardous Base Operations Support System to account for transactions on an accrual basis of accounting. Action is ongoing and scheduled for completion by June 30, 1996.

b. develop more meaningful performance measures for the Defense Reutilization and Marketing Service that show revenues and expenses by disposal program. In addition, make sure that the performance measures are consistent with revenues and expenses reported in the Statement of Operations.

Management Comments. The DLA partially concurred and agreed that performance should be measured in financial terms, but disagreed that it is either effective or efficient to develop those measures by disposal program.

Audit Response. The DLA comments are not responsive. DoD Guidance on Form and Content of Financial Statements for FY 1994 states that the annual financial statement should disclose the manner in which the entity's programs were performed. The DoD guidance also states that performance measures should not be limited only to those that relate to a reporting entity as a whole and that performance measures specific to major programs within a reporting entity are critical. Tracking costs on a program basis would assist in developing a fee structure that relates to the cost incurred by DRMS to provide those services. We request that DLA reconsider its response and provide additional comments in response to the final report.

3. We recommend that the Under Secretary of Defense (Comptroller):

a. suspend the Defense Reutilization and Marketing Service budget authority to bill the Military Components $208.3 million in FY 1995.

b. reconvene the Defense Reutilization and Marketing Service Unit Cost Working Group to develop a fee structure for the Defense reutilization and Marketing Service.

Management Comments. The Under Secretary of Defense (Comptroller) did not respond to the draft of this report.

Audit Response. We request that the under Secretary of Defense (Comptroller) provide comments on the final report by July 31, 1995.

Finding C. Internal Management Control Program

The DRMS had not effectively implemented the DoD Internal Management Control Program. The condition occurred because DRMS did not take corrective actions to improve the reporting of material weaknesses related to the preparation of financial statements in response to Inspector General, DoD, Report No. 94-164. In addition, DRMS did not change its inventory of assessable units to reflect the more stringent financial responsibilities of a DBOF business area. As a result, material weaknesses related to DRMS financial responsibilities have not been corrected or reported to higher command levels in the DRMS Annual Statement of Assurance.

Background

DoD Internal Management Control Program. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, provides guidance to DoD organizations on implementing OMB Circular A-123 and the DoD Internal Management Control Program (IMCP). The directive mandates emphasis on the prevention of abuse, fraud, and mismanagement and requires DoD organizations to report whether their accounting systems are in compliance with applicable accounting principles. Compliance with the IMCP has a direct and material effect on preparation of reliable financial statements.

The DRMS describes its internal control program in DRMS Regulation 5010.4, "Internal Management Control Program," March 16, 1994. Key points to the IMCP include:

o an inventory of assessable units ranked as low, moderate, or high risk;

o a biennial risk assessment of each assessable unit;

o a periodic review of each assessable unit to identify problems and to suggest solutions; and

o the reporting of each material weakness reported along with a plan for corrective action or a clear notation that action is necessary at higher command levels.

The Commander, DRMS, concurred with the recommendation from Inspector General, DoD, Report No. 94-164 to assign the responsibilities for managing the DRMS IMCP to a senior management official outside the functional directorates. The Commander delegated the responsibility to his Chief of Staff. On March 1, 1995, the Commander, DRMS, approved a reorganization plan that will assign the DRMS IMCP to a new Quality/Internal Controls Division.

That office is to provide program guidance, solicit feedback from other directorates, and prepare the DRMS Annual Statement of Assurance. The preparation of the Annual Statement of Assurance requires management personnel to use their judgment in deciding which weaknesses are material and which should be reported to higher commands through the IMCP process. DRMS Headquarters provides a significant number of staff resources to internal review audits and management evaluation visits, which are intended to identify, report, and correct problems.

DRMS Annual Statement of Assurance

The DRMS Annual Statement of Assurance for FY 1994 did not adequately disclose material internal control weaknesses related to the preparation of its financial statement. The DRMS Annual Statement of Assurance disclosed only one material weakness (lack of visibility over sales proceeds, a repeat from its FY 1993 Annual Statement of Assurance) directly related to preparation of its financial statements. The statement indicated that no future action was being planned in that area even though accounting problems at NSO, reported in Inspector General, DoD, Report No. 94-164, have not been corrected. The DRMS IMCP did not disclose the material weaknesses identified in Report No. 94-164, along with those identified in Findings A and B of this report. In addition, the DRMS IMCP was not effective in identifying and reporting material weaknesses pertaining to two systems with accounting functions, the Base Operating Supply System and DAISY controls over the National Sales Program and inventory.

Base Operating Supply System. Our review of the DRMS accounting for hazardous waste/material through the Base Operating Supply System disclosed material weaknesses related to the recording of the cost of disposing of those materials as revenue and the related expense. Had the assessable unit, sales of hazardous property, included a determination of the adequacy of internal controls related to financial statement presentation, the inadequacies in the Base Operating Supply System processing and recording of sales of hazardous waste/material, as discussed in Findings A and B would have been disclosed.

Although interface problems between the Base Operating Supply System and the Defense Business Management System (used by DoD agencies to generate trial balances and financial statements) were disclosed in the DFAS FY 1994 Annual Statement of Assurance report to the Secretary of Defense, the DRMS Annual Statement of Assurance report did not represent the problems as a major weakness. We believe that the timing problem related to presentation of the costs of disposal of hazardous material as both revenue and expense by the Base Operating Supply System and the establishment of an accounts payable, is a separate issue that requires a policy decision by the Under Secretary of Defense (Comptroller). The timing problem is not specifically addressed by the DoD Guidance on Form and Content of Financial Statements for FY 1994 and FY 1995 Financial Activity and needs to be disclosed as a material weakness until it is resolved.

DAISY National Sales Program. The DRMS did not disclose the material weaknesses that were reported in Inspector General, DoD, Report No. 94-164 related to developing an accounting system at its NSO that would meet generally accepted accounting principles for accounting for sales proceeds. The DRMS Annual Statement of Assurance report stated that only a joint review was conducted by DLA, DRMS, and DFAS-CO representatives to evaluate the procedures, processes and controls in place at the NSO and the interface with DFAS-CO. The Annual Statement of Assurance report concluded that all data required by DFAS-CO for preparation of DRMS 1994 financial statements could be provided and substantiated by the DAISY National Sales Program.

As discussed in Findings A and B, the DAISY National Sales Program is still inadequate and cannot be relied upon to generate the necessary financial data required by DFAS-CO in preparing financial statements. We believe that future DRMS Annual Statement of Assurance reports need to address the material weaknesses associated with systems problems between DRMS and DFAS-CO in preparing reliable revenue data used in preparation of DRMS financial statements.

Inventory of Assessable Units

The DRMS did not change its inventory of assessable units to reflect the more stringent financial responsibilities of a DBOF business area. DRMS management is responsible for maintaining an inventory of assessable units as a part of its IMCP. Inspector General, DoD, Report No. 94-164 recommended that DRMS include in its inventory of assessable units, the major DRMS functions related to the preparation of financial statements. DRMS reduced its FY 1994 inventory of assessable units to 72, including the development of one new unit, cash management. The DRMS IMCP is still ineffective, because DRMS did not develop assessable units to adequately cover the preparation of financial statements.

None of the other 71 DRMS assessable units were assigned a high risk assessment even though material weaknesses have been previously disclosed. We believe that DRMS should immediately develop assessable units that cover the material weaknesses related to the preparation of its financial statements. It should also reassess existing units related to areas where material weaknesses have been previously disclosed and determine whether the current risk assessment is accurate. For instance, controls over usable and scrap inventory are a material weakness because of lack of enforcement.

Controls Over Usable and Scrap Inventory. DRMS did not identify controls over inventory as a material weakness in its Annual Statement of Assurance for FY 1994. Our audit tests and recent criminal investigations show that DRMS should report controls over usable and scrap inventory as a material weakness.

Results of Audit Tests We completed internal control tests over usable and scrap inventory at 16 of the 19 DRMOs visited. Results from our judgmental samples showed that controls were not adequate.

o We counted the quantities of usable property at the various locations of DRMOs and compared the counts to the quantities on the DRMOs accountable records (floor to record tests). Of the 364 items sampled, 30 were not on the accountable records. The condition is indicative of receiving problems that still exist even though extensive procedures are currently applicable.

o We compared the accountable records of the DRMOs to counts we made at inventory locations for usable property (record to floor tests). Of the 174 items sampled, 23 had missing quantities. The results of the tests were slightly different from the floor to record tests in that partial quantities were missing instead of entire quantities. The condition is indicative of problems in maintaining accurate inventory records even though extensive procedures exist concerning accountability of property.

o Tests of scrap inventory showed that controls were inadequate at 12 of the 16 DRMOs. The condition occurred because the DRMOs were not weighing scrap in accordance with DRMS procedures. Scales at some DRMOs were not operational, tallies were not maintained at other locations, and scales were not conveniently located at other locations.

o Tests of pilferable items showed that controls were inadequate at 6 of the 16 DRMOs because quantities of material were missing or misstated. Pilferable items are identified upon receipt and are required to be accounted for and stored in secured areas to preclude theft. The controls were not fully implemented. For example, 5 of 11 pilferable items selected from a secure area at DRMO-Columbus had not been entered on the accountable records. As a result of our review, corrections were made.

o Tests of precious metal inventory showed that controls were inadequate at 9 of the 16 DRMOs because quantities were missing or misstated. Precious metals are recovered by DRMOs from scrap and should be accounted for and stored in secure areas. Accurate records were not maintained. For example, 4 of 14 items sampled at DRMO-San Antonio were misstated. Three items on the accountable record had been shipped, and one item contained only 80 percent of the recorded weight. After completing substantive research, the DRMO corrected the accountable records. The accountable records for precious metals should be accurate because of the additional controls required by existing DRMS procedures to safeguard the receipt, storage, and shipment of precious metals.

Although existing DRMS procedures on controlling usable and scrap inventory are adequate, the respective DRMOs were not adequately enforcing inventory controls. Additionally, the currently assigned risk assessments related to controls over inventory need to be upgraded to indicate a "high risk" until improvements are documented.

Management Comments on the Finding

DLA comments included responses to recommendations directed to DLA and its subordinate command, DRMS. DLA partially concurred with the finding; however, DLA did not consider the internal management control weaknesses to be material.

Recommendations, Management Comments, and Audit Response

We recommend that the Commander, Defense Reutilization and Marketing Service:

1. Include in future Annual Statements of Assurance, the material weaknesses in the areas of financial statement presentation, operating systems interface problems, and inventory controls.

Management Comments. The DLA concurred and stated that they will include as material weaknesses, the areas of financial statement presentation, operating systems interface problems and inventory controls, in future annual statement of assurances, as warranted.

2. Include in the inventory of assessable units, the major Defense Reutilization and Marketing Service functions related to the preparation of financial statements.

Management Comments. The DLA concurred and stated that it developed assessable units for cash management, liaison office functions, and DFAS-CO support.

Audit Response. The DLA proposed actions meet the intent of our recommendation. A copy of the description for each of those assessable units should be provided to us for review.

3. Reassess the level of risk assigned to existing assessable units and upgrade to high risk the risk assessments related to controls over inventory.

Management Comments. DLA partially concurred and stated that they have initiated a reassessment of all assessable units and the associated risk analysis. Action is ongoing and is estimated to be completed by December 31, 1995.

Audit Response. The DLA actions to reassess levels of risk and to review the Internal Management Control Program meet the intent of our recommendation. However, we continue to regard the identified control weaknesses as material.

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

Introduction

We evaluated the DLA Reutilization and Marketing Service Business Area for material instances of noncompliance with laws and regulations for the year ended September 30, 1994. The statement accounts on which we based our evaluation are presented in the Statement of Financial Position, Statement of Operations, and related overview and footnotes to the statements dated January 11, 1995. Such tests are required by the Chief Financial Officers Act of 1990. The laws and regulations reviewed are identified in Appendix B.

Compliance with applicable laws and regulations is the responsibility of DRMS managers. As part of obtaining reasonable assurance on whether the principal statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements and other laws and regulations designated by OMB and DoD. 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.

Results of Audit

Disposition of Residual Sales Proceeds. We identified a potential problem in the disposition of public sales proceeds that was resolved during the audit. Before FY 1992, DRMS deposited residual sales proceeds into a general receipt account of the U.S. Treasury (972651) in accordance with DoD Instruction 7310.1, "Disposition of Proceeds from DoD Sales of Surplus Personal Property," July 10, 1989. That Treasury account was not a revolving fund and it was not a part of DBOF. Since becoming a DBOF business area in FY 1992, DLA accounting procedures were modified and the disposition of residual sales proceeds was changed from the 972651 account to the DRMS DBOF account 97X4930.5N54. However, DoD Instruction 7310.1 had not been modified to allow the change in disposition.

In addition, we reviewed Public Law 152, "Federal Property and Administrative Services Act of 1949," sections 203 and 204 (United States Code, title 40, sections 484 and 485), to determine whether the change in disposition had been authorized. We could not find a change in the law that authorized the change in disposition. Accordingly, we requested a legal opinion from the Office of the General Counsel, DoD, to determine whether DLA and DRMS acted properly. The General Counsel, DoD, determined that DRMS could retain the proceeds in its DBOF account.

Theft of Materiel. In addition, two instances of theft were referred to investigators during this audit. One instance resulted from audit efforts. The other instance was discovered by management. The investigations are ongoing. We also noted a material weakness related to accountability over inventory at selected DRMOs.

Conclusion. The results of our tests indicate that with respect to the items tested, except for noncompliance described in Part II.A. of this report, management complied in all material respects with the laws and regulations referred to in Appendix B. We considered the instances of material noncompliance in forming our disclaimer of opinion on the selected financial data included in the DRMS FY 1994 financial statements.

Part III - Additional Information

Appendix A. Summary of Prior Audits and Other Reviews

Prior Audits and Other Reviews

During the last 4 years, multiple audits have been performed relating to the Chief Financial Officers Act and financial statements of DBOF business areas. The principle audits related to the DLA business areas of the DBOF are summarized below.

Inspector General (IG), DoD, Report No. 94-167, "Selected Financial Accounts of the Defense Logistics Agency Defense Business Operations Fund Financial Statements for FY 1993," June 30, 1994, summarized the results of several reports on the DLA DBOF accounts. The report provided an adverse opinion on the financial data examined and identified internal control weaknesses that were considered material under standards established by OMB Bulletin 93-06. Audit trails were not adequate, reconciliations were not performed to support reported amounts, and transactions were not matched to the proper accounting period. Material instances of noncompliance with laws and regulations were addressed. Requirements of the Federal Managers Financial Integrity Act, the DoD Accounting Manual, and OMB and DoD guidance on the form and content of financial statements were not effectively implemented. The report contained no recommendations.

IG, DoD, Report No. 94-164, "Financial Statements of the Defense Reutilization and Marketing Service for FY 1993," June 30, 1994, stated that the FY 1993 financial statements for DRMS were not prepared in accordance with generally accepted accounting principles, and key asset, revenue, and expense accounts were not adequately supported or compiled in the financial records. As a result, the financial statements could not be relied on for assessing the DRMS financial position, results of operations, or performance. Also, the DRMS implementation of the DoD IMCP was ineffective at reporting weaknesses related to the preparation of financial statements. As a result, internal control weaknesses affecting the ability of the DRMS to prepare financial statements were not corrected or reported to higher command levels. The report recommended that DRMS implement necessary accounting principles to report sales revenue and inventory in accordance with generally accepted accounting principles, implement fees for services, disclose information on sales, adapt existing cost accounting systems, report inventory at net-realizable value, and establish controls over accounts receivable and accounts payable including the identification of suspense account balances. The report recommended that DLA transfer accounting functions from the NSO to DFAS. The report recommended that the Comptroller, DoD, establish a fee structure for DRMS. DRMS generally concurred with the recommendations. However,

DLA nonconcurred with the recommendation related to the transfer of accounting functions from NSO to DFAS. DRMS told the Comptroller, DoD, that it did not need a fee structure.

IG, DoD, Report No. 94-159, "Fund Balances with the Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund," June 30, 1994, stated that the DLA business area's fund balances with the Treasury accounts were not prepared in accordance with generally accepted accounting principles for Federal agencies. As a result, presentation related to the DLA cumulative $1.04 billion for fund balance with the Treasury accounts in its FY 1993 statements of financial position, cash flow, and related footnotes are misleading and cannot be relied on by users of the financial statements. The report recommended that guidance be suspended related to fund balance with the Treasury because it was not in accordance with generally accepted accounting principles; that procedures and controls be issued to establish adequate audit trails, reconciliations, and controls over appropriation limits; that sublimits be established for business areas; and that discrepancies be disclosed in the FY 1993 statements of cash flow and accompanying footnotes. DLA concurred with the recommendation to establish appropriate sublimits for business areas, and partially concurred with the recommendation to disclose discrepancies in the FY 1993 statements of cash flow and accompanying footnotes. The Under Secretary of Defense (Comptroller) issued guidance that returned responsibilities for cash management back to the DoD Components for FY 1995.

IG, DoD, Report No. 94-158, "Cash Management Within the Defense Reutilization and Marketing Service," June 30, 1994, reported that the DFAS-CO retained pre-FY 1993 and FY 1993 sales proceeds in suspense accounts for extended periods rather than releasing the proceeds to qualified recipients in a timely manner. As a result, the funds could not be used by the qualified recipients for operating purposes. The report recommended that the DRMS immediately close pre-FY 1993 sales contracts and transfer the outstanding sales proceeds to the DRMS DBOF account. The report also recommended that NSO deposit all sales proceeds generated from sales of scrap material directly into the accounts of the qualified recipients. Additionally, the report recommended that DRMS review and release FY 1993 sales proceeds to qualified recipients. DLA concurred with all recommendations, indicating that action would be taken to transfer all sales proceeds being retained in several suspense accounts maintained by the DFAS-CO to the accounts of qualified recipients; to immediately deposit all future sales proceeds generated from the sales of scrap material into the accounts of qualified recipients; and to identify and transfer all sales proceeds being retained by local finance offices to the accounts of qualified recipients.

IG, DoD, Report No. 94-150, "Inventory Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994, stated that general ledger accounts, nonfinancial records, and yearend accounting adjustments did not reflect the correct value of inventory under the control and management of DLA. As a result, the asset balances presented on the financial statements were

misstated; were not properly classified; did not include all reportable inventories; and did not disclose all restrictions on the sale, use, or disposition, of inventories and other nonfinancial resources. The report recommended that procedures and controls be established to ensure that general ledger accounts, nonfinancial records, and yearend accounting adjustments reflect the correct value of inventory under the control and management of DLA. It also recommended that physical records and documentation provide adequate support for inventory accounts, other than stock on hand; and that valuations, categorization, and disclosures on the financial statements be performed in accordance with OMB and DoD guidelines. Additionally, the report recommended that a method be developed to value reutilization and disposal inventory held by wholesale supply organizations that accurately reflects the best estimate of net realizable value. DLA concurred with the recommendations concerning inventory counts and support for inventory accounts, other than stock on hand. DLA also concurred with the valuation, categorization, and disclosure issues identified in the report but nonconcurred that they were material internal control weaknesses. The Comptroller, DoD, concurred with the recommendations concerning inventory counts and support for inventory accounts, other than stock on hand. The Comptroller nonconcurred with the recommendations concerning valuation and disclosure of DLA inventory accounts.

IG, DoD, Report No. 94-149, "Property, Plant, and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994, reported that the DLA property, plant, and equipment account acquisition costs were materially understated by at least $229.4 million. In addition, at least $24.5 million in equipment assets were inaccurately reflected in the financial records. As a result, the financial statements were inaccurate. The report recommended that the Director, DLA, establish procedures to more effectively identify and report capital assets and reconcile capital asset data provided to the DFAS. The report also recommended that the FY 1993 financial statements be revised to show the effect of capitalizing assets and the problems identified in the audit. Additionally, the report recommended that the Comptroller, DoD, revise the depreciation policy for computer software programs to recognize costs over the estimated useful life of the programs. DLA concurred with the recommendation to identify and report real property on its financial statements and the need to periodically reconcile property, plant, and equipment financial data with property records. However, DLA and DFAS did not agree to revise the financial statements until FY 1994. The Deputy Comptroller (Financial Systems) agreed in principle to revise the capital asset guidance for depreciation of software programs and stated that the DBOF Corporate Board was reviewing current policy.

IG, DoD, Report No. 94-035, "Financial Reporting Procedures for Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund for FY 1992," February 8, 1994, identified significant weaknesses in internal controls that affect the reliability of financial data presented in the financial statements. The report also identified the property, plant, and equipment account for FY 1992 as being significantly understated,

because not all capital assets had been reported. The DoD Deputy Comptroller (Management Systems) commented that property used by DBOF organizations should be reported as an asset on the financial statement of the using organization.

IG, DoD, Report No. 93-164, "Financial Statements of the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund (Defense Fuel Supply Center Financial Data) for FY 1992," September 2, 1993, stated that the inventory financial data were generally accurate; however, data in the financial statements were not properly supported, and information in the notes, overview, and supplemental financial and management information portions of the financial statements were incomplete and inaccurate. The report recommended that DLA develop procedures to ensure that financial data are reconciled, supported and accurate; that the financial statements are revised to include all required notes and supplemental information; and that the financial statements are reliable and accurate. DLA nonconcurred with some of the noninventory findings and recommendations and stated that adjustments and disclosures identified would not be made to the FY 1992 data presented in the FY 1993 financial statements and related notes.

IG, DoD, Report No. 92-129, "Defense Stock Fund Financial Statements (Materiel Managed Under the Standard Automated Material Management System) for FY 1991," August 26, 1992, identified needed accounting adjustments to the original FY 1991 financial statements, including adjustments increasing the inventory financial data by $18 million. Additionally, the financial statements did not contain footnote disclosures related to inventory restrictions and unsupported account balances; and problems were identified with the physical inventory process. The report recommended that Defense Fuel Supply Center improve its accounting procedures, reconcile financial inventory data with stock records, and establish cutoff procedures to ensure that transactions are recorded in the proper accounting period. The Defense Fuel Supply Center concurred with the recommended changes to the financial statements. However, it disagreed with our qualified opinion on the Standard Automated Material Management System inventory and nonconcurred with recommendations to improve the Defense Fuel Supply Center accounting procedures.

Appendix B. Laws and Regulations Reviewed

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

United States Code, title 40, Sections 484 and 485 (Federal Property and Administrative Services Act of 1949, Public Law 152)

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

Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993

Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993

Office of Management and Budget Circular A-127, "Financial Management Systems," December 19, 1984

Office of Management and Budget Circular No. A-123, "Internal Control Systems," August 4, 1986

"DoD Guidance on Form and Content of Financial Statements for FY 1994 and FY 1995 Financial Activity," October 20, 1994

DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983

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

DoD Directive 7200.1, "Administrative Control of Appropriations," Revised July 27, 1987

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," May 1993

Defense Reutilization and Marketing Service Manual 4160.14, "Policy and Procedures for Administration at the Defense Reutilization and Marketing Offices," June 1993

Defense Reutilization and Marketing Service Manual 4160.14, Volume IV, "Policy and Procedures in Disposal Operations for Property Accounting," July 1994

Defense Reutilization and Marketing Service Manual 4160.14, Volume VI "Policy and Procedures for Cashier Functions at the Defense Reutilization and Marketing Offices," October 1993

Defense Reutilization and Marketing Service Handbook 4160.3, "Disposal Operating Procedures," March 1993

Appendix C. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
All Recommendations	Internal Control. Provide that financial statements are presented in accordance with generally accepted accounting principles.	Nonmonetary.
A.1.b.	Economy and Efficiency. Transfer funds from suspense accounts to an operating account.	Funds put to better use. $3.4 million (Appropriation 97X6875).
B.3.	Economy and Efficiency. Suspend budget authority and reduce fees to DoD supply management customers.	Funds put to better use. $208.3 million (Appropriation 97X4930.5N54).

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Alexandria, VA

Defense Reutilization and Marketing Service

Headquarters, Defense Reutilization and Marketing Service, Battle Creek, MI
Operations East, Defense Reutilization and Marketing Service, Columbus, OH
Operations West, Defense Reutilization and Marketing Service, Ogden, UT
Defense Reutilization and Marketing Region-Europe, Wiesbaden, Germany
National Sales Office, Defense Reutilization and Marketing Service, Memphis, TN
Defense Reutilization and Marketing Office-Alameda, CA
Defense Reutilization and Marketing Office-Chambersburg, Letterkenny Army Depot, Chambersburg, PA
Defense Reutilization and Marketing Office-Columbus, Columbus, OH
Defense Reutilization and Marketing Office-Corpus Christi, Corpus Christi, TX
Defense Reutilization and Marketing Office-Hill, Hill Air Force Base (AFB), UT
Defense Reutilization and Marketing Office-Kaiserslautern, Germany
Defense Reutilization and Marketing Office-Kastel, Germany
Defense Reutilization and Marketing Office-McClellan, McClellan AFB, CA
Defense Reutilization and Marketing Office-Mechanicsburg, Mechanicsburg, PA
Defense Reutilization and Marketing Office-Molesworth, United Kingdom
Defense Reutilization and Marketing Office-Nuernburg, Germany
Defense Reutilization and Marketing Office-North Island (San Diego Naval Air Station), Imperial Beach, CA
Defense Reutilization and Marketing Office-Ogden, Ogden, UT
Defense Reutilization and Marketing Office-Pendleton, Oceanside, CA
Defense Reutilization and Marketing Office-San Antonio, Kelly AFB, TX
Defense Reutilization and Marketing Office-San Diego, Imperial Beach, CA
Defense Reutilization and Marketing Office-Seckenheim, Germany
Defense Reutilization and Marketing Office-Stockton, Rough and Ready Island, Stockton, CA
Defense Reutilization and Marketing Office-Tooele, Tooele Army Depot, UT

Defense Finance and Accounting Service

Defense Finance and Accounting Service Center, Columbus, OH
Defense Finance and Accounting Service Center, Indianapolis, IN
Defense Finance and Accounting Service-Alameda, CA
Defense Finance and Accounting Service-Chambersburg, PA
Defense Finance and Accounting Service-Hill AFB, Ogden, UT
Defense Finance and Accounting Service-Kelly AFB, San Antonio, TX
Defense Finance and Accounting Service-Pensacola, FL
Defense Finance and Accounting Service-Warner Robins AFB, Robins, GA
266th Theater Finance Command, Heidelberg, Germany
9th Regional Finance and Accounting Office, Kaiserslautern, Germany
Royal Air Force Finance Office, Alconbury, United Kingdom

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)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Financial Management)
Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
    Inspector General, National Security Agency
Commander, Defense Reutilization and Marketing Service
Inspector General, Central Imagery Office

Non-Defense Federal Organizations

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

Chairman and Ranking Minority Member 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

Part IV - Management Comments

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY REFER TO DDAI

22 MAY 1995

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Financial Statements of the Defense Reutilization and Marketing Service Business Area of the Defense business Operations Fund for FY 1994, 4LE-2008

Enclosed is our response to your request of 17 April 1995.

Encl

JACQUELINE G. BRYANT
Chief, Internal Review Office

cc:
FOX
FOE
MMSC

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

FINDING A: Statement of Financial Position. The DRMS Statement of Financial Position for FY 1994 presented unreliable account balances. The condition occurred because:

o Guidance from the Comptroller, DoD, required management to use Appropriation Control and Reporting System data in the statement and

o DRMS had not established adequate accounting controls over collections, disbursements, accounts receivable, and accounts payable.

As a result, the Statement of Financial Position cannot be relied on in making decisions.

DLA COMMENTS: Concur. Our specific comments to the finding's issues are provided with each recommendation.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(x) Concur; however, weakness is not considered material.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J. Bryant, DDAI, 17 Aug 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

Defense Logistics Agency Comments

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION A.1.a: We recommend that the Commander, Defense Reutilization and Marketing Service provide milestones in the system change request (SCR) for the correction of accounting controls over collections and disbursements at the National Sales Office and overseas organizations.

DLA COMMENTS: Concur. A system is under development to improve the control over collections and disbursements. A functional specifications' walk through will be completed 26 May 1995. Additional milestones will be developed at that time. As pointed out in the audit, we are taking steps towards better funds control at all locations. The capitalization of all DRMOs under DFAS-CO for revenue transactions will allow us to change the generic station number to the DFAS-CO station number, allowing tracking of funds and reconciliation to the Treasury Report.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 29 February 1996

ACTION OFFICER: Richard R. Sninsky , FOX,
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant, DDRT, 18 May 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION A.1.b: We recommend that the Commander, Defense Reutilization and Marketing Service establish controls that provide for timely closing of sales contracts and reconciliation of collections and disbursements to financial network records.

DLA COMMENTS: Concur. Procedures for the timely closing of sales contracts have been established, a copy of which will be forwarded to your office. We are working with DFAS-CO to reconcile suspense account data from the Defense Disbursing Analysis Reporting System down to the contract detail necessary for DRMS to analyze balances.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 29 February 1996

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant DDRE, 17 May 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION A.1.c: We recommend that the Commander, Defense Reutilization and Marketing Service establish procedures to review the validity of accounts receivable and accounts payable in the Defense Reutilization and Marketing Region-Europe.

DLA COMMENTS: Concur. During FY 1994, DRMS-E was on a separate accounting system. On 1 October 1994, they converted to the Defense Business Management System (DBMS) which provides visibility of accounting information. Procedures for reviewing the validity of accounts receivable and accounts payable have been developed for DRMS-E. A copy will be forwarded to your office.

DISPOSITION:
(x) Action is considered complete.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
Bryant DDAI, 17 Aug 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION A.1.d We recommend that the Commander, Defense Reutilization and Marketing Service establish an Account Payable Non-Federal of $80.8 million for hazardous disposal contracts and modify the existing system change request to record accounts payable at the same time the collection is recognized.

DLA COMMENTS: Concur. The current variance between hazardous receivables and payables for FY 1992 - 1994 will be corrected. A system change will be done to have the Hazardous Base Operations Support System (BOSS) establish a payable when each delivery order is obligated so that the payables and collection coincide.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 30 June 1996

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
C. Bryant DDRI 17 May 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION A.2: We recommend that the Director, Defense Logistics Agency, transfer all accounting responsibilities and related resources for national sales from the National Sales Office to the Defense Finance and Accounting Service.

DLA COMMENTS: Partially concur. A review of the functions and responsibilities at the National Sales Office is in process. Upon completion of this review, specific decisions will be made regarding accounting responsibilities. You will be advised of the results of these decisions.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 29 December 1995

ACTION OFFICER: Richard R. Sninsky, FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant DDNI, 17 May 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

Final Report Reference

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

FINDING B: Statement of Operations. The DRMS Statement of Operations for FY 1994 was unreliable. The condition occurred because DRMS accounting policies, systems, and internal controls were not adequate to account for public sales proceeds, reduce buyer defaults, and to account for the hazardous disposal program on an accrual basis. In addition, major expense categories were not adequately supported and performance measures were not consistent with financial data. As a result, the excess of revenues over expenses (profit) was significantly overstated, performance measures were misleading, and the Statement of Operations cannot be relied on for making decisions.

DLA COMMENTS: Partially concur. We disclosed in our accounting statements disagreements between the auditors and our statements on net proceeds over expenses. We believe that the disclosure is consistent with the second paragraph on page 30 under the heading Operating Results. We request that the first paragraph under the heading Operating Results be deleted.

Revised Pages 28 and 29

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(x) Concur; however, weakness is not considered material.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
Bryant, DDAE, 17 May 95

DLA APPROVAL:

George T. Babbitt
GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION B.1.a: We recommend that the Commander, Defense Reutilization and Marketing Service establish the necessary accounting policies, systems, and internal controls to define the point of sale on an accrual basis of accounting, and apply that definition consistently throughout the Defense Reutilization and Marketing Service. Incorporate the definition into all relevant accounting systems and related procedures used to account for the public sales program including transactions on defaulted contracts.

DLA COMMENTS: Concur. We have established a Process Action Team (PAT) to define point of sale by type of sale. The team will develop procedures to implement accounting for sales on an accrual basis.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 31 October 1995

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant DDNT, 17 May 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION B.1.b: We recommend that the Commander, Defense Reutilization and Marketing Service establish the necessary accounting policies, systems, and internal controls to establish a policy that requires either a nonrefundable deposit on local sales contracts or a penalty for buyer defaults on local sales contracts.

DLA COMMENTS: Partially concur. On national sales, bidders who default are charged liquidation damages and are debarred from future sales until damages are paid. Default was a problem on local sales. However, recent policy changes effectively eliminated local sales, except those held on a cash and carry basis.

DISPOSITION:
(x) Action is considered complete.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant, DDAI, 17 May 95

DLA APPROVAL:

George T. Babbitt
GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION B.2.a: We recommend that the Director, Defense Logistics Agency change, as necessary, the accounting systems and procedures used to account for the hazardous disposal program on an accrual basis of accounting.

DLA COMMENTS: Concur. We will develop a system change (NLT 31 May 1995) to the Hazardous Base Operations Support System (BOSS). The change will have the system record a payable when each delivery order is obligated in order to have the revenues and expenses for hazardous disposal coincide.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 30 June 1996

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant, DDAI, 17 Mar 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION B.2.b: We recommend that the Director, Defense Logistics Agency develop more meaningful performance measures for the Defense Reutilization and Marketing Service that show revenues and expenses by disposal program. In addition, make sure that the performance measures are consistent with revenues and expenses reported in the Statement of Operations.

DLA COMMENTS: Partially concur. We agree that performance must be measured in financial terms, but disagree that it is either effective or efficient to develop these measures by disposal program. DRMS is a business area within the DBOF, not a compiliation of discrete businesses. Futhermore, the nature of the business precludes assimilating expenses by program efficiently and would not provide meaningful data to assess the business as a whole. We will develop financial performance measures and goals consistent with the revenue and expense information reported on the Statement of Operations and with current DBOF policies.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 31 March 1996

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
J Bryant, DDAJ, 17 May 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

FINDING C: Internal Management Control Program. The DRMS had not effectively implemented the DoD Internal Management Control Program. The condition occurred because DRMS did not take corrective actions to improve the reporting of material weaknesses related to the preparation of financial statements in response to Inspector General, DoD, Report No. 94-164. In addition, DRMS did not change its inventory of assessable units to reflect the more stringent financial responsibilities of a DBOF business area. As a result, material weaknesses related to DRMS financial responsibilities have not been corrected or reported to higher command levels in the DRMS Annual Statement of Assurance.

DLA COMMENTS: Partially concur. Our specific comments to the finding's recommendation are provided with each recommendation.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(x) Concur; however, weakness is not considered material.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
C. Bryant, DCAT 17 Aug 95

DLA APPROVAL:

George T. Babbitt
GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION C.1: We recommend that the Commander, Defense Reutilization and Marketing Service include in future Annual Statements of Assurance, the material weaknesses in the areas of financial statement presentation, operating systems interface problems, and inventory controls.

DLA COMMENTS: Concur. We will include as material weaknesses, the areas of financial statement presentation, operating systems interface problems and inventory controls, in future annual statement of assurances, as warranted.

DISPOSITION:
(x) Action is considered complete.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
DDAI, 17 Aug 95

DLA APPROVAL:

George T. Babbitt

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION C.2.: We recommend that the Commander, Defense Reutilization and Marketing Service include in the inventory of assessable units, the major Defense Reutilization and Marketing Service functions related to the preparation of financial statements.

DLA COMMENTS: Concur. We have developed assessable units for Cash Management, Liaison Office Functions, and DFAS-CO Support. These three areas constitute the major areas affecting the "front-end" input to the accounting system which feeds the financial statements.

DISPOSITION:
(x) Action is considered complete.

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
[signature] DDAI, 17 May 95

DLA APPROVAL:

[signature]
GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: Audit **PURPOSE OF INPUT**: Initial

AUDIT TITLE: Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994, 4LE-2008

RECOMMENDATION C.3: We recommend that the Commander, Defense Reutilization and Marketing Service reassess the level of risk assigned to existing assessable units and upgrade to high risk the risk assessments related to controls over inventory.

DLA COMMENTS: Partially concur. We have initiated a reassessment of all assessable units and associated risk analyses which will include initial and oversight follow-up reviews. Additionally, we are implementing an aggressive, on-going review of finance, inventory, and data systems, with the primary goal of improving internal controls and reducing risk in these key functions. The risk assessment related to controls over inventory has not been upgraded to high risk. DRMS is in process of doing a top to bottom review of the IMC program which includes the risk assessment of inventory. Based on the results of the review, if warranted, then the risk assessment will be upgraded.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 31 December 1995

ACTION OFFICER: Richard R. Sninsky , FOX
REVIEW/APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller
COORDINATION: James O'Laughlin, FOX
B.A. Blackman, FOX
DIAT 18 Jy 95

DLA APPROVAL:

GEORGE T. BABBITT
Major General, USAF
Principal Deputy Director