Audit Report

OFFICE OF THE INSPECTOR GENERAL

OFFICE OF NAVAL RESEARCH'S BUDGET AUTHORIZATIONS AND EXPENDITURES

Report No. 96-051

December 22, 1995

Department of Defense

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Acronyms

ONR	Office of Naval Research
RDT&E	Research, Development, Test, and Evaluation
SRA	Special Recoupment Account

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

December 22, 1995

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Audit Report on the Office of Naval Research's Budget Authorizations and Expenditures (Report No.96-051)

We are providing this audit report for management review and comment. We considered management comments on the draft of this report in preparing the final report. This report is the result of a Defense Hotline allegation regarding transfers of funds by the Office of Naval Research among research and development projects.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Assistant Secretary of the Navy (Financial Management and Comptroller) provide additional comments on Recommendations 1 and 2 by February 22, 1996.

If you have questions on this audit, please contact Mr. Raymond Spencer, Audit Program Director, at (703) 604-9071 (DSN 664-9071) or Mr. David Vincent, Audit Project Manager, at (703) 604-9058 (DSN 664-9058). If management requests, we will provide a formal briefing on the audit results. See Appendix E for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-051 **December 22, 1995**
(Project No. 5AB-8004)

The Office of Naval Research's Budget Authorizations and Expenditures

Executive Summary

Introduction. The audit was a result of a DoD Hotline allegation that command officials from the Office of Naval Research channeled 5 percent of the congressionally authorized program funds into reserve accounts to fund projects that Congress did not approve. Specifically, the Hotline allegation concerned FY 1994 funds totalling approximately $80 million. The Hotline allegation also stipulated that management required project managers in the Office of Naval Research to falsify reports to Congress regarding expenditures against approved program elements. The Hotline allegation also stated that Office of Naval Research management executives improperly established and managed these reserve accounts to fund projects the Office of Naval Research management deemed important.

Audit Objectives. The audit objective was to evaluate three allegations regarding the Office of Naval Research reserving funds. These funds were from the Research, Development, Test, and Evaluation, Navy budget authorization, and were allegedly used to fund Research and Development projects that were not approved by Congress. We also evaluated the adequacy of the Office of Naval Research's management control program as it applied to the primary audit objective.

Audit Results. The audit did not substantiate the three allegations. Appendix B of this report addresses each allegation and the specific results of our review. The Office of Naval Research complied with all statutory and regulatory financial management requirements. However, the Office of Naval Research's management control program needed improvement and might have contributed to the perception of improprieties. See Part I for a discussion of the finding. See Appendix C for a summary of the potential benefits of the audit.

Summary of Recommendations. We recommend that Office of Naval Research establish specific management control procedures for its special recoupment and deferral accounts and eliminate the suspense and administrative hold accounts. We also recommend a comprehensive review of all internal financial management practices to reduce administrative burden and improve controls.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred in principle with the finding and concurred in part to eliminate the suspense and administrative hold accounts in its accounting system, to establish strict management control procedures, and to perform a comprehensive review of all internal financial management practices.

However, the Navy nonconcurred with including the Naval Research Laboratory in the draft recommendation that a comprehensive review of accounting and administrative practices be performed. A summary of management comments is in Part I. The complete text of management comments is in Part III.

Audit Response. The Navy comments were mostly responsive. As a result of additional work and management comments, we revised one recommendation to delete reference to the Naval Research Laboratory. We request that the Chief of Naval Research provide comments on the unresolved recommendations by February 22, 1996.

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Part I - Audit Results

Audit Background

Mission. The primary mission of the Office of Naval Research (ONR) is to plan, promote, and manage the basic research, exploratory development, and advanced technology development programs for the U.S. Navy. To accomplish this mission, ONR uses the approved Research, Development, Test, and Evaluation (RDT&E), Navy appropriation.

Allegations. The audit was a result of a Defense Hotline allegation that command officials from the ONR channeled 5 percent of the congressionally authorized program funds into reserve accounts to fund projects that Congress did not approve. Specifically, the Hotline allegation concerned FY 1994 funds totalling approximately $80 million. The Hotline allegation also claimed that management required project managers in the Office of Naval Research to falsify reports to Congress regarding fund expenditures against approved program elements. In addition, the Hotline complainant alleged that ONR management executives improperly established and managed these reserve accounts to fund projects the Office of Naval Research management deemed important. Appendix B of this report addresses the three allegations and the results of our review.

Audit Objectives

The primary audit objective was to evaluate Defense Hotline allegations that top management at ONR reserved funds from the RDT&E, Navy budget appropriation, to fund Research and Development projects that were not approved by Congress.

To accomplish this objective, we specifically evaluated:

o the process of establishing and managing the special recoupment account (SRA) and deferral, suspense, and administrative hold accounts;

o the extensive reprogramming between program elements in the RDT&E, Navy appropriation;

o the Office of the Director, Defense Research and Engineering, oversight of reprogramming actions in excess of $1 million;

o the process of reporting reprogramming actions in excess of $4 million to Congress; and

o the management control program in the ONR Comptroller's office. Specifically, we reviewed Navy procedures for planning, programming, budgeting, and documenting accounting transactions related to SRA, deferral, suspense, and administrative hold accounts.

See Appendix A for a discussion on the scope and methodology of the audit.

Implementation of Management Control Program

The management control structure in the ONR Comptroller's office needed improvement. The ONR Comptroller had not fully implemented standard operating procedures for reserve accounts maintained in the accounting system. The resulting accounting and administrative inefficiencies can unnecessarily delay the expenditure of funds for the purpose for which they were appropriated. The absence of clearly defined control procedures led to misperceptions that funds were manipulated to fund unauthorized projects.

Evaluation of the Office of Naval Research RDT&E Operating Budget Accounts

DoD Directive 5010.38 provides that "each DoD Component shall implement a comprehensive system for internal management controls that provides reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation." According to Office of Management and Budget Circular A-123, each agency shall maintain a current internal control directive assigning management responsibility for internal controls in accordance with this circular and internal control guideline.

The ONR accounting system included as many as four separate reserve accounts. Specifically, these reserve accounts were special recoupment, deferral, suspense, and administrative hold accounts. The SRA, suspense, and administrative hold accounts were internal administrative accounts used to address congressional adjustments, legal requirements, unforeseen deficiencies, or other requirements in the science and technology accounts. The deferral account was an official general ledger account that the Under Secretary of Defense (Comptroller) or the Navy Comptroller use to withhold funds until programmatic or fiscal decisions are made or until a reprogramming is signed.

Management control procedures for the SRA were outdated and not adequately documented. No written procedures were established for the deferral, suspense, and administrative hold accounts.

Reserve Accounts

Special Recoupment Account. The stated purpose of the SRA is to minimize disruption of ongoing programs by setting aside funding so the funds cannot be obligated. The SRA was also used to hold congressional fund increases that the

Office of the Under Secretary of Defense (Comptroller) has deferred pending decisions on such things as "Appropriated but not authorized," Supplemental Bills, and Rescissions.

The ONR accounting system subdivides the appropriated funds for each program element into a series of related taskings. The SRA reserve account is a distinct tasking within the program element and represents the deferred program funds. The other program element tasking consists of an allocated amount for the total ONR approved program. After all congressional undistributed amounts have reduced the SRA, the remaining balance in the SRA should be returned to the project manager.

However, in many instances, the funds were never returned to the project. For example, the "ONR Allocation Status Report," report 134, as of April 4, 1995, for program year 1994, showed that program element 602233N had a balance of $197,725 in the SRA.

We also evaluated the SRA to determine whether adequate operating procedures were established for managing this account. Some procedures had been established for the SRA. However, these management control procedures did not provide the detailed information necessary to describe and communicate responsibilities and authorities for managing the SRA account. Specifically, the procedures did not include management control requirements related to timely correction of management control weaknesses and appropriate action for violation of management controls as required by Office of Management and Budget Circular A-123. Therefore, the ONR standard operating procedures for the SRA were inadequate.

Deferral Account. The ONR established deferral accounts for the stated purpose of ensuring that funds would be available to meet Under Secretary of Defense (Comptroller) and Navy Comptroller objectives. The Under Secretary of Defense (Comptroller) and the Navy Comptroller must sometimes delay the initiation or continuation of particular RDT&E programs.

DoD Manual 7110.1M, Budget Manual, authorizes the withhold of resources from obligation temporarily through the establishment of management reserves with the intent of providing for contingencies and apportioning them for later use.

Accounts may require a deferral for the following reasons:

o uncertainty as to the character of the final congressional action,

o requirements for additional justification or documentation of development plans, and

o reprogramming changes requiring prior notification or approval of Congress.

We found that ONR had no written management control procedures for deferral accounts.

Suspense Accounts. These accounts contain "branch codes" to assign specific tasks to ONR project managers. The branch code "SU" indicates that a suspense account was created to withhold funding from program elements pending a reprogramming by higher authority, usually the Chief of Naval Operation; Assistant Secretary of the Navy (Research, Development, and Acquisition); or a Navy sponsor (RDT&E, Navy Appropriation Sponsor). Suspense account holds can also be directed by a sponsor who has identified deficiencies in the RDT&E, Navy Budget Activities (6.1 through 6.5) accounts. Beginning in FY 1995, the suspense accounts exist only in the RDT&E, Navy Budget Activities (6.3 through 6.7) accounts.

As with the deferral accounts, ONR had not established management control procedures for suspense accounts to ensure that funds were safeguarded against misuse.

Administrative Hold Accounts. Administrative hold accounts set aside funds that cannot be spent by the project managers. The ONR would establish an administrative hold account for a program element when:

- o no appropriation has been approved at the beginning of a fiscal year,
- o funding is deferred pending probable congressional reductions,*
- o congressionally earmarked funds await determination regarding congressional intent,*
- o funding has not been assigned to a project manager,* and
- o project managers cannot commit more funding than allowed under a continuing resolution authority.

Beginning in FY 1995, administrative hold accounts were eliminated for the science and technology accounts (6.1 through 6.3) but were still utilized for 6.4 through 6.7 accounts.

The ONR had not established management control procedures for administrative hold accounts to ensure that funds were safeguarded against misuse.

Accounting and Administrative Actions

We examined all reprogramming actions for FY 1994. These reprogramming actions totalled 3,422 separate data entries transacted through 431 different transfer numbers. This average of 27 reprogramming actions per month involved an average of 214 separate transactions over 16 months that the ONR

*Once this determination is made, funds are released from the administrative hold account.

Technical Director had to approve and personnel in the ONR Comptroller office had to manually input into the ONR accounting system. These extensive reprogramming actions resulted in accounting and administrative inefficiencies because each action required a separate justification memorandum, each of which required a series of approvals. In addition, each reprogramming action entailed a series of detailed accounting decisions related to specific program elements or tasks that need to be increased and decreased. The need for this degree of control over reprogramming actions needs to be re-evaluated.

We also examined in detail all accounting transactions related to program elements 601152N, 601153N, 602233N, and 603555N for FY 1994. In order to accomplish this, we examined at least four separate accounting reports to establish the validity of one accounting transaction. For example, to verify one accounting transaction in a given program element, we reviewed all transactions for obligations, disbursements, contracts, and work request orders, in addition to the four reserve accounts that were being maintained. These four separate reserve accounts (SRA, deferral, suspense, and administrative hold) had been created to accomplish the same thing: set aside a reserve for a program element so that the funds could not be obligated.

The primary mission of ONR is to promote and manage basic research and development programs for the Navy. The RDT&E, Navy appropriation, is provided to ONR in order to accomplish this mission. When this funding is unnecessarily reserved for contingencies for a significant amount of time, ONR is impeded from accomplishing this mission. Specifically, in FY 1994, a total of $34 million was reprogrammed into just the SRA account. For this same year, the total of all congressional undistributeds was only $19 million. The remaining balance of $15 million should have been expeditiously returned to the program element, but in most cases it was not and remained in the SRA for some time. As of February 14, 1995, more than 16 months after the start of FY 1994, $6 million remained in the deferral account established for FY 1994 program funds.

Conclusion

Management control procedures for establishing and managing SRA accounts at ONR are inadequate because they are incomplete or out-of-date. The ONR had not established management control procedures for managing deferral, suspense, and administrative hold accounts.

The objective in establishing four separate reserve accounts (SRA, deferral, suspense, and administrative hold) was to set aside a reserve so that program element funds could not be obligated. However, the SRA, suspense, and administrative hold accounts are redundant. Eliminating the suspense and administrative hold accounts would increase accounting and administrative efficiency.

Extensive reprogramming actions both within and between program elements at the ONR appeared to create significant amounts of unnecessary work. In addition, management controls were difficult to verify because of the absence of a clear and well-defined audit trail of accounting transactions. These issues are compounded by a cumbersome and administratively inefficient accounting system. The net result of extensive reprogramming actions, difficulty in verifying the efficiency of management controls, and an inefficient accounting system is that funds Congress appropriated for research and development projects cannot be efficiently obligated for these purposes, because they are reserved for contingencies over unnecessarily extended periods.

A process action team or similar mechanism is needed to evaluate the accounting systems and procedures at the ONR and streamline the functions and responsibilities of the ONR Comptroller Office. A primary goal should be to reduce the administrative burden created by redundant reports. Also, ONR Comptroller Office should emphasize improving management controls and enhancing the existing audit trail.

Recommendations, Management Comments, and Audit Response

On October 23, 1995, the Principal Deputy Assistant Secretary of the Navy (Financial Management and Comptroller) provided comments to our recommendations. The Principal Deputy concurred in principle with the finding and concurred in part with each of the three recommendations for corrective action. As a result of management comments, we revised draft Recommendation 3. For a complete text of management comments, see Part III.

We recommend that the Chief of Naval Research:

1. Direct the Office of Naval Research Comptroller to eliminate all suspense and administrative hold accounts from its accounting system for its Research, Development, Test, and Evaluation, Navy appropriation (6.1 through 6.7) accounts.

Management Comments. The Navy concurred in part and stated that all suspense accounts for ONR 6.1 through 6.7 programs were eliminated as of October 1, 1994, for the FY 1995 funds. The Navy also stated that administrative hold "accounts" cannot be eliminated because they are not accounts in the accounting system, but verbal direction to the Responsible Office from higher authority to reserve funds. Administrative holds that had previously been implemented via the suspense accounts that now have been eliminated will be controlled administratively and not entered into the accounting system.

Audit Response. The Navy comments regarding elimination of suspense accounts for FY 1995 funds are generally responsive. However, we believe that the use of administrative holds could probably be eliminated and, if not, should be better controlled.

If funds must be reserved based on verbal directions from higher authority, the Responsible Office should formally document this direction to maintain an audit trail and then place these funds in the SRA until final disposition is determined. Accordingly, we request that the Office of Naval Research clarify how administrative holds would be controlled administratively and not entered into the accounting system. In addition, we request that the Office of Naval Research provide us with a copy of management control procedures for these administrative holds, if their continued use is considered necessary.

2. Direct the Office of Naval Research Comptroller to establish strict management control procedures for the initial allocation to special recoupment and deferral accounts. These procedures should govern:

o when the accounts should be established,

o who has the signature authority to establish the accounts, and

o what percentage of the appropriation should be held for the future undistributeds.

The Office of Naval Research Comptroller should also develop written procedures for managing the special recoupment and deferral accounts throughout the 2-year life of the appropriation. Once all congressionally undistributed amounts and transfers have been disbursed, these reserve accounts should be eliminated and any account balance transferred to the appropriate program element.

Management Comments. The Navy concurred in part with this recommendation, stating that written procedures had been established for the special recoupment and deferral accounts. These procedures would be distributed to appropriate ONR personnel no later than October 31, 1995, and would manage these accounts over the 2-year life of the appropriation.

However, the Navy nonconcurred with eliminating the reserve accounts and returning any account balance to the program element after all congressional undistributed amounts and transfers have been disbursed. The Navy stated that, based on experience, only the amount historically required is withheld.

Audit Response. The Navy comments regarding the development and distribution of written management control procedures for special recoupment and deferral accounts are responsive. To avoid the need for a separate followup tasking, we request the Navy furnish us a copy of these management control procedures in response to this final report.

The SRA and deferral accounts can be eliminated after all congressional undistributed amounts and transfers have been disbursed. For the program manager to obligate the funds for their appropriated purpose, the program manager has to manage the programs with as much flexibility as possible. This control includes knowing when the reserve funds will be returned after all congressionally undistributed amounts and transfers have been disbursed.

The ONR Comptroller was not returning reserve funds in a timely manner, making full program execution more difficult. However, this report has served its purpose by alerting Navy fiscal managers of the need to monitor unobligated reserve balances at ONR. No further response is required.

3. Organize a process action team with the necessary knowledge and skills to conduct a comprehensive review of accounting and administrative practices at the Office of Naval Research. This team should develop specific recommendations to improve economy and efficiency within the Office of Naval Research Comptroller.

Management Comments. The ONR concurred in part with this recommendation. The ONR Comptroller formed an Internal Review Team in May 1994, which the ONR believes meets the intent of the recommended process action team. The objective of the Internal Review Team is to improve the economy and efficiency of the overall comptroller organization. As a result of this audit, the team has also been directed to ensure that management controls are in place for each procedure evaluated.

The Navy nonconcurred with including NRL in the draft recommendation, noting that the finding pertains principally to ONR.

Audit Response. The Navy alternative action and comments are responsive. We deleted reference to NRL from the recommendation.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

To accomplish the objective, we:

o reviewed the FYs 1993, 1994, and 1995 Program Budget Decisions;

o reviewed budget allocations and congressional undistributed reductions and transfers;

o reviewed the appropriateness of research and development funding allocations and associated accounting reports;

o analyzed and summarized all ONR reprogramming actions between and within program elements for FYs 1994 and 1995 through February 1995;

o reviewed all accounting transactions for FY 1994 program elements (601152N, 601153N, 602233N, and 603555N); and

o tracked one job order for testing in program element 601153N of funds obligated from the Office of Naval Research through FY 1994 at the Naval Research Laboratory.

Methodology

Use of Computer-Processed Data. We performed tests on the reliability of computer-processed data provided by ONR that was extracted from the Navy Standard Accounting and Reporting System. As a result of the tests and assessments, we concluded that the computer-processed data are sufficiently reliable to be used in meeting the audit objective. We also analyzed all accounting entries for reprogrammings within and between program elements; summarized all reprogrammings for FYs 1994 and 1995 through February 1995; analyzed all accounting entries for the four program elements in FY 1994 that illustrated the budget allocation, obligations, contracts, and disbursements; and used computer data to track a job order at the Naval Research Laboratory through FY 1994. This data included biweekly billings of charges to wages, travel, supplies, and overhead expenses.

Audit Period, Standards, and Locations. We conducted this economy and efficiency audit from November 1994 through July 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as

implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls as were considered necessary. Appendix D lists the organizations visited or contacted during the audit.

Command Efforts to Improve Management Controls

In June 1994, the ONR Comptroller initiated a internal review program to ensure that management control procedures were documented. However, none of the reserve accounts we reviewed had established procedures.

In July 1995, the Chief of Naval Research directed the ONR Comptroller to establish management control procedures for the SRA and deferral accounts in accordance with our recommendations. The objective of these procedures is to avoid mismanagement of funds that could be subject to misuse. In addition, the ONR Comptroller initiated an education program to enable ONR program element managers to understand the need for the SRA and deferral accounts.

Prior Audits and Other Reviews

The Office of the Assistant Inspector General for Auditing conducted one audit, Report No. 94-36, "Financial Status of Navy Expired Year Appropriations," February 10, 1994. The report stated that the Navy had claims of $861.4 million pending in the Research, Development, Test, and Evaluation appropriation that could result in funding deficiencies.

The report recommended that the Assistant Secretary of the Navy (Financial Management)* establish procedures for identifying future requirements and contingent liabilities that may cause deficiencies in the future. Also, the report recommended to maintain contingent liabilities in the accounting records and reports after funds expire.

*Renamed Assistant Secretary of the Navy (Financial Management and Comptroller).

Appendix B. Results of Review of Allegations

We did not substantiate the three primary allegations concerning misappropriation of funds at the Office of Naval Research.

Allegation 1. Command officials from the Office of Naval Research (ONR) are channeling 5 percent of congressionally authorized program funds into reserve accounts to fund projects that were not approved by Congress. In FY 1994, these funds totaled approximately $80 million.

Unsubstantiated. The ONR is reserving funds from the RDT&E Navy appropriation for congressional adjustments, legal requirements, or unforeseen deficiencies and requirements in the science and technology accounts. The purpose of these reserve accounts is to minimize disruption of ongoing programs by setting aside funding so the project managers cannot obligate these funds. We did not substantiate that ONR was using any funds illegally or for programs that had not been approved by congressional action. However, the amount of funds set aside in the various accounts did exceed the congressionally undistributed amounts and transfers.

Allegation 2. Management required project managers at ONR to falsify reports to Congress regarding fund expenditures against approved program elements.

Unsubstantiated. The ONR on a semi-annual basis is required to submit the "Report of Programs" (DD Form 1416) to congressional committees. This report summarizes all reprogramming actions approved during the period. Column I reports all congressionally directed undistributed amounts and transfers. Therefore, Congress is aware of the portion of the RDT&E Navy Appropriation that has not been spent on the approved program during the fiscal year.

Allegation 3. Office of Naval Research management executives established and managed these reserve accounts to fund projects deemed important by ONR management.

Unsubstantiated. The special recoupment, deferral, suspense, and administrative hold accounts are managed by ONR management executives. However, we did not substantiate that the reserve accounts were being used to fund projects that were not approved by Congress. All expenditures from the reserve accounts were for authorized projects.

Appendix C. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.	Management Controls. Reduces the administrative burden of operating two additional reserve accounts.	Nonmonetary.
2.	Management Controls. Prevents misuse of funds.	Nonmonetary.
3.	Management Controls. Creates a more effective and efficient financial management operation. Allows timely reprogramming of unobligated funds.	Undeterminable.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Under Secretary of Defense (Comptroller)
Director, Defense Research and Engineering

Department of the Navy

Office of the Assistant Secretary of the Navy (Financial Management and Comptroller)
Office of the Assistant Secretary of the Navy (Research, Development, and Acquisition), Washington, DC
Office of Naval Research, Arlington VA
Naval Research Laboratory, Washington, DC
Naval Sea Systems Command Headquarters, Arlington, VA
Naval Surface Warfare Center, Annapolis, MD
Naval Surface Warfare Center, Bethesda, MD

Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service, Cleveland, OH
Defense Accounting Office, Arlington, VA

Appendix E. Report Distribution

Office of the Secretary Defense

Under Secretary of Defense for Acquisition and Technology
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Director, Defense Research and Engineering
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Assistant Secretary of the Navy (Research, Development, and Acquisition)
Office of Naval Research
Naval Research Laboratory
Naval Sea Systems Command
Naval Surface Warfare Center
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the 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

Non-Defense Federal Organizations

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 III - Management Comments

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20350-1000

OCT 2 3 1995

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

Subj: DRAFT AUDIT REPORT ON DEFENSE HOTLINE ALLEGATIONS REGARDING THE OFFICE OF NAVAL RESEARCH'S BUDGET AUTHORIZATIONS AND EXPENDITURES, 25 AUGUST 1995 (PROJECT NO. 5AB-8004)

Ref: (a) DODIG memo of 25 Aug 95

Encl: (1) Department of the Navy Response to DODIG Draft Report of 25 Aug 95

The Department of the Navy (DON) has reviewed the subject draft audit report, forwarded by reference (a), and assessed the finding and recommendations contained therein. Detailed comments are provided in enclosure (1).

Although none of the hotline allegations were substantiated, it was determined that procedures and management controls for reserve accounts were not clearly defined and documented. The DON concurs in principle with the finding, and concurs in part with each of the three recommendations for corrective action.

The DON acknowledges the agreement of your staff to delete references to the Naval Research Laboratory, where no specific deficiencies were identified for inclusion in the finding. In addition, we note that some of the recommended actions reflect sound business practices which were already in progress or completed prior to the audit. These practices are noted in our comments, which also include recommendations for corrections and clarifications to more accurately reflect some of the information provided during the audit.

My point of contact concerning this matter is Mr. Ken Heising, FMO-213, at (703) 607-1555.

GLADYS J. COMMONS
Principal Assistant Secretary of the Navy
(Financial Management and Comptroller)

Copy to:
CNR
NRL

Office of Naval Research Comments

Department of the Navy Response

to

DODIG Draft Report of August 25, 1995

on

Defense Hotline Allegations Regarding the Office of Naval Research's Budget Authorizations and Expenditures (Project No. 5AB-8004)

PART 1 - AUDIT RESULTS

Page 4, Paragraph 1, Implementation of Management Control Program

"The management control program in the ONR Comptroller's office does not satisfy DoD Directive 5010.38, "Internal Management Control Program," and OMB Circular A-123, "Management Accountability and Control." The ONR Comptroller has not fully implemented standard operating procedures for reserve accounts maintained in the accounting system. The resulting accounting and administrative inefficiencies can unnecessarily delay the expenditure of funds to the purpose for which they were appropriated. The absence of clearly defined control procedures led a dedicated employee to inappropriately conclude that funds were manipulated to fund unauthorized projects."

DON Response: Concur in principle. While no substantial delays in expenditures occurred during FY 1994 at the Office of Naval Research (ONR), it is true that the lack of standard operating procedures could cause accounting and administrative inefficiencies which could contribute to a delay in expenditure of funds. Relative to execution, the manner in which the reserve accounts are handled has not had an adverse impact on either obligations or expenditures; and overall, the science and technology (S&T) accounts have met or exceeded the goals set for execution. Up-to-date standard operating procedures would have been helpful in preventing misunderstandings involving the use of the reserve accounts. The ONR Comptroller instituted an ongoing financial management training program in September 1994 to educate ONR program managers, their support staff, and other interested employees in various aspects of ONR financial management. Future training sessions will discuss the purposes

Encl (1)

of these reserve accounts. Standard operating procedures for the reserve accounts, which will include management controls, have been developed and will be distributed no later than 31 October 1995.

Page 4, Paragraph 3, Evaluation of the Office of Naval Research RDT&E Operating Budget Accounts:

"The ONR accounting system . . . "

DON Response: The Office of Naval Research, like all Department of Navy activities, uses an accounting system owned and maintained by the Defense Finance and Accounting Service (DFAS). References here and elsewhere to "ONR's accounting system" should be corrected to distinguish between the Department of Defense (DoD) "accounting system" and ONR's internal management information system. In most cases, it was reports from the internal management information system, and not the DoD accounting system, that the auditors used to analyze the information on reprogrammings and the reserve accounts.

Page 4, Paragraph 3:

"[The ONR accounting system] included as many as four separate reserve accounts. Specifically, these reserve accounts were special recoupment accounts (SRA), deferral, suspense, and administrative hold accounts."

DON Response: There were three reserve "accounts" entered into the accounting system: SRA, deferral, and suspense. The suspense account was used by ONR to implement administrative holds in the accounting system. Administrative holds were not an "account", but rather they were direction from the Chief of Naval Operations resource sponsors and the Assistant Secretary of the Navy (Financial Management and Comptroller). As administrative holds were never a distinct "account", but were implemented in the accounting system via the suspense account, references here and throughout the report to any "administrative hold account(s)" should be deleted.

Page 5, Paragraph 2, Special Recoupment Account:

"The ONR accounting system subdivides the appropriated funds

for each program element into a series of related taskings. The SRA reserve account is a distinct tasking within the program element and represents the deferred program funds. The other program element tasking consists of an allocated amount for the total ONR approved program."

DON Response: In the DFAS accounting system, the SRA does not necessarily represent "deferred" program. It does represent "reserved" program. A "deferral" is an official general ledger account, and not all SRA funds are "deferred." Recommend that the word "deferred" here be replaced with the word "reserved."

Page 5, Paragraph 2:

"After all congressional undistributed amounts have reduced the SRA, the remaining balance in the SRA should be returned to the project manager."

DON Response: We cannot agree that the remaining balance in the SRA should be returned automatically after congressional undistributed amounts have been disbursed. As correctly stated in Part II, Appendix B, Results of Review of Allegations, Allegation 1; ONR reserves funds from the Research, Development, Test, and Evaluation, Navy (RDT&E,N) appropriation for congressional adjustments, legal requirements, or unforeseen deficiencies and requirements in the science and technology accounts. Therefore, even after all the congressional undistributed amounts have been reduced, there may still be funds left in the SRA to cover unforeseen deficiencies and requirements.

Page 7, Paragraph 2, Administrative Hold Accounts:

"Beginning in FY 1995, administrative hold accounts were eliminated for the science and technology accounts (6.1 through 6.3) but were still utilized for 6.4 through 6.7 accounts."

DON Response: As discussed above, administrative holds were not an "account". It is correct that for Science and Technology (S&T) programs, the suspense (SU) account (which was used to record administrative holds) is no longer being used. However, as of 1 October 1994, for FY 1995 funds, the ONR Comptroller eliminated the use of the suspense account for all budget

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activities, not just 6.1 through 6.3. We recommend this statement be moved to the Suspense Account section of the report and corrected to read "Beginning in FY 1995, suspense accounts were eliminated for all of ONR's accounts in Budget Activities 6.1 through 6.7."

Page 7, Paragraph 6, and Page 8, Paragraph 1, Accounting and Administrative Actions:

"A clearly defined audit trail is a key element in implementing an effective management control system for any accounting system. However, at both the ONR and Naval Research Laboratory, the job-order cost system was administratively cumbersome and inefficient. The poorly implemented reporting systems hindered our attempts to verify summarized accounting detail. . . Accordingly, this cumbersome audit trail makes unnecessarily difficult verification of even a relatively small sample of detailed transactions."

DON Response: The DFAS accounting system used by ONR Headquarters is not a job-order cost accounting system. Since the discussion is not applicable to ONR, reference to ONR should be deleted.

Further, we do not agree, and the report provides no basis for concluding, that the system used by the Naval Research Laboratory (NRL) is "administratively cumbersome and inefficient." We also do not agree that "poorly implemented reporting systems" resulted in a "cumbersome audit trail" or otherwise "hindered" the review. Such an assessment is inappropriate and misleading, and should be deleted.

The audit team initially set out to review the entire range of source document, accounting, and billing records supporting twenty-six (26) separate billings applicable to FY 1994 Basic Research (6.1) funds issued to NRL by ONR. The sheer volume of records inherent to the broad scope and specific level of detail desired by the audit team resulted in a complex and time consuming review process. Despite this, the auditors were still able to follow audit trails and validate the accuracy of selected transactions.

The draft report does not provide any specific examples to

support a negative assessment of NRL's operations, nor was this issue addressed to management in the course of the audit or during the formal exit briefing. Subsequent to receipt of the draft report, ONR and NRL management officials met again with DoD IG officials, who identified three specific examples that led them to conclude that NRL's system was inefficient and poorly implemented:

- The decentralized time and attendance (T&A) process made it difficult for the auditors to verify T&A source records (time cards) due to the volume of transactions (26 pay periods for 1365 employees). DoD IG officials stated that the T&A process should be centralized.

- NRL's decentralized travel process made it extremely difficult to verify source documentation (travel orders). Because of this, the audit team was unable to validate source documents pertaining to travel.

- The use of microfiche files to identify source document numbers made it extremely time consuming and inefficient to complete the audit as scheduled. The scope of the audit had to be narrowed to review of financial records and transactions for a single job order. DoD IG officials asserted that the fact that the scope had to be narrowed is indicative of "inefficient and poorly implemented" systems.

In response to these three examples, the following information is offered in support of our nonconcurrence:

- The audit team was advised at the outset of the audit that payroll services for NRL were provided by the Defense Finance and Accounting Service (DFAS) as directed by the OSD Comptroller. The Defense Civilian Pay System (DCPS), the system mandated by the OSD Comptroller, dictates decentralized T&A processing. If the DoD IG believes centralized T&A processing provides a better audit trail, a recommendation to that effect should be directed to DFAS.

- The travel process at NRL is not decentralized. The on-site audit team never requested source documents pertaining to travel.

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- The scope of the audit had to be narrowed because the initial review of NRL records, which was intended to be completed in a two-week time frame, encompassed 613 funded job orders applicable to 364 separate and distinct research projects performed in 23 NRL divisions and branches. The audit technique selected by the audit team required them to review 55,666 detailed financial records and 134,490 individual accounting transactions. The audit team decided to narrow the scope of their review due to time constraints. In addition, reviewing details for twenty-six (26) separate billings, versus cumulative transactions for the fiscal year, required the review of records in off-line storage, microfiche and hard copy reports. The records for individual billing periods had been closed for billing/accounting purposes and placed in historical storage. Due to the volume and historical nature of information requested by the audit team, on-line computer files could not be used to satisfy the request.

NRL's on-line billing system is based on a cumulative cost system. Each interim billing covers cumulative costs for the fiscal year less costs previously billed. If the audit team had accepted cumulative costs supporting the cumulative year-end billing for Fiscal Year 1994, the financial system could have provided the information in "tailored" reports with all of the supporting details.

Page 8, Paragraph 2:

"When this funding is unnecessarily reserved for contingencies for a significant amount of time, ONR is impeded from accomplishing this mission. Specifically, in FY 1994, a total of $34 million was reprogrammed into just the SRA account. For this same year, the total of all congressional undistributeds was only $19 million. The remaining balance of $15 million should have been expeditiously returned to the program element, but in most cases it was not and remained in the SRA for some time."

DON Response: As discussed previously, the SRA is established to deal with more than just congressional undistributed reductions. The remaining balance was used to fund legal requirements such as the Small Business Innovation Research (SBIR) program and the Federal Laboratory Consortium; DoD

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direction for the Technology Reinvestment Program; canceled account adjustments; Assistant Secretary of the Navy (Research, Development and Acquisition) and sponsor requirements; as well as unforseen deficiencies and emerging requirements in the science and technology (S&T) accounts. In fact, the manner in which these accounts are handled has not had an adverse impact on either obligations or expenditures; and overall, the S&T accounts have met or exceeded the goals set for execution.

Page 8, Paragraph 2:

"As of February 14, 1995, more than 16 months after the start of the FY 1994, $6 million remained in the deferral account established for FY 1994 program funds."

DON Response: This statement, which could be misinterpreted as an extension of the SRA data immediately preceding it, is not related to the SRA in any way. Deferrals, as referred to in this statement, would be in the official general ledger deferral account by direction of the Assistant Secretary of the Navy (Financial Management and Comptroller) and/or the Department of Defense (DoD) Comptroller. In fact, the $6 million referred to in this statement represented a deferral in one program, Program Element 0708011N, Manufacturing Technology, which is not a science and technology (S&T) program. While it is prudent for the DoD or Assistant Secretary of the Navy (Financial Management and Comptroller) to release funds from deferral as soon as possible, there are frequently programmatic reasons for withholding them. Since the ONR Comptroller has no control over the release of deferred funds, including the funds in this example, this statement should be deleted.

Page 9, Paragraph 2, Conclusion:

"A process action team is needed to evaluate the accounting systems and procedures at the Office of Naval Research (ONR) and Naval Research Laboratory (NRL) and streamline the functions and responsibilities of the ONR Comptroller Office. It should also reduce the administrative burden created by redundant reports. This team should develop recommendations for improving management controls and enhancing the existing audit trail."

DON Response: Due to the lack of specific negative findings

and the moratorium imposed by the OSD Comptroller on changes to legacy accounting systems, including the system in use at the Naval Research Laboratory, specific reference to NRL should be deleted. It is important to note that NRL's financial processes and systems are reviewed for audit trail and internal control integrity purposes as part of the annual System Manager/User Review prescribed by the Federal Managers' Financial Integrity Act (FMFIA). Financial policy, procedures, and day-to-day operations are also reviewed annually as part of the Management Control Program prescribed by SECNAVINST 5200.35C. In addition, the accuracy and integrity of financial records and reports are audited annually as a part of on-going audits conducted by the Naval Audit Service pursuant to the Chief Financial Officers (CFO) Act of 1990.

Recommendations for Corrective Action:

"1. We recommend that the Chief of Naval Research direct the Office of Naval Research Comptroller to eliminate all suspense and administrative hold accounts from its accounting system for its Research, Development, Test, and Evaluation, Navy appropriation (6.1 through 6.7) accounts."

DON Response: Concur in part. The Office of Naval Research Comptroller eliminated all suspense accounts for its 6.1 through 6.7 programs as of 1 October 1994 (for FY 1995 funds). Administrative hold "accounts" cannot be eliminated because they are not accounts in the accounting system. Administrative holds (i.e., verbal direction to the Responsible Office to reserve funds from RDT&E,N programs) are placed pending formal actions by the Office of the Secretary of Defense (OSD), Assistant Secretary of the Navy (Research, Development and Acquisition), Chief of Naval Operations (N091), or the Assistant Secretary of the Navy (Financial Management and Comptroller). At ONR, administrative holds, which were previously implemented via the suspense accounts which have now been eliminated, will be controlled administratively and not entered into the accounting system.

"2. We recommend that the Chief of Naval Research direct the Office of Naval Research Comptroller to establish strict management control procedures for the initial allocation to special recoupment and deferral accounts. These procedures should govern:

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o when the accounts should be established,

o who has the signature authority to establish the accounts, and

o what percentage of the appropriation should be held for the future undistributeds.

In addition, the Office of Naval Research Comptroller should also develop strict written procedures for managing the special recoupment and deferral accounts throughout the 2-year life of the appropriation. Once all congressionally undistributed amounts and transfers have been disbursed, these reserve accounts should be eliminated and any account balance transferred to the appropriate program element."

DON Response: Concur in part. Written procedures for the establishment and management of the special recoupment and deferral accounts over the two-year life of the appropriation have been developed and will be distributed to appropriate ONR personnel no later than 31 October 1995. These procedures will include the definitions and uses of the reserve accounts; how and when reserve accounts are established; the authority to establish, request and approve the funds; and the responsible comptroller staff office to deal with the transactions. In addition, the procedures will address management controls such as periodic reporting, use of computerized systems, authorizations for use of funds, separation of duties, supervision, and the continual review/maintenance of the written procedures.

The Department of the Navy cannot concur in eliminating the deferral or SRA accounts after all congressionally undistributed amounts and transfers have been disbursed. There are frequently programmatic reasons to defer funds, and it is not within the authority of the ONR Comptroller to return deferred funds until they have been released by both the Office of the Secretary of Defense and the Assistant Secretary of the Navy (Financial Management and Comptroller). In addition to congressional undistributed reductions, the SRA is used to handle legal requirements (such as SBIR, the Federal Laboratory Consortium, etc.), unforseen deficiencies, and emerging requirements in the science and technology (S&T) accounts. Based on experience, only the amount historically required is withheld. It would be

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disruptive to programs to release funds early in the year and then recall them when deficiencies and requirements are surfaced. Funds will be returned in a timely fashion to the program manager for execution. It should be noted that these funds are already in the appropriate program element and only have to be released back to the program manager.

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"3. We recommend that the Chief of Naval Research organize a process action team with the necessary knowledge and skills to conduct a comprehensive review of accounting and administrative practices at the Office of Naval Research and Naval Research Laboratory. This team should develop specific recommendations to improve economy and efficiency within the Comptroller's office at both the Office of Naval Research and Naval Research Laboratory."

DON Response: Concur in part. ONR Comptroller formed an Internal Review Team in May, 1994, which we believe meets the intent of the recommended process action team. This team was tasked to evaluate, improve and document the accounting and administrative practices of the ONR Comptroller office. This team's work will improve the economy and efficiency of the comptroller organization overall. The team is led by a senior financial management supervisor, is composed of employees most knowledgeable in the area being reviewed, and includes representatives from at least three of the five branches in the directorate. Each draft procedure is reviewed by the team leader, all five branch heads, and the department head. Final review and approval is by the ONR Comptroller or his deputy. As a result of this audit, the team has been directed to ensure that management controls are in place in each of the procedures evaluated.

Procedures for "New Employee Orientation," "Check Handling," and "Security" have already been evaluated, and written procedures reflecting improvements were finalized in September, 1994, February, 1995 and March, 1995 respectively. Additional procedures in the areas of "Journal Voucher Review/NULOs," "Policy as Regards Outside Contacts," "1301 Reviews," "Handling of Correspondence," and "Centralized Master Edit Table" have been written and are awaiting approval by the ONR Comptroller. In addition, the procedures on "Deferrals," and "Special Recoupment Account" have been developed and will be distributed no later than 31 October 1995.

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In view of previous discussions pertaining to the Naval Research Laboratory, there are no negative findings which provide a basis for specifically including NRL as a party to this formal audit recommendation. Accordingly, reference to NRL should be deleted. Nevertheless, it should be noted that the Department of the Navy continues to recognize the importance of continuous review and improvement as a sound business practice applicable to all processes, including those which are not associated with specific deficiencies.

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Audit Team Members

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

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