Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE LOGISTICS AGENCY ACTIONS TO IMPROVE PROPERTY, PLANT, AND EQUIPMENT FINANCIAL REPORTING

Report No. 97-148

May 29, 1997

Department of Defense

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Acronyms

DBOF	Defense Business Operations Fund
DDRE	Defense Distribution Region East
DDRW	Defense Distribution Region West
DFSC	Defense Fuel Supply Center
DLA	Defense Logistics Agency
DPAS	Defense Property Accountability System
IG	Inspector General
PP&E	Property, Plant, and Equipment

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

May 29, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting (Report No. 97-148)

We are providing this report for your review and comments. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Director, Defense Logistics Agency, provide additional comments on Recommendation 2. by June 30, 1997. Recommendations are subject to resolution if management nonconcurs or fails to comment.

We appreciate the courtesies extended to the audit staff. Questions on this audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. John K. Issel, Audit Project Manager, at (614) 751-1400. If management requests, we will provide a formal briefing on the audit results. See Appendix C for the report distribution. The audit team members are listed on the inside back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-148
(Project No. 5FJ-2011.02)

May 29, 1997

Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting

Executive Summary

Introduction. During our work on the "Audit of the Property, Plant, and Equipment Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund," we identified issues pertaining to the accuracy of the property, plant, and equipment of the Defense Logistics Agency (DLA). We initiated the property, plant, and equipment audit to support the Chief Financial Officers Act of 1990 (Public Law 101-576, November 15, 1990), as amended by the Government Management Reform Act of 1994 (Public Law 103-356, October 13, 1994). This report is the third in a series of reports on property, plant, and equipment accounts of the Defense Business Operations Fund. The two previous reports addressed accounting and reporting of the Air Mobility Command property, plant, and equipment and capitalization of the Defense Logistics Agency software developments.

Defense Business Operations Fund activities must account for and report in their annual financial statements all assets used in providing goods or services to DoD. The assets purchased by Defense Business Operations Fund activities, such as the DLA, are capitalized. Property is capitalized when it is recorded as a capital asset in financial accounting records. The cost of property not capitalized is recorded as a current operating expense. Assets that should be capitalized include real property facilities and major equipment items, such as mechanized materials handling systems, which meet established capitalization thresholds and criteria for the useful life of an item. The FY 1996 beginning balance of assets capitalized by the DLA was $1.6 billion.

Audit Objectives. The primary objective of the audit was to determine whether the property, plant, and equipment accounts on the FY 1996 Consolidated Financial Statements of the Defense Business Operations Fund were presented fairly in accordance with the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. A subobjective was to evaluate whether the DLA implemented corrective actions recommended by previous Inspector General, DoD, reports on the capitalization and reporting of its property, plant, and equipment. We also assessed management controls and compliance with laws and regulations as applicable to the audit objective.

Audit Results. The DLA made significant progress toward correcting problems identified in prior audit reports. For example, the DLA required its organizations to perform inventories of all assets and to capitalize and record the inventories in financial records. This effort resulted in a $1.3 billion increase in the property, plant, and equipment reported on the DLA financial statements for FY 1995. However, additional actions are needed. Three DLA organizations, including 50 separate activities and locations, did not identify and report at least $422.3 million of capital assets ($386.9 million in real property and $35.4 million in materials handling equipment.) Consequently, the financial information used to report $1.6 billion of

property, plant, and equipment on the DLA financial statements for FY 1995 was understated by at least $422.3 million. This understatement will also adversely affect the DLA FY 1996 financial statements.

The recommendations in this report, if implemented, will improve the reliability and usefulness of the financial reporting of DLA property, plant, and equipment accounts. See Part I for a discussion of the audit results.

Summary of Recommendations. We recommend that the Director, DLA, require DLA organizations that did not comply with DLA guidance and DoD policy to allocate sufficient resources to identify all property, plant, and equipment, including real property facilities used in business operations. The organizations should record the results of the inventory in financial records and should report financial information on real property in the annual financial statements. In addition, the DLA needs to establish procedures to ensure that all assets are entered into the Defense Property and Accountability System.

Management Comments. The Principal Deputy Director, DLA, generally concurred with the recommendations, and stated that he will direct the Distribution Depot Region West to perform a complete inventory of its property, plant, and equipment and report the real property assets on the financial statements. He stated that the Defense Fuel Supply Center will continue to capitalize minor construction costs and the real property associated with Government-Owned-Contractor-Operated fuel terminals. He also stated that a mechanism will be established to ensure that reliable data on capital assets are entered into the Defense Property Accountability System. However, he did not agree that all of the real property used by Defense Fuel Supply Center should be reported on the financial statements. He stated that the Defense Fuel Supply Center does not control military fuel terminals and pipelines. Therefore, the Defense Fuel Supply Center does not control who derives the benefit from these assets, when the benefit is derived, and under what conditions it is derived, as required by DoD 7000.14-R, the "DoD Financial Management Regulation." He suggested we refer this issue to the Under Secretary of Defense (Comptroller) for resolution.

Audit Response. The Defense Fuel Supply Center does not control who receives benefits from assets used to store and deliver fuel. However, because those assets are used to accomplish its mission, the Defense Fuel Supply Center should report them. Therefore, we do not believe that referral of this issue to the Under Secretary of Defense (Comptroller) is necessary. We request that the Director, DLA, reconsider his comments and provide revised comments on the final report.

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Part I - Audit Results

Audit Background

This audit is part of the audit of "Property, Plant, and Equipment Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund" (Project No. 5FJ-2011).

Defense Logistics Agency. The Defense Logistics Agency (DLA) and many DoD support organizations were incorporated into the Defense Business Operations Fund (DBOF) on October 1, 1991, to improve efficiency and reduce the costs of providing services to DoD activities. The DLA portion of the DBOF consists of four major business areas: supply management, distribution depots, reutilization and marketing, and industrial plant equipment. The business areas procure and sell supplies to DoD Components and other customers; store and distribute supply items; dispose of excess and surplus materiel; and control and maintain industrial plant equipment. Until FY 1995, DLA had a fifth business area, a clothing factory, which manufactured clothing and textiles for all DoD Components. DLA maintains the equipment used by the clothing factory, which was closed in FY 1994 under the Defense Base Realignment and Closure Act.

DLA Financial Statements. For FY 1995, the DLA financial statements showed property, plant, and equipment (PP&E) assets costing $1.6 billion, accumulated depreciation of $998.7 million, and a net value of $639.7 million. Details on PP&E assets by business area are in Table 1 below.

Table 1. PP&E Accounts Reported by DLA on FY 1995 Financial Statements
(millions)

Business Area	Acquisition Cost	Accumulated Depreciation	Value Reported
Supply Management	$ 207.9	$141.7	$ 66.2
Distribution Depots	1,114.9	677.5	437.3
Reutilization and Marketing	304.6	170.7	133.9
Industrial Plant Equipment	0.0	0.0	0.0
Clothing Factory	10.9	8.6	2.2
Total for DLA	**$1,638.4**	**$998.7**	**$639.7**

The ending balances for FY 1995 represent the starting balances for FY 1996.

Audit Objectives

The primary objective of the audit was to determine whether the PP&E accounts on the FY 1996 Consolidated Financial Statements of the DBOF were presented fairly in accordance with the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. A subobjective of the audit was to evaluate whether DLA implemented corrective actions recommended by previous Inspector General (IG), DoD, reports on the capitalization and reporting of PP&E. We also assessed management controls and compliance with laws and regulations as applicable to the audit objective. See Part II, Appendix A, for the audit scope and methodology, and Appendix B for a summary of prior audit coverage related to the objective.

Defense Logistics Agency Financial Reporting of Property, Plant, and Equipment

The DLA made significant progress toward correcting problems identified in prior audits on the reporting of PP&E on financial statements. However, three major DLA organizations (consisting of 50 separate activities and locations) we reviewed did not accurately record all PP&E assets in their financial records. This condition occurred because the DLA organizations:

o had not allocated sufficient resources to perform directed inventories to identify all PP&E assets,

o had not complied with DoD reporting policy that requires DBOF activities to report their real property facilities used in operations, and

o had not established the necessary procedures to ensure that accurate and reliable financial information was entered into the Defense Property and Accountability System (DPAS).

As a result, the financial information used to develop the $1.6 billion in PP&E values on the FY 1995 DLA financial statements was understated by at least $422.3 million, which reduced the usefulness of the statements. The FY 1996 PP&E balance will also be adversely affected because the ending balances for FY 1995 represent the starting balances for FY 1996.

Financial Reporting Policy

DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, "Reporting Policy and Procedures," December 1994, requires DoD activities to be responsible for:

> 1. Ensuring the accuracy, completeness, timeliness and documentary support for all data. . . submitted. . . for. . . inclusion in financial reports.
>
> 2. Establishing appropriate internal controls to assure the accuracy of data. . .
>
> 3. Reviewing all reports. . . to assess the accuracy of financial information being reported.

For FY 1995, the DoD policy requires DBOF activities to capitalize and report all assets that have an acquisition value of $50,000 or greater and a useful life

of 2 or more years. Capital assets include, but are not limited to, physical plant and property (including minor construction), equipment, and software. Beginning in FY 1996, DBOF activities must capitalize all assets with an acquisition value of $100,000 or more.

DLA Corrective Actions

Previous audits disclosed that DLA financial reporting of PP&E contained material inaccuracies, and that because of the lack of adequate procedures, controls, and accounting systems, DLA could not produce reliable financial data. See Appendix B, Summary of Prior Audits and Other Reviews, for more details on previously reported deficiencies. To correct the reported problems, DLA took action by issuing guidance, "Financial Recording of Capital Assets," on October 17, 1994. The guidance required DLA organizations to develop a complete listing of all capital assets by performing a complete inventory and entering the results into financial records. After this information was collected, DLA performed reconciliations at some reporting organizations to validate the accuracy of the financial data.

As a result of DLA efforts, the value of the reported PP&E was significantly improved. For example, reported PP&E values increased from $319 million on the FY 1993 DLA Statement of Financial Position to $1.6 billion on the FY 1995 DLA Statement of Financial Position. The ending balances for FY 1995 represent the starting balances for FY 1996.

PP&E Reported in FY 1995

Although DLA took action to correct the financial reporting of PP&E, the data used to develop its FY 1995 financial statements were still materially understated. We reviewed three DLA organizations: the Defense Distribution Region East (DDRE), the Defense Distribution Region West (DDRW), and the Defense Fuel Supply Center (DFSC). At those organizations, PP&E assets costing $422.3 million was not recorded in the financial statements. Our review included comparisons of property records to financial reports for 2 of the 14 Distribution Depots within the DDRE, 7 of the 14 Distribution Depots within the DDRW, and 41 of the 500 fueling locations managed by the DFSC.

For the three organizations we reviewed, the combined PP&E value reported on the FY 1995 DLA Financial Statements was $1,184 million. The $422.3 million in unrecorded assets consisted of $386.9 million in real property facilities and $35.4 million in mechanized materials handling systems. Table 2 shows the amount of PP&E that each organization reported in FY 1995 and the amount not recorded.

Table 2. PP&E Accounts Reported by DLA on FY 1995 Financial Statements and Unrecorded Amounts
(millions)

Organization	PP&E Reported	PP&E Unrecorded
DDRE	$890.4	$ 17.1
DDRW	224.6	233.5
DFSC	3.4	171.7
Total	**$1,118.4**	**$422.3**

Reporting of Real Property

Two DLA organizations, DDRW and DFSC, had not adequately identified or reported $386.9 million of real property assets.

Defense Distribution Depots. The DDRW is the headquarters for 14 distribution depots. DDRW management had not allocated sufficient resources to perform directed inventories to identify all PP&E assets. The FY 1995 financial data for DDRW showed only $59.8 million for the value of real property facilities used in its operations. This value represents only one facility, located at Defense Depot Sharp, California. The DDRW facility engineers provided us with property records for 7 of the 14 Defense Depots managed by the DDRW. Those records identified facilities valued at an additional $215.1 million that were not reported. For example, the property records showed that the DDRW used 11 facilities, valued at $50.9 million, at McClellan Air Force Base, California.

Defense Fuel Supply Center. The DFSC manages DoD bulk petroleum products from the point of purchase to end use by the customer. To accomplish its mission, the DFSC manages hundreds of fuel storage and pipeline assets. But the DFSC did not report any of these assets in the DLA financial statements. We obtained DLA records for 41 DFSC locations showing at least 40 minor construction projects, valued at $4.3 million, which were completed in the last 5 years, and for 32 buildings or fuel storage facilities valued at $167.4 million. When we asked why these assets were not shown on DLA

financial statements, DFSC personnel stated that since DoD agencies could not hold title to real property, these assets should not be included in their reported PP&E accounts.

However, the issue of DoD agency ownership and financial statement reporting of real property assets had been settled previously. An Under Secretary of Defense (Comptroller) policy memorandum, issued on December 29, 1993; an opinion from the General Accounting Office, issued on May 3, 1994; and IG, DoD, audit reports issued between February 1994 and November 1996 had all specified that DBOF organizations that had preponderant use of real property assets should reflect those assets in their financial statements. (See Appendix B for details of the audit reports.) Other DLA business areas, such as Defense Distribution Depots, already included some real property assets on their financial records. Consequently, DFSC should also report the real property assets used to perform its mission.

Reporting of Materials Handling Systems

In addition to the understated real property values discussed previously, three DLA activities did not include $35.4 million of mechanized materials handling systems in financial records. Specifically, the DDRE Defense Depots Columbus, Ohio, and Richmond, Virginia, and the DDRW Defense Depot San Diego, California, did not report $35.4 million of materials handling or conveyor systems. We attribute this condition to a lack of procedures to ensure that accurate and reliable financial information on PP&E was entered into the DPAS.

The Under Secretary of Defense (Comptroller) has designated DPAS as the DoD-wide system for financial reporting of PP&E, and the DLA distribution depots have adopted DPAS. Before DPAS was adopted, the DLA distribution depots maintained records of PP&E assets on the Base Operating Supply System and the Equipment Management and Control System. The Base Operating Supply System was used to account for DLA property; DLA used this system to enter PP&E records into DPAS for financial reporting purposes. However, at the distribution depots, mechanized materials handling systems were not included in the Base Operating Supply System. The reason was that materials handling systems, when installed in warehouses, were considered fixed systems and less susceptible to pilferage. Materials handling systems were recorded in the Equipment Management and Control System only for scheduling needed maintenance. Because only the assets in the Base Operating Supply System were entered into DPAS, materials handling systems costing $35.4 million were not included in DLA financial statements.

Summary

DLA made significant progress toward correcting problems identified in prior audit reports on the reporting of PP&E. However, at the three major DLA organizations, significant amounts of PP&E we reviewed were not reported in the FY 1995 DLA financial statements. The material understatement of DLA assets (at least $422.3 million) will adversely affect the FY 1996 financial statements. DLA needed better oversight at those organizations to improve the accuracy of the PP&E reported on its annual financial statements.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Logistics Agency:

1. Direct the Defense Distribution Region West to allocate sufficient resources to perform a complete inventory of its property, plant, and equipment, giving specific instructions to ensure that all real property assets are entered into its financial statement reports.

Management Comments. The Principal Deputy Director, DLA, stated that he will direct the Distribution Depot Region West to allocate sufficient resources to perform a complete inventory of its property, plant, and equipment and to report the real property assets on the financial statements. The estimated completion date is August 31, 1997.

2. Require the Defense Fuel Supply Center to establish procedures to ensure compliance with the DoD policy of reporting in the annual financial statements all real property assets used to accomplish its mission.

Management Comments. The Principal Deputy Director, DLA, stated that the DFSC will continue to capitalize minor construction costs and the real property associated with Government-Owned-Contractor-Operated fuel terminals. He did not agree that all of the real property DFSC uses to accomplish its mission should be shown on the financial statements. He stated that the DFSC does not control the military fuel terminals and pipelines. Therefore, the DFSC is unable to direct who derives the benefit from these assets, when the benefit is derived, and under what conditions it is derived, as required by DoD 7000.14-R. He suggested we refer this issue to the Under Secretary of Defense (Comptroller) for resolution.

Audit Response. The DFSC does not control who receives benefits from the assets used in the storage and delivery of fuel. However, because those assets are used to accomplish its mission, the DFSC should report them. Therefore,

we do not believe that referral of this issue to the Under Secretary of Defense (Comptroller) is necessary. We request that the Director, DLA, reconsider his comments and provide revised comments on the final report.

3. Establish procedures to ensure that all property, plant, and equipment assets are entered into the Defense Property Accountability System for reporting on the financial statements. Specifically, mechanized materials handling systems included in the Equipment Maintenance and Control System, but not in the Base Operating Supply System, should be entered into the Defense Property Accountability System.

Management Comments. The Principal Deputy Director, DLA, stated that he will establish a mechanism to ensure that reliable data on capital assets are entered into the Defense Property Accountability System. The estimated completion date is August 31, 1997.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Methodology

We reviewed DoD policies issued from September 1991 through June 1996 on DBOF financial operations. Our review included the policies, procedures, and controls used to prepare the FY 1995 financial statements for the PP&E accounts of DLA. FY 1995 financial statements were reviewed because FY 1995 ending PP&E balances represent beginning balances for FY 1996; therefore, material errors in these statements would adversely affect the FY 1996 statements. We compared the assets recorded on property records to assets shown on financial records for 2 of the 14 distribution depots in DDRE, 7 of the 14 depots within DDRW, and 41 of more than 500 fueling locations managed by DFSC. The three organizations (DDRE, DDRW, and DFSC) reported PP&E assets costing $1.1 billion out of a total of $1.6 billion in PP&E assets for DLA. This financial-related audit was conducted from May through August 1996, in accordance with Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," and auditing standards issued by the Comptroller General of the United States as implemented by the IG, DoD.

We relied on computer-processed data from the DPAS, the Base Operating Supply System, and the Equipment Management and Control System to conduct this audit. To assess the reliability of the computer-processed data, we compared the capital assets on property records at selected DLA organizations, activities, and locations to the assets on financial records. Additionally, we verified the property records against actual on-hand assets at selected locations. We found that the computer-processed data were incomplete and could not be relied on to accurately report in annual financial statements the value of PP&E belonging to DLA. Statistical sampling procedures were not used for this audit. We followed up on PP&E reporting deficiencies identified during previous audits to determine whether corrective actions had been taken.

Organizations Visited or Contacted

Contacts During the Audit. We visited or contacted individuals or organizations within the DoD. Further details are available on request.

Management Control Program

Since FY 1995, the DLA has reported a material management control weakness in financial accounting for PP&E in its annual statements of assurance required by the Federal Managers' Financial Integrity Act. The statements provided a plan of action and estimated that the weakness would be corrected by the end of FY 1996. However, sufficient corrective actions had not been taken to meet this time frame. We identified material management control weaknesses as defined by Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982;" Office of Management and Budget Circular No. A-123, "Internal Control Systems;" and DoD Directive 5010.38, "Internal Management Control Program." DLA has not met its milestones for implementing DPAS; as a result, real property facilities and general property are not being reported in the financial records, and the expected completion dates for corrective actions have changed several times since DLA began reporting the material weakness concerning the accounting and reporting of PP&E. Correcting the management control weaknesses will not result in any quantifiable monetary benefits, but will significantly improve the accuracy of financial data reported. A copy of this final report will be provided to the senior officials responsible for management controls in the Office of the Secretary of Defense and DLA.

Appendix B. Summary of Prior Audits and Other Reviews

In prior audits of the DLA portion of DBOF financial statements, IG, DoD, auditors found that the PP&E accounts were significantly understated because not all equipment was included and real property and software were excluded. The primary audits are discussed below.

IG, DoD, Report No. 97-097. This report, "Capitalization of Software Developed for the Distribution Standard System," was issued on February 19,1997. The report stated that DLA had not properly capitalized $57.8 million of software developed for the Distribution Standard System. As a result, the FY 1995 financial statements for the DLA Defense Distribution Depot business areas were materially understated. To improve the reliability of the financial data, the IG, DoD, recommended that the Director, DLA, establish procedures to comply with the policy in DoD 7000.14-R on the capitalization of software development. DLA agreed to take corrective action.

IG, DoD, Report No. 97-112. This report, "Air Mobility Command Financial Reporting of Property, Plant, and Equipment," was issued on March 19, 1997. The report stated that the Air Mobility Command and the Defense Finance and Accounting Service Denver Center did not take action to properly account for and report on financial statements the PP&E used in the Air Mobility Command operations. The IG, DoD, recommended that the Commander, Air Mobility Command, in conjunction with Defense Finance and Accounting Service, implement the policies, procedures, and controls outlined in DoD 7000.14-R that are necessary to obtain and maintain financial data that accurately reflect the values of PP&E accounts. Corrective actions have been initiated.

IG, DoD, Report No. 95-197. This report, "Statement of Financial Position for the Defense Logistics Agency Distribution Depot Business Area of the Defense Business Operations Fund, as of September 30, 1994," was issued on May 19, 1995. The auditors disclaimed an opinion on the Statement of Financial Position because of factors affecting a majority of the amounts listed in the statement. The reported value of PP&E was materially understated because not all real property facilities were included. DLA initiated corrective actions, but the distribution depots' PP&E values would not be accurately reported until the end of FY 1995. As addressed in Part I, corrective actions have not been completed.

IG, DoD, Report No. 95-144. This report, "Recovery of Deprecation for Real Property Facilities," was issued on March 13, 1995. The report addressed the Under Secretary of Defense (Comptroller) policy on DBOF funding. The report stated that the Under Secretary of Defense (Comptroller) did not promptly revise DBOF funding policy; also, depreciation for military construction and non-DBOF-funded minor construction projects was included in the cost recovery rates of the DLA distribution depots. As a result, the DLA distribution depots overcorrected $84 million from the Military Departments

from FYs 1993 through 1995 for services provided. Subsequently, by complying with congressional direction, the Under Secretary of Defense (Comptroller) reimbursed the Military Departments for the majority of funds overcorrected, and DoD policy was revised to exclude from cost recovery rates the depreciation for military construction and non-DBOF-funded minor construction projects.

IG, DoD, Report No. 94-149. This report, "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," was issued on June 28, 1994. This report stated that DLA acquisition costs for PP&E were materially understated by at least $229.4 million. The report recommended that the Director, DLA, establish procedures to more effectively identify and report capital assets and reconcile data on capital assets provided to the Defense Finance and Accounting Service. DLA agreed to identify and report real property on its financial statements and to periodically reconcile PP&E financial data with property records. DLA established guidance requiring its organizations to develop a comprehensive listing of all capital assets by performing complete inventories and entering the results into financial records. After this information was collected, DLA performed reconciliations at some reporting organizations to validate the accuracy of the financial data. As a result of DLA efforts, the value of the reported PP&E was significantly less understated. For example, reported PP&E values increased from $319 million on the FY 1993 DLA Statement of Financial Position to $1.6 billion on the FY 1995 DLA Statement of Financial Position.

IG, DoD, Report No. 94-035. This report, "Financial Reporting Procedures for Defense Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund," was issued on February 8, 1994. The PP&E account reported on the DLA financial statements for FY 1992 was materially understated because DLA had not complied with DoD policy by reporting all capital assets. DLA also did not report the value of real property assets it used in providing goods and services. Guidance from the Under Secretary of Defense (Comptroller) required DBOF organizations to report on financial statements the value of real property assets when they could establish preponderant use of those assets in producing goods and services. DLA stated that the DoD policy was contrary to the United States Code, which gives the Military Departments jurisdiction over real property facilities. The Comptroller General upheld the DoD policy. As a result, DLA initiated actions to improve the financial reporting of real property by its distribution depots.

Appendix C. Report Distribution

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Part III - Management Comments

Defense Logistics Agency Comments

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IN REPLY REFER TO DDAI

5 MAR 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting (Project No. 5FJ-2011.02)

This is in response to the January 15, 1997 Draft Report. If you have any questions, please contact Mrs. LaVaeda Coulter, (703) 767-6261.

Encl

OLIVER COLEMAN
Acting Chief, Internal Review Office

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Subject: DRAFT REPORT: Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting (Project No. 5FJ-2011.02)

Finding: The DLA made significant progress toward correcting problems identified in prior audits on the reporting of PP&E on financial statements. However, three major DLA organizations (consisting of 50 separate activities and locations) we reviewed did not accurately record all PP&E assets in their financial records. This condition occurred because the DLA organizations:

o had not allocated sufficient resources to perform directed inventories to identify all PP&E assets,

o had not complied with DoD reporting policy that requires DBOF activities to report their real property facilities used in operations, and

o had not established the necessary procedures to ensure that accurate and reliable financial information was entered into the Defense Property and Accountability System (DPAS)

As a result, the financial information used to develop the $1.6 billion in PP&E values on the FY 1995 DLA financial statements was understated by at least $422.3 million, which reduced the usefulness of the statements. The FY 1996 PP&E balances will also be adversely affected because the ending balances for FY 1995 represent the starting balances for FY 1996.

DLA Comments: Partially concur. Our specific comments to the finding are provided under the context of the recommendations.

Internal Management Control Weakness:
Concur; weakness will be reported in the DLA Annual Statement of Assurance.

Action Officer: Richard Sninsky, FOXS
Review/Approval: B.A. Blackman, FOX
Coordination: LaVaeda Coulter, DDAI, 767-6261
Oliver Coleman, Acting Chief, Internal Review Office
Oliver Coleman 4 MAR 97

DLA Approval:

RAY E. McCOY
Major General, USA
Principal Deputy Director

05 MAR 1997

Subject: Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting (Project No. 5FJ-2011.02)

Recommendation No. 1.: We recommend that the Director, Defense Logistics Agency direct the Defense Distribution Region West (DDRW) to allocate sufficient resources to perform a complete inventory of its property, plant, and equipment, giving specific instructions to ensure that all real property assets are entered into its financial statement reports.

DLA Comments: Concur. Via a memorandum, we will direct DDRW to allocate sufficient resources to perform a complete inventory of its property, plant, and equipment and ensure that real property assets are reported on the financial statements.

Disposition: Action is on going. ECD: 31 Aug 1997

Action Officer: Richard Sninsky, FOXS
Review/Approval: B.A. Blackman, FOX
Coordination: LaVaeda Coulter, DDAI, 767-6261
Oliver Coleman, Acting Chief, Internal Review Office
Oliver Coleman 4 MAR 97

DLA Approval:

[illegible]
[illegible], USA
[illegible] Deputy Director

05 MAR 1997

Subject: Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting (Project No. 5FJ-2011.02)

Recommendation No. 2.: We recommend that the Director, Defense Logistics Agency require the Defense Fuel Supply Center (DFSC) to establish procedures to ensure compliance with DoD policy to report all real property assets used to accomplish its mission in annual financial statements.

DLA Comments: Partially concur. While we agree to continue to capitalize minor construction costs and real property associated with the cited Government-Owned-Contractor-Operated (GOCO) fuel terminals, we do not agree that **all** of the real property that DFSC uses to accomplish its mission should be reflected in their financial statements. Our reasons are as follows:

o DoD 7000.14-R, Volume 11B, chapter 58, paragraph E.2.b., requires the reporting entity to obtain the benefit and control access to the benefit inherent in the asset. Specifically, this criteria requires the reporting entity to be able to direct who derives the benefit, the timing of when the benefit is derived and under what conditions it is derived.

o We do not agree that **all** of the real property assets that DFSCs' fuel moves through, meets the above criteria because DFSC does not have operational control of the Military installation fuel terminals and pipelines. The sub-reporting entity, DFSC, does not control the receipt, storage, issuance, and movement of the fuel. DFSC does not identify, schedule, nor perform the maintenance and repairs of the facilities.

o Therefore, we do not agree that DFSC meets the requirement of obtaining the benefit and controlling the access to the benefit inherent in the real property fuel related assets on the Military installations. We suggest that you refer this issue to the Office of the Under Secretary of Defense (Comptroller), Accounting Policy, for resolution.

Disposition: Action is on going. ECD: If any, to be determined based on results of resolution.

Action Officer: Richard Sninsky, FOXS
Review/Approval: B.A. Blackman, FOX
Coordination: LaVaeda Coulter, DDAI, 767-6261
Oliver Coleman, Acting Chief, Internal Review Office

DLA Approval: Oliver Coleman 4 MAR 97

RAY E. McCOY
Major General, USA
Principal Deputy Director

05 MAR 1997

Subject: Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting (Project No. 5FJ-2011.02)

Recommendation No. 3.: We recommend that the Director, Defense Logistics Agency establish procedures to ensure that all property, plant, and equipment assets are entered into the Defense Property Accountability System for reporting on the financial statements. Specifically, mechanized materials handling systems included in the Equipment Maintenance and Control System, but not in the Base Operating Supply System, should be entered into the Defense Property Accountability System.

DLA Comments: Concur. We will establish a mechanism to ensure that capitalizable items included in the Equipment Maintenance and Control System are entered into DPAS.

Disposition: Action is on going. ECD: 31 August 1997

Action Officer: Richard Sninsky, FOXS
Review/Approval: B.A. Blackman, FOX
Coordination: LaVaeda Coulter, DDAI, 767-6261
Oliver Coleman, Acting Chief, Internal Review Office
Oliver Coleman 4 MAR 97

DLA Approval:

RAY E. McCOY
Major General, USA
Principal Deputy Director
05 MAR 1997

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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