Audit Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL STATEMENTS OF THE DEFENSE REUTILIZATION AND MARKETING SERVICE FOR FY 1993

Report No. 94-164 June 30, 1994

Department of Defense

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Acronyms

CFO	Chief Financial Officers
DAISY	Defense Automated Inventory System
DBMS	Defense Business Management System
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DRMS	Defense Reutilization and Marketing Service
IMC	Internal Management Control
NSO	National Sales Office
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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June 30, 1994

MEMORANDUM FOR THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 (Report No. 94-164)

We are providing this report for your review and comments. It discusses the FY 1993 financial statements of the Defense Reutilization and Marketing Service, but we did not attempt to render a formal audit opinion. Comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Based on comments received from the Defense Logistics Agency we added two recommendations to the Comptroller of the DoD. Therefore, we are requesting that the Comptroller of the DoD provide comments on those recommendations and that the Defense Logistics Agency reconsider its responses to certain items. We request that comments be provided on the unresolved recommendations by August 29, 1994.

The courtesies extended to the staff are appreciated. If you have any questions about this audit, please contact Mr. Stuart Dunnett, Audit Project Manager, at (614) 337-8009. Copies of the final report will be distributed to the organizations listed in Appendix D. The audit team members are listed on the inside back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-164 **June 30, 1994**
(Project No. 2LE-2020)

FINANCIAL STATEMENTS OF THE DEFENSE REUTILIZATION AND MARKETING SERVICE FOR FY 1993

EXECUTIVE SUMMARY

Introduction. This audit was required by the Chief Financial Officers Act of 1990 (Public Law 101-576). The Defense Reutilization and Marketing Service (DRMS) is primarily responsible for disposing of excess, scrap, and hazardous DoD property. During FY 1993, DRMS reported in its financial statements $271.6 million in revenues and $396.5 million in expenses for the disposal of that type of property.

DoD established the Defense Business Operations Fund in FY 1992 as a revolving fund to provide a financial structure for business components, such as DRMS, to operate and to encourage increased cost visibility and monetary savings through better business practices. Prior to its inclusion in the Defense Business Operations Fund, DRMS was not required to prepare auditable financial statements.

Objectives. The primary objective of this audit was to determine whether the FY 1993 financial statements for DRMS were presented fairly and in accordance with generally accepted accounting principles for Federal agencies. We assessed performance measures, financial records, and compliance with laws and regulations pertaining to the preparation of the financial statements to determine the usefulness of reported information.

Audit Results. The FY 1993 financial statements for DRMS were not prepared in accordance with generally accepted accounting principles, and key asset, revenue, and expense accounts were not adequately supported or compiled in the financial records. As a result, the financial statements cannot be relied upon for assessing the DRMS financial position, results of operations, or performance (Finding A).

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

Internal Controls. Internal controls were not effective to ensure that financial statements were prepared in accordance with generally accepted accounting principles and that material internal control weaknesses identified by external and internal sources were corrected or reported to higher command levels. Part I discusses the internal controls assessed and Part II provides details of weaknesses identified.

Potential Benefits of Audit. The audit identified no quantifiable monetary benefits. However, improved financial management in DRMS through enhanced accounting and internal control systems should result in increased cost visibility and monetary benefits through better business practices (see Appendix B).

Summary of Recommendations. We recommended that the Commander, Defense Reutilization and Marketing Service reassess the proposed fee for reutilization to consider an item's condition; develop fees for transfer, donation, reimbursable sales, and hazardous disposal programs based on operating costs; account for reimbursable sales separate from nonreimbursable sales; track operating costs by disposal program; value inventory at net realizable value; and link sales revenue to related accounts. We recommended that the Director, Defense Logistics Agency transfer the accounting functions and related resources from the National Sales Office to the Defense Finance and Accounting Service. We also recommended that the Commander, DRMS reevaluate the inventory of assessable units to include preparation of financial statements, and assign the responsibility for implementing the DoD Internal Management Control Program at a more appropriate management level. Further, based on management comments to the draft report, we recommended that the Comptroller of the Department of Defense develop a fee structure for the DRMS's reutilization, transfer, donation, reimbursable sales, and hazardous disposal services that is based on operating costs and direct the Defense Logistics Agency to establish the procedures necessary to bill customers and record revenue in the financial statements.

Management Comments. The Defense Logistics Agency responded to all of the recommendations. Although partially concurring with a need to put a fee structure in place for reutilization, donation, transfer, reimbursable sales, and hazardous disposal programs, the Defense Logistics Agency stated that the DRMS could not unilaterally implement a fee structure and begin charging customers for those services. He therefore recommended that the associated recommendations be redirected to DoD.

The Defense Logistics Agency agreed to make the accounting changes needed at the National Sales Office to account for sales revenue and related cash, accounts receivable, bad debts, and accounts payable; to restate the value of inventory and report cost of goods sold at net realizable value; disclose pertinent information about suspense accounts; and to make the necessary changes in the Internal Management Control Program. However, DLA stated that it was premature to start tracking DRMS operating costs by program, that reimbursable sales need not be accounted for separately from nonreimbursable sales, and that the National Sales Office should retain its accounting functions rather than transferring the functions to Defense Finance and Accounting Service. A discussion of the Defense Logistics Agency comments is in Part II of this report. The complete text of the Defense Logistics Agency comments is in Part IV.

Audit Response. Based on the Defense Logistics Agency's comments, we added recommendations requesting the Comptroller of the DoD to establish a fee structure for DRMS to bill customers. Also, we revised another recommendation to clarify our draft recommendation requesting that reimbursable sales be recorded as a separate category on DRMS's financial statements. We request that the Defense Logistics Agency reconsider its position on tracking operating cost by disposal program, and transferring accounting functions from the National Sales Office to the Defense Finance and Accounting Service. Further, we request that the Comptroller of the DoD and the Defense Logistics Agency provide comments on the recommendations by August 29, 1994.

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

Part I - Introduction

Background

Chief Financial Officers Act of 1990. The Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576) requires annual audits of Defense Business Operations Fund (DBOF) activities. The CFO Act is intended to improve financial management in the Federal Government through enhanced accounting and internal control systems. DoD managers face major challenges in developing meaningful financial information and a sound internal control structure as envisioned by the CFO Act.

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

Performance Measures. Performance measures are an integral part of the CFO Act and the Government Performance and Results Act of 1993. Traditional performance measures used by private companies, such as net income, are not relevant to most Federal activities because Government activities generally do not experience competition. Federal activities are to provide measures that assist users of financial statements in evaluating efforts, costs, and accomplishments; the manner in which efforts and accomplishments have been financed; and the management of assets and liabilities. Performance measures in DoD are intended to help identify ways to reduce the size and expense of DoD support activities without sacrificing service or quality.

Defense Reutilization and Marketing Service. The Defense Reutilization and Marketing Service (DRMS) is a field activity of the Defense Logistics Agency (DLA). DRMS is primarily responsible for disposing of excess, scrap, and hazardous DoD property through various disposal programs. During FY 1993, DRMS reported in its financial statements $271.6 million in revenues and spent $396.5 million on disposal programs. Preparation of financial statements is a joint responsibility of DRMS and the Defense Finance and Accounting Service (DFAS). Prior to its inclusion in the DBOF, DRMS was not required to prepare auditable financial statements. In FY 1993, DoD required that the DRMS financial statements include comparisons of revenues and costs of material disposal on a program basis. To provide this performance measurement information, DRMS needs to charge all customers appropriate fees and track relevant operating costs by program.

Objectives

Our primary objective was to determine whether the DRMS financial statements for FY 1993 were presented fairly and in accordance with generally accepted accounting principles for Federal agencies. We also assessed performance measures, financial records, and compliance with laws and regulations pertaining to the preparation of financial statements to determine the usefulness of reported information.

Scope and Methodology

Because FY 1993 is the first year that an audit of the financial statements was performed, we limited the scope of our review to determine whether the accounting principles and financial records used by DRMS adequately accounted for key asset, revenue and expense accounts. We reviewed computer-processed data, sales contracts, FYs 1991 and 1992 bad debt records, and other relevant accounting records. We did not evaluate the general and application controls of the various computer-processed systems used to prepare the financial data. We evaluated the presentation of financial and performance information for selected accounts in the FY 1992 and FY 1993 financial statements for compliance with Office of Management and Budget (OMB) Bulletin 93-02, "Form and Content of Agency Financial Statements," October 1992 and DoD policies. We evaluated the data shown in the FY 1993 financial statements to determine whether they fairly represented the financial position and results of DRMS operations and provided the required performance data.

We conducted our audit in accordance with generally accepted Government auditing standards issued by the U.S. Comptroller General, as implemented by the Inspector General, DoD and OMB Bulletin No. 93-06 "Audit Requirements for Federal Financial Statements" January 1993. Accordingly, we included tests of internal controls that we considered necessary. The audit was performed from November 1992 through January 1994. Organizations visited or contacted during the audit are in Appendix C.

Internal Controls

In planning and performing the audit, we considered the DRMS overall internal control structure. The purposes of the consideration were to determine the magnitude and scope of audit effort necessary for expressing an opinion on the financial statements and to determine whether the internal control structure complied with the DoD Internal Management Control (IMC) Program. The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987.

Controls were not effective to ensure that financial statements were prepared in accordance with generally accepted accounting principles and that material internal control weaknesses identified by external and internal sources were corrected or reported to higher command levels. Preparation of reliable financial statements was not included as an assessable unit under the IMC Program. Recommendations A.1., B.1., and B.2. will correct the weaknesses reported, if implemented. No monetary benefits are associated with the internal control weaknesses. Appendix B summarizes other potential benefits of the audit. A copy of the report will be provided to the internal control officers in the Office of the Secretary of Defense and DLA.

Prior Audits and Other Reviews

No prior audits of DRMS financial statements have been performed. However, the Inspector General, DoD, and the DRMS staff have completed numerous audits and reviews that have pointed out operating deficiencies that adversely affect the DRMS ability to produce reliable financial data. DRMS management generally agreed with the conditions reported, but made no substantial efforts to correct the problems. The principal audits and reviews are summarized in Appendix A.

Other Matters of Interest

This audit and related financial management audits and reviews all concluded that DFAS accounting systems, controls, and procedures were not adequate to prepare reliable financial statements in FY 1993. The following DFAS deficiencies were identified during those audits.

o DRMS used the DLA chart of general ledger accounts for recording financial transactions. Because the accounts differ from DoD's chart of accounts, consolidating transactions is difficult.

o DFAS was unable to provide detailed transaction data pertaining to the total account balances reported because its accounting systems and procedures were not adequate. Availability of that "audit trail" is essential for an independent auditor to attest to the accuracy of reported balances.

Because the deficiencies were identified in previous reports or will be addressed at the DoD level after ongoing Inspector General, DoD, audits are completed, we will issue no further recommendations on those matters to DoD at this time.

Part II - Findings and Recommendations

Finding A. Financial Statements

The FY 1993 financial statements for the Defense Reutilization and Marketing Service were not prepared in accordance with generally accepted accounting principles, and key accounts reported on the statements were not adequately supported by or compiled in the financial records. The conditions occurred because:

o a fee structure had not been established at a level required to cover operating costs,

o separate accounting for reimbursable sales transactions had not been established,

o a system to compile and report costs by disposal program had not been established,

o inventory was not reported at net realizable value, which overstated assets, understated the cost of goods sold account, and distorted performance data,

o accounting systems and procedures were inadequate, and

o National Sales Office personnel continued to perform most accounting for national sales contracts although they have been unable to correct longstanding accounting problems.

As a result, the Defense Reutilization and Marketing Service FY 1993 financial statements, were unreliable and future statements will remain so until a sustained commitment is made to change the Defense Reutilization and Marketing Service fee structure, accounting procedures, and financial accounting systems. Accordingly, we disclaim our opinion on the FY 1993 financial statements.

Background

Disposal Programs. Under the direction of DLA, the DRMS is responsible for reutilizing, selling, and disposing of excess, scrap, and hazardous personal property generated by DoD activities. Personal property includes most material other than land, buildings, and records. DRMS provides the following primary disposal services.

Reutilization, Transfer, and Donation Programs. DRMS redistributes excess DoD property within DoD and to other authorized Federal, state, local, and nonprofit organizations through reutilization, transfer, and donation programs. Reutilization allows DoD activities to draw items that had been turned in to the DRMS as excess by other DoD activities. Other Federal

activities can obtain excess DoD property through the transfer program. State and local governments and certain nonprofit activities are authorized to obtain excess DoD property through the donation program.

Public Sales Program. DRMS disposes of approximately 80 percent of the usable and scrap material it receives through public sales. The proceeds from those sales is either deposited into the DRMS DBOF account (non-reimbursable sales) or is transferred to DoD Components that turned in the property (reimbursable sales). DRMS provides contracting and accounting support for public sales proceeds, including accounting for the sales. The service includes demilitarization (destruction or rendering inoperable for military purposes) of munitions list items before they are sold, cash management for items sold, and other functions needed to prepare material for sale.

Hazardous Material and Waste Disposal. DRMS manages contracts for the disposal of hazardous material and waste generated by DoD activities. Although DRMS sells some hazardous property through the public sales program, most hazardous property is disposed of through disposal contracts. DRMS bills DoD Component customers only for the actual costs (no surcharge) of disposal contracts.

Financial Transactions. To compile financial statements data, the DRMS records, classifies, and summarizes transactions at over 200 DRMS locations worldwide. DRMS personnel generally perform most of the accounting work for sales and inventory transactions. Those transactions are processed through the Defense Automated Inventory System (DAISY). DFAS offices support DRMS financial operations by maintaining data systems, making payments to and collecting funds from Government activities and contractors, processing documents, and preparing financial statements. DAISY does not interface with any DFAS accounting system.

Generally accepted accounting principles are the foundation of financial statements. Financial statements must disclose relevant accounting principles to help statement users understand the information presented. Accounting principles for Federal agencies are promulgated by the U.S. Comptroller General and the Director, OMB. DRMS is responsible for the accuracy of information entered into financial systems and reported on the financial statements and for adhering to established accounting principles and procedures.

Fee Structure

The generally accepted accounting principle of revenue recognition was not reflected in the fee structure (procedures to assess fees, bill customers, and collect and record proceeds) established by DRMS for disposal activities. A fee structure had not been established at a level required to cover FY 1993 operating costs of the primary DRMS disposal programs; reutilization, transfer,

donation, and public sales; and hazardous property disposal. Revenue should be recognized when it is earned, measurable, and collectible. This would be at the time DRMS services are rendered.

As a result of implementing the DBOF financial structure in FY 1992, DRMS no longer obtained direct operations and maintenance funds to sustain its operations. Instead, DRMS obtained revenues from lump sum billings at the Military Component level and public sales proceeds (customer fees should have been established at a level required to cover all operating costs included in the President's budget). A DoD study on DBOF pricing concluded that DoD's goals in establishing the DBOF would be attained only by establishing a fee structure that reflected the real cost of providing services at the desired level. If DRMS does not generate sufficient revenues to sustain operations, the DBOF working capital requirements will be adversely affected.

Reutilization Program. DRMS planned to start billing DoD customers $25 per line item withdrawn through the reutilization program during FY 1993. That fee, together with proceeds from nonreimbursable public sales was intended to offset DRMS operating costs of the reutilization, transfer, donation, and public sales programs. However, because the Military Departments deemed a flat fee per line item to be inequitable, the Comptroller of the DoD rescinded its policy on March 18, 1993. DRMS planned to implement a fee structure for reutilization customers starting in FY 1995. The fee was to be a fixed percentage of the original acquisition value and set at a high enough level to cover all reutilization, transfer, donation, and public sales program costs that are not recovered through nonreimbursable sales proceeds.

We believe that the planned fee structure contains two of the same inequities as the rescinded $25 flat fee. First, it does not take into account an item's condition, which could range from new, fully operational, to scrap. The DRMS used an acquisition value table for foreign military sales to reduce the price charged to foreign customers based on an item's condition code. That table could be used to provide a mechanism that automatically reduces the fee assessed to DoD Component reutilization customers that is commensurate with an item's assigned condition code. Second, the proposed fee structure requires reutilization customers to pay for the costs associated with the transfer, donation, and reimbursable sales programs.

Transfer, Donation, and Reimbursable Sales Programs. Prior to this audit, DRMS personnel believed that the laws governing the transfer, donation, and reimbursable sales programs precluded them from charging customers for those services. However, no reasonable basis existed for DRMS not to charge customers a fee that would allow DRMS to at least recover its costs for the care and handling of material transferred, donated, or sold. Because transfer and donation programs take precedence over public sales, items with the highest resale value were often removed from inventory before they could be sold. Such removal resulted in lost revenue to DoD activities because had the items been sold, proceeds would have been returned to the activity turning in the property or used to offset the DRMS operating costs. Additionally, DRMS contributed to the inappropriate subsidies made by some Military Department activities to morale, welfare, and recreation activities by not billing for its costs

associated with reimbursable sales, as required by Public Law 97-214, "Military Construction Codification Act." Funds that should have been used to offset DRMS operating costs were instead used for morale, welfare, and recreation projects.

The DRMS legal counsel researched the legality of charging a fee to transfer and donation customers. Based on its research, DRMS concluded that no statutory bar existed that precluded it from charging for costs of care and for handling material furnished through the services.

Hazardous Material and Waste Disposal Contracts. DRMS personnel estimated that a surcharge of between 34 and 48 percent, added to the cost of disposal contracts, would be needed to recover the operating costs for hazardous material disposal. However, they were reluctant to charge customers such a high surcharge because they believed it could lead to unauthorized and possibly illegal disposal of hazardous material. The reluctance of DRMS was unwarranted because laws were established that allow for large civil fines and criminal prosecution of those who illegally dispose of hazardous material or waste. Instead of adding a surcharge directly to the cost of disposal contracts, DRMS proposed that inventory control points increase existing surcharges for hazardous material purchases and transfer the funds received to DRMS as operating revenue. The DLA Comptroller rejected that proposal on June 9, 1993, because it violated a basic tenet of DBOF, that only the activities using a DRMS service should be charged a fee commensurate with the level of service requested. No further action was taken to establish a surcharge on disposal contracts. However, DRMS is continuing its efforts to increase the surcharge on purchases of hazardous material from the inventory control points.

In addition to providing DRMS with operating revenue, we believe a surcharge added directly to disposal contracts would provide incentives to DoD Components to reduce disposal costs. For example, our review of 14 Military Department recycling programs showed that because of the high cost of hazardous material disposal, some recycling program managers reduced those costs through increased recycling and purchases of equipment such as solvent recyclers and oil filter pressers. The Military Departments, not the DRMS, were reducing costs because they had the incentive to do so.

Effect of No Fee Structure on FY 1993 Financial Statements. The DRMS FY 1993 financial statements showed that operating expenses exceeded revenues by about $125 million. DRMS recouped the FY 1992 revenue shortfalls of $108 million by directly billing the DoD Components $27 million each. In FY 1994, DRMS plans to bill the DoD Components a total of $207 million to recoup additional cumulative losses from FY 1992 through FY 1994. Lump sum billing causes wide fluctuations in revenues from year to year that have no bearing on the DRMS business activity and precludes the preparation of comparative financial statements. Additionally, lump sum billing at the DoD Component level is inconsistent with DBOF policies because it does not give customers visibility over DRMS costs and provide a basis of comparison or "benchmark" for customers to determine the most cost-effective way to obtain needed services. If DRMS programs are efficient, fees should be reasonable.

Reimbursable Sales

The generally accepted accounting principle requiring full disclosure of discrete entities was not followed for reimbursable sales transactions. Reimbursable public sales transactions are equivalent to consignment sales, whereby a third party (DRMS) takes possession of goods from and sells them for DoD Component owners. Based on DRMS records, about 28 percent of the sales proceeds collected by DRMS in FY 1993 were reimbursed to activities such as Military Department installations with qualified recycling programs and morale, welfare, and recreation activities.

DRMS did not identify a need to separately disclose inventory and cost of goods sold information for reimbursable sales transactions. DRMS financial records commingled all sales and inventory transactions regardless of whether or not they related to reimbursable sales. As a result, the FY 1993 financial statements did not show that DRMS devoted significant resources to consignment sales for which it received no revenue.

Program Costs

The generally accepted accounting principle requiring full disclosure for discrete business segments was not followed for program costs. A system to compile and report DRMS costs by disposal program had not been established. In a memorandum dated October 1992, the Comptroller of the DoD mandated that DRMS report operating costs by disposal program starting in FY 1993. DRMS reported total operating costs of $396.5 million in the FY 1993 financial statements. Footnote information provided with the statements further broke those operating costs down by object classification (that is, payroll and travel) rather than by program cost. Cost information by disposal program would provide valuable performance information to assess whether or not DRMS disposal methods are cost-effective.

For budgetary purposes, DRMS tracked personnel and other costs by program in its subsidiary cost accounting system. However, DRMS had not adapted that system to compile and report program costs at the level of detail required for use in its financial statements. Additional cost codes are required to track the costs of reutilization, donation, transfer, and reimbursable sales programs. Besides providing a means to compile required performance data, tracking costs on a program basis would also aid in developing fees that relate to actual DRMS costs of providing the services.

Inventory Valuation

The generally accepted accounting principle of consistency was not followed by DRMS in inventory valuation. In accordance with DoD guidance, DRMS is required to report excess, obsolete, and unserviceable inventory at their net realizable value. The reporting is required for consistency within DoD because DoD inventory control points are required to record the value of inventory they turn in to the DRMS and to report the related inventory losses from those records on their financial statements. However, DRMS reported $5.1 billion of inventory in its FY 1993 financial statements. The inventory was valued at either the latest acquisition cost or the standard price instead of the net realizable value. By not reporting inventory at net realizable value, the FY 1993 financial statements significantly overstated assets, understated costs of goods sold, and distorted performance data.

Overstated Assets. The $5.1 billion, representing 99 percent of total assets reported on the FY 1993 financial statements, were overstated by approximately $5 billion. Based on DoD guidance, the net realizable value of the inventory should have been reported at 2.04 percent of the value of the latest acquisition cost or approximately $105 million.

Cost of Goods Sold. The cost of goods sold account was understated because inventory was not valued appropriately. Inventory valuation affects the cost of goods sold account on the statement of operations and changes in net position. When inventory is sold, it should be dropped from the statement of financial position and recorded at the same value in a cost of goods sold account. The corresponding sales revenue should be recorded on the statement of operations and changes in net position as revenues from sales of goods to the public. This basic accounting principle ensures the matching of revenues to the related expenses during a given period. In FY 1993, DRMS reported $0 cost of goods sold and matched that cost against approximately $129.3 million of sales proceeds. Using the reported annual sales proceeds as a basis, DRMS should have reported losses of over $6 billion in FY 1993 ($129.3 million divided by 2.04 percent net realizable value). DRMS did not report the $6 billion loss because latest acquisition cost or standard price do not fairly represent the value of inventory sold.

Performance Data. Using latest acquisition cost or standard price to value DRMS inventory instead of net realizable value, distorted FY 1993 performance data. DRMS management reports valued material disposed of through reutilization, transfer, and donation at latest acquisition cost or standard price and compared that value against actual public sales proceeds. For example, DRMS management reports valued material disposed of through the transfer and donation programs at approximately $600 million each and showed those amounts with the $244 million in public sales proceeds. Such action implies that the transfer and donation programs are much larger or more beneficial than the public sales program.

However, if inventory were valued at net realizable value, the actual FY 1993 performance would have been distorted, as illustrated in the table.

Comparative Inventory Values

Disposal Program	Acquisition Dollar Value (billions)	Net Realizable Dollar Value (millions)
Public Sales	$24.0	$244.0[1]
Reutilization	2.2	43.9[2]
Transfer	.6	11.5[2]
Donation	.6	13.0[2]
Total	$27.4	$312.4

[1]Actual sales (includes both reimbursable and non-reimbursable sales)
[2]Net realizable value computed at 2.04 percent of acquisition value (differences between transfer and donation amounts due to rounding of acquisition dollar value).

As illustrated above, DRMS disposed of $244 million (78 percent) of the usable and scrap material it receives through the public sales program. That is in contrast to the $11.5 million to $13 million value of material transferred and donated versus the reported $600 million. That information along with other relevant performance data are not readily apparent in the FY 1993 financial statements or management reports.

Financial Accounting Records

Key accounts reported on the DRMS FY 1993 financial statements were not adequately supported by or compiled in the financial records. Records used to summarize public sales and related cash, accounts receivable, and accounts payable transactions either omitted key information or were not supported by subsidiary ledgers. We attributed the missing and unsupported information to inadequate DRMS accounting systems and procedures.

Public Sales Revenue. Public sales revenue recorded in the FY 1993 financial statements was not supported by DRMS financial records. DRMS sold inventory to the public either nationally or locally. The National Sales Office (NSO) in Memphis, Tennessee, accounted for national sales contracts, while individual Defense Reutilization and Marketing Offices accounted for local sales contracts. Of the $271.6 million of revenues reported in the FY 1993 financial statements, $129.3 million purportedly represented nonreimbursable sales proceeds. The remaining $142.3 million came primarily from reimbursements from the DoD Components for hazardous contract costs. DRMS could not provide support for the $129.3 million sales figure, such as specific sales transactions recorded in DAISY or any other subsidiary accounts.

The $129.3 million was derived from DFAS records of cash collections, but, was not reconciled with DAISY records. In FY 1993, DAISY records showed total sales proceeds of over $244 million.

Cash Management. The FY 1993 financial statements understated DRMS cash by at least $30.5 million, which had accumulated in suspense accounts used by DRMS because data on public sales deposited in suspense accounts were not compiled in the financial records. DRMS deposited the proceeds from public sales collected by the NSO into the DFAS - managed suspense accounts. Money deposited into suspense accounts remains under the operating control of DRMS until disposition because DFAS cannot release funds until DRMS personnel process appropriate fund transfer documents. As long as the DRMS maintains suspense balances, the cash balance should be reported in the DRMS financial statements as cash (debit) and accounts payable (credit). However, the $30.5 million was not reflected in the FY 1993 financial statements.

Accounts Receivable. The FY 1993 financial statements did not include accounts receivable from public sales, allowances for estimated uncollectible debt, and the bad debts that resulted when DRMS did not collect the receivables. That data was not compiled in DRMS financial records. OMB Bulletin 93-02 requires that receivables from non-Federal entities be reported on the statement of financial position net of an allowance for estimated uncollectible debt. The uncollectible debt should be reported as an expense on the statement of operations.

DRMS did not disclose in its financial statements outstanding accounts receivable and the allowances for estimated uncollectible debt from contracts awarded by NSO because the information was kept in hundreds of manual files at the NSO. DRMS had not developed procedures to summarize and report the data. The receivable balance at any given time was material because NSO personnel did not bill customers and collect money promptly for scrap material sold on national sales contracts. Total FY 1993 scrap sales proceeds were about $84.1 million. Our review of ten national sales contracts showed that contractors had received $1.3 million of scrap materiel and DRMS had collected $807,887 of that amount. The difference of $549,396 should have been shown as an accounts receivable in the DRMS financial records. Because the accounts receivable were not tracked and cash collections were not reconciled with DAISY records, DRMS had no assurance that money was collected, deposited, and recorded in the appropriate revenue accounts.

Bad Debts. Both DRMS and DFAS maintained records on uncollected accounts receivable (that is, bad debts). We reviewed available records for FYs 1991 and 1992 bad debts (FY 1993 data were not available at the time of this audit). The records showed that during the 2-year period, DRMS transferred $757,979 to DFAS for collection and wrote off an additional $243,481. DFAS deemed $456,018 of the $757,979 debt to be uncollectible. The $699,499 bad debt represented lost income to the DBOF and to reimbursable customers. Because DRMS did not track accounts receivable, no records existed to determine the total amount of uncollectible accounts receivable that should have been recorded as bad debt expense. For example, contract files at NSO disclosed additional uncollected debts

that had not been referred to DRMS headquarters for initial collection action because the contract files had not been closed. We could not quantify the total amount of uncollectible debt that remained in the NSO manual files.

Accounts Payable. The accounts payable account on the FY 1993 financial statements was not adequately supported because it omitted $30.5 million that was held in suspense accounts. All money held in DRMS suspense accounts was payable either to a qualified recipient or to a DBOF account. Personnel at activities that were authorized reimbursement of sales proceeds told us that it was difficult to match material turned in to the DRMS with sales proceeds received. Several activities cited examples in which they never received reimbursement for material that they delivered to and that was sold by DRMS. We attributed those problems to the lack of subsidiary accounts within DRMS and to DRMS not collecting all money owed to them on reimbursable sales contracts.

Accounting Systems. The accounting systems and procedures used by DRMS to record sales proceeds and related accounts, and inventory values were inadequate. In August 1992, the Acting Comptroller of the DoD selected the Defense Business Management System as the primary accounting system for all DBOF business areas. Defense Business Management System has 10 general ledger accounts to record DRMS sales and inventory transactions. Instead of using the Defense Business Management System, DRMS elected to use DAISY to record those transactions. DAISY was the only system available to DRMS during FY 1993 for obtaining summary information on sales revenues and inventory values. However, it does not nor was it ever intended to comply with the criteria prescribed by DLA Manual 7000.1, "Accounting and Finance Manual," August 18, 1980, for financial accounting systems. The DRMS lack of emphasis on financial management and its ineffective internal controls have resulted in a system that does not provide critical financial information.

DAISY data on public sales revenue were unreliable because DRMS lacked key internal controls to ensure accurate data entry, processing, and summarizing.

o Personnel at DRMS headquarters screened DAISY sales data for obvious errors (large keypunch errors) and altered original entries. For example, in FY 1993 DRMS personnel adjusted upward the FY 1993 total by about $20 million or 9 percent. In FY 1992, DRMS personnel made a downward adjustment of 7 percent. There were no audit trails to support the adjustments.

o Proceeds that DRMS personnel deposited into the DRMS DBOF account were commingled in DAISY with proceeds that were returned to turn-in activities. As discussed earlier, the reimbursable sales should be accounted for separately.

o DAISY is a single-entry accounting system that does not integrate recorded revenues to related accounts, and DRMS personnel did not reconcile the reported revenue to cash deposits. Because DAISY had multiple entries for a single sale and allowed users only 90 days to recall a specific transaction, a reconciliation would be difficult to accomplish.

o Sales revenue recorded in DAISY for 736 contract lines, valued at $6.2 million, had an error rate of about 50 percent. For example, one Defense Reutilization and Marketing Office recorded $1.7 million in DAISY for a sale of $13,702. The errors occurred because DRMS lacked controls to reconcile completed contracts with information reported in DAISY.

o Operating personnel did not enter or DAISY eliminated 115 of the 736 contract lines (about 16 percent). DRMS personnel explained that DAISY sometimes dropped recorded information from the system after it had been entered.

o The DRMS had neither adopted the accrual basis of accounting for sales nor established appropriate cutoff procedures. Accrual accounting and appropriate cutoff procedures was necessary to ensure that all transactions were recorded in DAISY in the proper period.

Accounting Resources

During FY 1993, DRMS personnel continued to perform most accounting functions for national sales contracts although they have been unable to correct longstanding problems in that area. Since FY 1991, fundamental changes have occurred in DoD's approach to financial management. Much of the responsibility, authority, control, and resources for financial accounting have been transferred to DFAS, in accordance with DoD's overall DBOF improvement plan. In FY 1992, DRMS transferred its headquarters accounting personnel to DFAS; but it did not transfer any positions or accounting functions from the NSO. The Director of NSO told us that NSO was not staffed with accounting personnel nor was it responsible for accounting for national sales. The Director believed that NSO was responsible only for contract administration functions. However, NSO personnel performed most accounting for national sales, including computing amounts due or refundable; billing customers; collecting proceeds; and directing the disposition of funds collected.

Many of the problems we found with the DRMS accounting systems and procedures have plagued the DRMS for years and can be attributed to a lack of management emphasis on financial accounting. A sustained commitment from personnel experienced in accounting functions is needed to correct the problems. We believe that DFAS should address the accounting problems with public sales revenue we identified in this report because DFAS is responsible for DoD's accounting systems and for preparing DRMS financial statements. Accounting for sales revenue is similar to other accounting functions already performed by DFAS. Therefore, we believe that DLA should transfer all responsibilities and resources related to financial accounting for national sales from NSO to DFAS. This would place a major DRMS accounting function, which has not been adequately accomplished by NSO, under DFAS in accordance with DoD's improvement plan.

Recommendations, Management Comments, and Audit Responses

Changes to Recommendations. Based on comments we received from DLA, we added Recommendations A.3.a. and A.3.b. to the Comptroller of the DoD.

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

a. Implement the necessary accounting principles to report sales revenue and inventory transactions in accordance with generally accepted accounting principles for Federal activities. Specifically the Defense Reutilization and Marketing Service should:

i. Reassess the proposed reutilization fee structure planned for implementation in FY 1995 to consider an item's condition. Use the acquisition value tables already in use for foreign military sales to charge reutilization customers a fee that relates more closely to an item's condition.

ii. Develop a fee structure that is based on relevant operating costs for transfer, donation, reimbursable sales, and hazardous disposal services. Establish the procedures necessary to bill customers and record revenue in the financial records.

Management Comments. DLA partially concurred with the recommendations and stated that DLA no longer plans to implement a reutilization fee structure by FY 1995 because of the many concerns throughout DoD about the appropriate cost recovery methodology for DRMS. Additionally, DLA stated that if a fee structure is developed, only the administrative portion of hazardous disposal cost would need to be recovered from DRMS customers through a fee. For both recommendations, DLA stated that it cannot unilaterally agree to implement a fee for these services without DoD approval and suggested that the question be referred to the Office of the Secretary of Defense.

Audit Response. A fee structure needs to be established before DRMS can start billing DoD Components for those services. Therefore, we added a recommendation to the Comptroller of the DoD (see Recommendation A.3.). No further response on these recommendations is required from DLA.

iii. Establish the necessary accounting procedures to disclose information about reimbursable sales in the inventory held for sales, and cost of goods sales accounts in the financial statements.

Management Comments. DLA partially concurred with the recommendation. However, DLA did not agree that inventory held for sale under one of the reimbursable sales programs should be accounted for as consignment sales. DLA's rationale was that some property could be withdrawn by reutilization, transfer, or donation customers; and by legal title transfers from the turn-in activity to the DRMS upon receipt. DLA further stated that procedures for

disposal of property outlined in chapter 37 of DoD Manual 7220.9M would have to be changed.

Audit Response. DLA's comments are not responsive. The intent of our recommendation was that the value of all inventory related to reimbursable sales that were sold during the year (cost of goods sold), and scrap held at yearend on contracts, should be presented as separate categories ("Reimbursable Sales") within the inventory and cost of goods sold accounts in DRMS financial statements. To clarify our recommendation we eliminated the term "consignment sales" from our draft recommendation. We request that DLA provide comments on the revised recommendation.

iv. Adapt the existing Defense Reutilization and Marketing Service cost accounting system to track operating costs on a program basis by obtaining additional cost codes and implementing the procedures necessary to track program costs at the required detail.

Management Comments. DLA partially concurred with the recommendation. While agreeing that tracking costs on a program basis would provide a means to compile required performance data and aid in the development of a fee structure, DLA stated that it would be premature to accept the recommendation until an approach to recover DRMS's cost has been agreed to by the DoD establishment.

Audit Response. DLA's comments are not responsive. It is not premature to start tracking operating costs on a program basis. DRMS was required to disclose the program cost starting in its FY 1993 financial statements, but did not because cost had not been tracked on a program basis. There is no reason to wait for final approval of a fee structure from DoD before accumulating operating costs by disposal program. We request that DLA reconsider its response and provide additional comments in response to the final report.

v. Report all Defense Reutilization and Marketing Service inventories at net realizable value on all internal and external reports. The value of inventory sold should be recorded in a cost of goods sold account.

Management Comments. DLA concurred with the recommendation and stated that the DBOF Corporate Board Special Committee for Oversight of Policy Actions is addressing DBOF inventory valuation policy. DLA intends to restate yearend inventory at net realizable value and to report disposed inventory as cost of goods sold at net realizable value. The disposed inventory is to be included in the FY 1994 financial statements.

b. Establish the necessary internal controls and procedures to ensure that:

i. Recorded sales can be linked to cash collections, accounts receivables, and accounts payable. Accounts receivable from non-Federal entities should be reported on the statement of financial position and the uncollectible debt should be reported on the statement of operations.

Management Comments. DLA concurred with the recommendation, but suggested that DFAS has the responsibility to report information on allowances for losses and bad debt expenses using the DBMS. Also, procedures to link sales revenue to related accounts receivable, cash, and accounts payable was being automated by NSO and accomplished in conjunction with DFAS. DLA stated that the estimated completion date is contingent upon full implementation of the Defense National Sales Program (DNSP) and DFAS's acceptance of the reporting issue. DLA did not comment on the reporting of accounts receivables from non-Federal entities.

Audit Response. DLA's comments are not responsive because the NSO will continue to determine amounts due or refundable, bill customers, collect proceeds, and direct the disposition of funds collected. We believe accounting functions should be transferred to the DFAS in accordance with the Defense Business Operations Fund (DBOF) Improvement Plan (Recommendation 2.). DFAS cannot report information about allowances for losses and bad debt expenses using the DNSP until responsibility for maintaining accounts receivable is formally transferred to DFAS. We request that DLA reconsider its position and provide comments on the reporting of accounts receivables from non-Federal entities in the financial statements.

ii. Suspense account balances controlled by Defense Reutilization and Marketing Service are reported as cash and accounts payable.

Management Comments. DLA partially concurred with the recommendation and stated that OMB Bulletin 94-01 requires suspense account balances to be reported in the fund balances with Treasury account as a "Non-Entity Asset--Fund Balance." DLA stated that if DoD does not resolve the fund balance issue before preparation of the FY 1994 financial statements, DLA will disclose the suspense account balances and related accounts payable in footnotes to the financial statements.

Audit Response. DLA's proposal to report suspense account balances and related accounts payable in the footnotes to the FY 1994 financial statements meets the intent of our recommendation.

2. We recommend that the Director, Defense Logistics Agency distinguish contract administration functions from financial accounting functions at the National Sales Office. After the accounting functions are identified, the Defense Logistics Agency should transfer all accounting responsibilities and related resources for national sales from the National Sales Office to the Defense Finance and Accounting Service.

Management Comments. DLA partially concurred with the recommendation but did not agree that accounting functions performed at the NSO should be transferred to DFAS. Many of the manual processes that were observed during the audit have now been automated.

Audit Response. DLA's comments are not responsive. DRMS has not corrected long-standing problems in accounting for sales. As of June 10, 1994, no significant improvement had occurred in accounting for sales proceeds. None of the critical functions needed to properly account for sales revenues and related cash, accounts receivable, bad debts, and accounts payable had been automated and the information was not readily available through manual means. Also, planned action to automate the accounting process had not been implemented. DRMS does not have the accounting personnel necessary to correct the problems beause accounting personnel with the required expertise were transferred to DFAS when DRMS became a DBOF activity. We request that DLA reconsider its response and provide additional comments.

3. We recommend that the Comptroller of the Department of Defense:

a. Establish a fee structure for the Defense Reutilization and Marketing Service that is based on relevant operating costs for reutilization, transfer, donation, reimbursable sales, and hazardous disposal services.

b. Require the Defense Logistics Agency to implement a fee structure, and to establish the procedures necessary to bill customers and record revenue in the financial records.

Finding B. Internal Management Control Program

The Defense Reutilization and Marketing Service did not effectively implement the DoD Internal Management Control Program in reporting weaknesses related to the preparation of financial statements. The condition occurred because the Defense Reutilization and Marketing Service did not change its inventory of assessable units to reflect the more stringent financial responsibilities of a Defense Business Operations Fund business area. Additionally, the Defense Reutilization and Marketing Service did not place program responsibilities at an appropriate level of command. As a result, internal control weaknesses affecting the ability of the Defense Reutilization and Marketing Service to prepare reliable financial statements have not been corrected or reported to higher command levels.

Background

DoD Internal Management Control Program. OMB Circular A-123 requires that DoD report annually to the President and the Congress on the status of its accounting and control systems. DoD Directive 5010.38 provides guidance to DoD activities on implementing the OMB Circular and the DoD Internal Management Control (IMC) Program. The Directive mandates emphasis on the prevention of waste, fraud, and mismanagement and requires DoD activities to report whether or not their accounting systems are in compliance with applicable accounting principles. Compliance with the IMC Program has a direct and material effect on preparation of reliable financial statements. The DoD guidance on form and content of financial statements requires the financial statements to include a summary of reports on internal accounting and administrative control systems submitted under the OMB Circular.

DRMS describes its internal control program in DRMS Regulation 5010.4, "Internal Management Control Program." Key points to the program's success are:

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

o a biennial risk assessment of each assessable unit;

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

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

The Commander, DRMS delegated responsibility for management of the IMC Program to the Office of Planning and Resource Management. That office is to provide program guidance, solicit feedback from other directorates, and prepare the DRMS annual assurance statement. The preparation of annual assurance statements requires resource management personnel to use their judgment in deciding which weaknesses are material and which should be reported to higher commands through the IMC Program process. DRMS headquarters provides a significant number of staff resources to internal review audits and management evaluation visits, which are intended to identify, report, and correct problems.

Internal Management Control Program

The DRMS FYs 1992 and 1993 IMC Program reports did not adequately disclose the inability of accounting systems, policies, and processes to effectively comply with generally accepted accounting principles. In its FY 1993 annual assurance report, DRMS disclosed its lack of visibility over sales proceeds, but did not disclose other internal control problems affecting its ability to prepare reliable financial statements. We attribute this to an ineffective inventory of assessable units.

Inventory of Assessable Units

The DRMS IMC Program was ineffective because DRMS did not change its inventory of assessable units to adequately cover the preparation of financial statements. DRMS management selected the functional areas for review and those areas constituted its inventory of assessable units. In FY 1993, DRMS identified 95 assessable units for review. However, in its Report No. 92-02, "Internal Management Control System Review," June 8, 1992, DRMS auditors concluded that the assessable units did not adequately include all key functional areas requiring internal controls, and the changes that took place as a result of an April 1992 reorganization of DRMS created a need to reassess the assessable units. The reorganization reduced the number of regions from five to one and created operations offices in Ogden, Utah, and Columbus, Ohio, and a National Sales Office in Memphis, Tennessee. The reorganization also made significant changes in responsibilities for public sales accounting. For example, the National Sales Office was created to provide central accounting and contract support for national sales.

Being designated as one of DoD's DBOF business areas in FY 1992 resulted in the DRMS fundamentally changing the way that it handled financial accounting. However, at the time of the audit, DRMS had not adequately addressed its heightened fiscal responsibilities in its inventory of assessable units. For example, although DRMS personnel performed most key accounting functions for sales and inventory transactions, DRMS management did not identify those transactions to be assessable units. On the other hand, DRMS management

considered areas such as beneficial suggestion program, incentive awards, and processing personnel actions as key management areas requiring evaluation through the IMC Program.

Command Level of Program Responsibilities

DRMS did not place program responsibilities at an appropriate level of command to address financial management problems. We believe that placing responsibility for managing the IMC Program at the Office of Planning and Resource Management does not provide the necessary independence to manage the program. For example, in an assessment of internal controls for input into the FY 1992 annual assurance report, the DRMS Directorate of Disposal Management and Environmental Protection stated, "Nonconcur that revenues and expenditures are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports, based on the problems that were experienced with data integrity." The material weakness was not reported in the DRMS FY 1992 assurance report. We verified the existence of data integrity problems during FY 1993; however, the DRMS Comptroller did not correct the problems or report them as material weaknesses.

The program manager responsible for the IMC Program told us that he did not consider material conditions reported by internal audits and management evaluation visits in preparing the annual assurance report. The program manager's nonuse of internal review audits and reviews constituted an ineffective use of resources devoted to the oversight of DRMS operations. Weaknesses in financial management have plagued DRMS for years and reflect negatively on resource management personnel. Consequently, resource management personnel may be reluctant to disclose the magnitude of those problems. Therefore, we believe that responsibility for the IMC Program should be given to a senior management official outside the functional directorate.

Recommendations, Management Comments, and Audit Response

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

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

Management Comments. DLA concurred with the recommendation and stated that corrective action would be completed by December 31, 1994.

2. Assign the responsibility for managing the Internal Management Control Program to a senior management official, outside the functional directorates. The senior management official should report directly to the commander.

Management Comments. DLA concurred with the recommendation and stated that the responsibility has been transferred to the command section.

Part III - Additional Information

Appendix A. Summary of Prior Audits and Other Reviews

No prior audits of DRMS financial statements have been done. However, the Inspector General, DoD and the DRMS staff have completed numerous audits and reviews that have pointed out operating deficiencies that adversely affect the DRMS ability to produce reliable financial data. DRMS management generally agreed with the conditions reported, but made no substantial efforts to correct the problems. The principal audits, and other reviews are summarized below.

Inspector General, DoD, Report No. 93-132, "Condition and Economic Recoverability of Material in the Disposal Process," June 30, 1993, stated that inaccurate condition codes were assigned to condemned materiel, material could not be physically traced or accounted for adequately, and material had been withdrawn without a valid requirement. The report recommended that management document their justifications for condemning materiel and that challenges be documented and retained by DRMS. In addition, the report recommended that controls be revised or established to ensure that materiel is authorized to be withdrawn and is adequately accounted for by reutilizing activities. The Air Force agreed with the intent of the recommendation while the other Military Departments disagreed. The Defense Logistics Agency agreed with the recommendation that controls be revised.

DRMS Internal Review Report No. 92-04, "Review of Cashier and Cash Control Procedures," October 22, 1992, stated that the internal control measures in the DRMS-Handbook 4160.3, "Disposal Operating Procedures," September 1992 handbook were adequate, although not always followed. The report recommended that the sales contracting officers at NSO resume "in-process" sales reviews as prescribed by the handbook, to ensure contracts and their supporting documentation are accounted for and that collections, refunds, and adjustments are processed. Management concurred with the findings and recommendations.

DRMS Internal Review Report No. 92-02, "Internal Management Control System Review," June 8, 1992, stated that alternative review procedures used by DRMS provided an inadequate and incomplete evaluation of internal controls, the assessable units in DRMS did not adequately include all areas that require internal controls, the DRMS reorganization created a need to reassess the assessable units in DRMS, and the control program did not comply with regulations. The report recommended that DRMS review the existing assessable units and verify that all major program functions subject to waste, fraud, and abuse are a part of an assessable unit. Management concurred with the recommendations.

DRMS Internal Review Report No. 92-01, "Review of the Resource Recovery and Recycling Program (RRRP)," April 6, 1992, highlighted internal control weaknesses through the large difference between the quantities of scrap in the accountable records and the amounts removed, duplicate payments to generators, procedural and clerical errors on special funding sheets, and delays in reimbursing the generators of recyclable materials. The report recommended that the Defense Reutilization Marketing Offices manage their scrap operations to ensure that accountable records reflect accumulated scrap, that weights indicated on the disposal turn in documents are based on actual weights, and that recycling program documentation be kept to ensure that the special funding sheet can be cross-referenced to the turn-in documents to ensure proper reimbursement. The report also recommended that periodic review procedures be developed to evaluate the cashiers' performance in order to eliminate duplicate payments. Management concurred with the recommendations.

DRMS Internal Review Report No. 90-02, "Survey of Suspense Account Administration," February 28, 1990, stated that suspense accounts were not being used as intended. The report recommended that more emphasis be placed on closing contracts and that DRMS reconcile its suspense account balances with the Accounting and Finance Office records. The report also recommended that DRMS revise its policy on using suspense accounts. Management concurred with the recommendations but did question their achievability.

Inspector General, DoD, Report No. 90-008, "Review of the Disposal of Recyclable Materials," October 31, 1989, discussed implementation of recycling programs for reporting the status of materials offered for sale or sold for participating DoD Component activities. The report stated that the Automated Proceeds Tracking System did not provide timely and accurate responses to activities' requests for the status of material offered for sale or the status of proceeds received. The report recommended that management improve policy guidance for the recyclable materials program. The DoD Deputy Comptroller (Management Systems) concurred with the intent of the recommendation, but nonconcurred with the corrective action.

Appendix B. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
A.1.a.i.	Internal Control. Provide a more equitable fee structure for the DoD Components that no longer requires them to subsidize donation, transfer, and reimbursable sales. Also, establishment of a fee structure that takes into consideration an item's physical condition.	Nonmonetary.
A.1.a.ii.	Internal Control. Allow DRMS to perform services without incurring a net operating loss and bill customers equitably.	Nonmonetary.
A.1.a.iii.	Internal Control. Sales information will accurately reflect operations for financial reporting purposes.	Nonmonetary.
A.1.a.iv.	Internal Control. Provide DRMS management with visibility over relevant data needed to identify cost drivers. In addition, facilitates cost recovery through user fees.	Nonmonetary.
A.1.a.v.	Internal Control. Reported inventory balances will more closely reflect actual operations.	Nonmonetary.
A.1.b.i.	Internal Control. Improved cash management and accountability by tracking all cash transactions up through the general ledger.	Nonmonetary

Recommendation Reference	Description of Benefit	Type of Benefit
A.1.b.ii.	Internal Control. Conformance with generally accepted accounting principles and proper visibility over funds with Treasury.	Nonmonetary.
A.2.	Economy and Efficiency. Facilitate reliable and timely reporting of sales and accounts receivable data and consolidate like functions within DRMS. DFAS personnel are better qualified to perform accounting functions.	Nonmonetary.
A.3.a.	Economy and Efficiency. Provide an equitable fee structure for the Defense Reutilization and Marketing Service customers.	Nonmonetary.
A.3.b.	Economy and Efficiency. Allow DRMS to perform services without incurring a net operating loss.	Nonmonetary.
B.1.	Internal Control. Revised assessable unit. Will conform with major DRMS functional areas.	Nonmonetary.
B.2.	Internal Control. Place responsibility for monitoring DRMS assessable units at a more independent level of DRMS management to detect and follow-up with material problems.	Nonmonetary.

Appendix C. Organizations Visited or Contacted

Defense Logistics Agency

Headquarters, Defense Reutilization and Marketing Service, Battle Creek, MI
Defense Reutilization and Marketing Office-Alameda, Alameda, CA
Defense Reutilization and Marketing Office-Anniston, Anniston Army Depot, Anniston, AL
Defense Reutilization and Marketing Office-Barstow, Marine Corps Logistics Base, Barstow, CA
Defense Reutilization and Marketing Office-Belvoir, Fort Belvoir, VA
Defense Reutilization and Marketing Office-Benning, Fort Benning, GA
Defense Reutilization and Marketing Office-Campbell, Fort Campbell, KY
Defense Reutilization and Marketing Office-Chambersburg, Letterkenny Army Depot, Chambersburg, PA
Defense Reutilization and Marketing Office-Charleston, Charleston, SC
Defense Reutilization and Marketing Office-Columbus, Columbus, OH
Defense Reutilization and Marketing Office-Corpus Christi, Corpus Christi, TX
Defense Reutilization and Marketing Office-Crane, Naval Surface Warfare Center, Crane, IN
Defense Reutilization and Marketing Office-Davisville, Naval Construction Battalion Center, Davisville, RI
Defense Reutilization and Marketing Office-Devens, Fort Devens, MA
Defense Reutilization and Marketing Office-Duluth, Duluth, MN
Defense Reutilization and Marketing Office-Eglin, Eglin Air Force Base, FL
Defense Reutilization and Marketing Office-El Toro, East Irvine, CA
Defense Reutilization and Marketing Office-Gillem, Fort Gillem, Forest Park, GA
Defense Reutilization and Marketing Office-Ord, Fort Ord, CA
Defense Reutilization and Marketing Office-George, George Air Force Base, CA
Defense Reutilization and Marketing Office-Hill, Hill Air Force Base, UT
Defense Reutilization and Marketing Office-Hood, Fort Hood, TX
Defense Reutilization and Marketing Office-Jackson, Fort Jackson, SC
Defense Reutilization and Marketing Office-Jacksonville, Naval Air Station, Jacksonville, FL
Defense Reutilization and Marketing Office-Keesler, Keesler Air Force Base, MS
Defense Reutilization and Marketing Office-Key West, Naval Air Station, Key West, FL
Defense Reutilization and Marketing Office-Knox, Fort Knox, KY
Defense Reutilization and Marketing Office-LeJeune, Camp LeJeune, NC
Defense Reutilization and Marketing Office-Leonard, Fort Leonard Wood, MO
Defense Reutilization and Marketing Office-Lewis, Fort Lewis, WA
Defense Reutilization and Marketing Office-Little Rock, Jacksonville, AR
Defense Reutilization and Marketing Office-Loring, Loring Air Force Base, ME
Defense Reutilization and Marketing Office-Mayport, Mayport Naval Station, Mayport, FL

Defense Logistics Agency (cont'd)

Defense Reutilization and Marketing Office-McConnell, McConnell, KS
Defense Reutilization and Marketing Office-Meade, Fort Meade, MD
Defense Reutilization and Marketing Office-Mechanicsburg, Mechanicsburg, PA
Defense Reutilization and Marketing Office-Montgomery, Gunter Air Force Base, Montgomery, AL
Defense Reutilization and Marketing Office-Nellis, Nellis Air Force Base, NV
Defense Reutilization and Marketing Office-Norfolk, Norfolk Naval Station, Norfolk, VA
Defense Reutilization and Marketing Office-North Island (San Diego Naval Station), Imperial Beach, CA
Defense Reutilization and Marketing Office-Ogden, Ogden, UT
Defense Reutilization and Marketing Office-Oklahoma City, Tinker Air Force Base, Oklahoma City, OK
Defense Reutilization and Marketing Office-Patrick, Patrick Air Force Base, FL
Defense Reutilization and Marketing Office-Pendleton, Oceanside, CA
Defense Reutilization and Marketing Office-Pensacola, Naval Air Station, Pensacola, FL
Defense Reutilization and Marketing Office-Philadelphia, Philadelphia, PA
Defense Reutilization and Marketing Office-Puget Sound, Puget Sound Naval Shipyard, Bremerton, WA
Defense Reutilization and Marketing Office-Richmond, Defense General Supply Center, Richmond, VA
Defense Reutilization and Marketing Office-Riley, Fort Riley, TX
Defense Reutilization and Marketing Office-San Antonio, Kelly Air Force Base, TX
Defense Reutilization and Marketing Office-Sill, Fort Sill, OK
Defense Reutilization and Marketing Office-St. Juliens Creek, Portsmouth, VA
Defense Reutilization and Marketing Office-Stockton, Rough and Ready Island, Naval Communications Center, Stockton, CA
Defense Reutilization and Marketing Office-Tampa, MacDill Air Force Base, FL
Defense Reutilization and Marketing Office-Tooele, Tooele Army Depot, UT
Defense Reutilization and Marketing Office-Twentynine Palms, Twentynine Palms, CA
Defense Reutilization and Marketing Office-Warner Robins, Robins Air Force Base, GA
Defense Reutilization and Marketing Office-Whidbey Island, Naval Air Station Whidbey Island, Oak Harbor, WA

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Comptroller of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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
  Commander, Defense Reutilization and Marketing Service
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

Office of Management and Budget

Non-Defense Federal Organizations (cont'd)

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

Chairman and Ranking Minority 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 Defense, Committee on Appropriations
- House Committee on Armed Services
- House Committee on Government Operations
  - House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Defense Logistics Agency Comments

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

IN REPLY
REFER TO DDAI

0 3 JUN 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 (Project No. 2LE-2020)

This is in response to your 29 March 1994 request.

1 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Office

cc:
FO

FORMAT 1 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

FINDING A: ***Financial Statements.*** The draft FY 1993 financial statements for the Defense Reutilization and Marketing Service were not prepared in accordance with generally accepted accounting principles, and key accounts reported on the statements were not adequately supported by or compiled in the financial records. The conditions occurred because:

- a fee structure had not been established at a level required to cover operating costs,
- separate accounting for reimbursable sales transactions had not been established,
- a system to compile and report costs by disposal program had not been established,
- inventory was not reported at net realizable value, which overstated assets, understated the cost of goods sold account, and distorted performance data,
- accounting systems and procedures were inadequate, and
- National Sales Office personnel continued to perform most accounting for national sales contracts although they have been unable to correct longstanding accounting problems.

As a result, the Defense Reutilization and Marketing Service FY 1993 financial statements, when prepared, will be unreliable and future statements will remain so until a sustained commitment is made to change the Defense Reutilization accounting systems. Accordingly, we disclaim our opinion on the FY 1993 financial statements.

DLA COMMENTS: ***Partially concur.*** Our specific comments to finding's policy, procedural, systems, and reporting issues are provided with each recommendation.

INTERNAL MANAGEMENT CONTROL WEAKNESS:

( ) Nonconcur.
( ) Concur; however, weakness is not considered material.
(x) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 94
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
L. Coulter, DDAI, 26 May 94
J Bryant, DDAI, 26 May 94

DLA APPROVAL:

2 JUN 1994

FORMAT 2 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.a(1). We recommend that the Director, Defense Reutilization and Marketing service implement the necessary accounting principles to report sales revenue and inventory transactions in accordance with generally accepted accounting principles for Federal activities. Specifically, the Defense Reutilization and Marketing Service should reassess the proposed reutilization fee structure planned for implementation in FY 1995 to consider an item's condition. Use the acquisition value tables already in use for foreign military sales to charge reutilization customers a fee that relates more closely to an item's condition.

DLA COMMENTS: Partially concur. Currently, there is no reutilization fee structure planned for FY95. DRMS costs will be recovered through a combination of proceeds from public sales and surcharges added to the cost of material sold by the Services and DLA (Supply Management). Since there are still many concerns throughout DoD about an appropriate cost recovery methodology for DRMS, we cannot unilaterally agree to your recommendation. We suggest that you refer this recommendation to OSD for their consideration.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: Dependent on OSD policy decision.
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not Applicable
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(x) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 94
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
Carole Clark, FOX, X46481
L. Coulter, DDAI, 26 May 94
J Bryant, DDAI, 26 May 94

DLA APPROVAL:

2 JUN 1994

FORMAT 3 OF 12
TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.a(2). We recommend that the Director, Defense Reutilization and Marketing service implement the necessary accounting principles to report sales revenue and inventory transactions in accordance with generally accepted accounting principles for Federal activities. Specifically the Defense Reutilization and Marketing Service should develop a fee structure that is based on relevant operating costs for transfer, donation, and reimbursable sales and for hazardous disposal services. Establish the procedures necessary to bill customers and record revenue in the financial records.

DLA COMMENTS: Partially concur. Same comments as Recommendation A.1.a(1). Additionally, if a fee structure is developed, only the administrative portion of hazardous disposal costs would need to be recovered from DRMS customers through a fee.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: Same as Recommendation A.1.a(1).
( ) Action is considered complete.

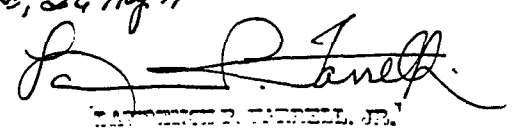
RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(x) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 94
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
Carole Clark, FOX, x46481, 23 May 1994
L. Coulter, DDAI, 26 May 94
Bryant, DDOI, 24 May 94

DLA APPROVAL:

2 JUN 94



FORMAT 4 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.a(3). We recommend that the Director, Defense Reutilization and Marketing Service implement the necessary accounting principles to report sales revenue and inventory transactions in accordance with generally accepted accounting principles for Federal activities. Specifically the Defense Reutilization and Marketing Service should establish the necessary accounting procedures and fees to account for reimbursable sales transactions as consignment sales. Information about consignment sales, inventory, and related accounts should be disclosed in the financial statements.

DLA COMMENTS: Partially Concur. We do not agree that DRMS reimbursable sales transactions are equivalent to consignment sales. Classifying inventory transactions as consignment sales must be examined based on legal title and asset ownership criteria. DRMS does indeed own this inventory as they have legal title, possess, and control these goods.

GAAP specifies that goods out on consignment are included in the inventory of the consignor and excluded from the inventory of the consignee. If we were to accept your recommendation and account for DRMS reimbursable sales transactions as consignment sales, GAAP dictates that the inventory would be accounted for as an asset of the consignor (Military Service and DLA turn-in activities) and would not be accounted and reported on the consignee books (DRMS). Your approach changes DoD accountability policy for disposal property (DoD 7220.9-M, Chapter 37). Additionally, because property may be withdrawn from DRMS custody by reutilization, transfer and donation customers without reimbursement to the generator, GAAP procedures for consignments do not appear to be appropriate.

Your finding states that as a result of DRMS not accounting for these transactions as consignment sales, the financial statements did not show that DRMS devoted significant resources to consignment sales for which it received no revenue. If that is the intended result of this recommendation, we believe we can provide this information in subsequent fiscal year footnotes. If we have misinterpreted your intent and you want changes made to the DoD accountability policy for disposal property, we suggest you refer this recommendation to OSD for their consideration.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: Contingent upon final publishing date of FY 1994 Financial Statements and Footnotes
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(x) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief, Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
L. Coulter, DDAI, 26 May 94
J. Bryant, DDAI, 26 May 94

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

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TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.a(4). We recommend that the Director, Defense Reutilization and Marketing Service implement the necessary accounting principles to report sales revenue and inventory transactions in accordance with generally accepted accounting principles for Federal activities. Specifically the Defense Reutilization and Marketing Service should adapt the existing Defense Reutilization and Marketing Service cost accounting system to track operating costs on a program basis by obtaining additional cost codes and implementing the procedures necessary to track program costs at the required detail.

DLA COMMENTS: Partially Concur. Your finding states that the generally accepted accounting principle (GAAP) requiring separate accounting for discrete entities was not followed for program costs. Your finding also states that OSD mandated that DRMS report operating costs by disposal program.

As you know, the entity concept provides for defining boundaries to determine information needs. The boundaries established by OSD for DRMS to report operating costs were:

- Cost per Hazardous Line Item
- Cost per Dollar of Proceeds

The mandate you cite requires unit cost reporting at the aggregate level, not at the program level. The mandated unit cost measure is Cost per Dollar of Proceeds (R/T/D/S). This measure includes (at the aggregate level) reutilization, transfer, donation and sales costs. This measure was also set forth in the DRMS FY 1993 annual operating budget.

While we agree that tracking costs on a program basis would provide a means to compile required performance data, the performance data is not currently required at the program level. We also agree that tracking costs on a program basis would aid in developing fees that relate to actual DRMS costs. However, we believe it is premature to accept this recommendation when an approach to recover DRMS costs has not been agreed to by the DoD establishment.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(x) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not Applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(x) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
Sharon Harler , FOB, x47768
L. Coulter, DDAI, 24 May 1994
J Bryant, DDAI, 26 May 94

DLA APPROVAL:

2 JUN 1994

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

FORMAT 6 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.a(5). We recommend that the Director, Defense Reutilization and Marketing Service implement the necessary accounting principles to report sales revenue and inventory transactions in accordance with generally accepted accounting principles for Federal activities. Specifically, the Defense Reutilization and Marketing Service should report all Defense Reutilization and Marketing Service inventories at net realizable value on all internal and external reports. The value of inventory sold should be recorded in a cost of goods sold account.

DLA COMMENTS: Concur. DoD's inventory valuation policy is currently being addressed by the DBOF Corporate Board Special Committee for Oversight of Policy Actions. DLA is represented on both groups. We have proposed that DoD's inventory valuation policy also pertains to DRMS inventory and require valuation at net realizable value (NRV).

If official policy and detailed procedures (e.g. entries to write-down to NRV on Supplier books and property turn-in documents) for disposal property is not published in time for the development of the FY94 financial statements, we intend to restate the inventory value for financial reporting purposes on the FY94 financial statements.

For CFO reporting purposes we intend to show the net realizable value of the disposed inventory as cost of goods sold. However, for the DRMS budget exhibits, the disposed inventory would have to be shown as a "below the line" inventory gain/adjustment, as DRMS would have no cost basis in the inventory.

DISPOSITION:

(x) Action is ongoing. Estimated Completion Date: Publication date of FY94 financial statements.

( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not Applicable.

DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:

(x) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
L. Coulter, DDAI, 26 May 1994
Bryant, DDAI, 26 May 94

DLA APPROVAL:

2 JUN 1994

FORMAT 7 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.b(1). We recommend that the Director, Defense Reutilization and Marketing Service establish the necessary internal controls and procedures to ensure that recorded sales can be linked to cash collections, accounts receivables, and accounts payables. Accounts receivable from non-Federal entities should be reported on the statement of financial position and the debt should be reported on the statement of operations.

DLA COMMENTS: Concur, however we suggest that you also address some of this recommendation to DFAS. Establishing and implementing the controls and procedures to link sales to accounts receivables, cash collections and accounts payable will be automated by the National Sales Office (NSO) and accomplished in conjunction with DFAS. Additionally, since the Defense Business Management System (DBMS) currently has the capability to account for allowances for losses on receivables and bad debts, the reporting of this information on the financial statements appears to be contingent upon DFAS using the system and reporting this information.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: Contingent upon full implementation of the DNSP system and DFAS acceptance of the reporting issue.
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
( ) Concur; however, weakness is not considered material.
(x) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
L. Coulter, DDAI, 26 May 1994
Bryant, DDAI, 26 May 94

DLA APPROVAL:

FORMAT 8 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.1.b(2). We recommend that the Director, Defense Reutilization and Marketing Service establish the necessary internal controls and procedures to ensure that suspense account balances controlled by Defense Reutilization and Marketing Service are reported as cash and accounts payable.

DLA COMMENTS: Partially concur. We understand that OMB Bulletin 94-01 requires suspense account balances to be reported (in the FY 1994 financial statements) as a "Non-Entity Asset--Fund Balance", not cash.

Additionally, since one of your draft audit reports **(DoDIG Project 4LE-2001)** specifically addresses the DoD Comptroller's definition of Fund Balance with the Treasury below the appropriation level of DBOF (to include suspense account balances), we suggest that you refer this recommendation to OSD for their consideration.

If specific policy is not issued (i.e., the OSD definition of Fund Balance is not changed to report DBOF business-area level suspense account balances as cash and not "Fund Balance") in time for the preparation of the Fiscal Year 1994 financial statements, we intend to disclose the suspense account balances (reported as Fund Balance and accounts payable) in the future fiscal year footnotes.

DISPOSITION:
- (x) Action is ongoing. Estimated Completion Date: Contingent upon OSD policy guidance and publication date of FY 1994 financial statements.
- ( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
- (x) Nonconcur.
- ( ) Concur; however, weakness is not considered material.
- ( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
L. Coulter, DDAI, 26 May 1994
J. Bryant, DDRS, 26 May 94
DLA APPROVAL:

2 JUN 1994

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

FORMAT 9 OF 12

TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION A.2. We recommend that the Director, Defense Logistics Agency distinguish contract administration functions from financial accounting functions at the National Sales Office. After the accounting functions are identified, the Defense Logistics Agency should transfer all accounting responsibilities and related resources for national sales from the National Sales Office to the Defense Finance and Accounting Service.

DLA COMMENTS: Partially Concur. We reviewed the business processes of the National Sales Office (NSO) in May 1994. We determined that transferring integrated functions of the NSO to DFAS would be not prudent. In our review, we found that the functions performed by the NSO should remain at the NSO. There are no accounting functions that should be separated from the inventory system and their business processes. The NSO will continue to be responsible for their business processes and the preparation of transaction documentation related to their business processes and inventory system. DFAS will continue to be responsible for processing transactions in the accounting system.

Many of the manual processes that you observed during your review from November 1992 through January 1994 are now automated. As an example, for DFAS to perform the NSO business processes of billing, DFAS would need access to both the manual contract files and the Daisy National Sales Program (DNSP) system. Either DFAS Columbus would need access to the inventory system and contract file documentation or employees of DFAS would need to be transferred to the NSO. We believe that the costs of both of these options are not justified.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(x) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(x) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
L. Coulter, DDAI, 26 May 1994
J Bryant, DDAI, 26 May 94
DLA APPROVAL:

2 JUN 1994

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

FORMAT 10 OF 12
TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

FINDING B. ***Internal Management Control Program.*** The Defense Reutilization and Marketing Service did not effectively implement the DoD Internal Management Control Program in reporting weaknesses related to the preparation of financial statements. The condition occurred because the Defense Reutilization and Marketing Service did not change its inventory of assessable units to reflect the more stringent financial responsibilities of a Defense Business Operations Fund business area.

Additionally, the Defense Reutilization and Marketing Service did not place program responsibilities at an appropriate level of command. As a result, internal control weaknesses affecting the ability of the Defense Reutilization and Marketing Service to prepare reliable financial statements have not been corrected or reported to higher command levels.

DLA COMMENTS: Concur.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 31 December 1994
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(x) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
Frank Bokowski, CA, x46323, 23 May 1993
L. Coulter, DDAI, 26 May 1994
Bryant, DDAI, 26 May 94

DLA APPROVAL:

9 JUN 1994

FORMAT 11 OF 12
TYPE OF REPORT: AUDIT **DATE OF POSITION:**

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE: Preparation of the Financial Statements of the Defense Reutilization and Marketing Service for FY 1993 **(Project No. 2LE-2020)**

RECOMMENDATION B.1. We recommend that the Director, Defense Reutilization and Marketing Service specifically identify in the inventory of assessable units, the major Defense Reutilization and Marketing Service functions related to the preparation of financial statements.

DLA COMMENTS: Concur.

DISPOSITION:
(x) Action is ongoing. Estimated Completion Date: 31 December 1994
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: Not applicable.
DLA COMMENT:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
( ) Concur; however, weakness is not considered material.
(x) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Richard Sninsky, FOX, x46481, 23 May 1994
PSE REVIEW/APPROVAL: James Rountree, CAPT, Acting Chief Financial Officer, 24 May 1994
COORDINATION: James O'Laughlin, FOX, x46100, 23 May 1994
Frank Bokowski, CA, x46323
L. Coulter, DDAI, 26 May 1994
Bryant, DDAI, 26 May 94

DLA APPROVAL:

2 JUN '94

LAWRENCE P. FARRELL, JR.
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