# Audit Report

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

OFFICE OF THE INSPECTOR GENERAL

DEFENSE HOMEOWNERS ASSISTANCE FUND
FINANCIAL STATEMENTS FOR FY 1993

Report No. 94-155

June 30, 1994

Department of Defense

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**Acronyms**

| | |
|---|---|
| DFAS | Defense Finance and Accounting Service |
| HQUSACE | Headquarters, U.S. Army Corps of Engineers |
| HUD | Housing and Urban Development |
| JFMIP | Joint Financial Management Improvement Program |
| OMB | Office of Management and Budget |
| USACE | U.S. Army Corps of Engineers |

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

June 30, 1994

MEMORANDUM FOR SECRETARY OF DEFENSE
COMPTROLLER AND CHIEF FINANCIAL OFFICER OF THE DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Defense Homeowners Assistance Fund Financial Statements for FY 1993 (Report No. 94-155)

We are providing this report for your information and use and for use by the Congress. Financial statement audits are required by the Chief Financial Officers Act of 1990. Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," requires the Inspector General, Department of Defense, to express an opinion on the financial statements and report on the adequacy of internal controls and compliance with laws and regulations. We issued a draft report of Part II, "Internal Controls," and Part III, "Compliance With Laws and Regulations," on April 29, 1994. The Defense Finance and Accounting Service and the U.S. Army Corps of Engineers took action to improve the accuracy of the statements, but did not furnish revised statements in time for them to be validated.

In Part I, we express an adverse opinion because the audited financial statements did not present fairly the financial position, the results of operations, cash flows, or budget and actual expenses of the Homeowners Assistance Fund (the Fund). The Defense Finance and Accounting Service understated the Fund's net position by $32.6 million, revenues and financing sources by $34.9 million, and expenses by $8.0 million. Also, the asset value of homes acquired by the Fund was overstated in the statements.

Part II discusses the lack of internal controls for communicating between entities, accumulating and reporting costs, inventorying homes, and controlling funds. Part III discusses the improper use of cash basis accounting, misstatement of Appropriations Expensed, improper use of small purchase procedures, and incomplete information in the Overview and Footnotes.

This report contains no recommendations that are subject to resolution in accordance with DoD Directive 7650.3; accordingly, comments are not required.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 604-9109 (DSN 664-9109), or Mrs. Saundra G. Elion, Project Manager, at (703) 604-9113 (DSN 664-9113). The distribution of this report is listed in Part IV, Appendix C. A list of audit team members is inside the back cover.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

**Office of the Inspector General, Department of Defense**

**Report No. 94-155** **June 30, 1994**
(Project No. 3FH-2012)

# DEFENSE HOMEOWNERS ASSISTANCE FUND FINANCIAL STATEMENTS FOR FY 1993

## EXECUTIVE SUMMARY

**Introduction.** The Chief Financial Officers Act of 1990 requires an annual audit of financial statements for funds such as the Defense Homeowners Assistance Fund (the Fund). The Fund is a revolving fund that provides financial assistance to DoD civilian, military, and Coast Guard homeowners who incur financial losses when selling their homes in areas where real estate values have declined because of base closures or realignments. The U.S. Army Corps of Engineers (USACE) manages and operates the Fund, and the Defense Finance and Accounting Service (DFAS) prepares the financial reports and financial statements. The Fund had a total of $209.3 million available at the beginning of FY 1993 ($133.0 million from appropriations, $74.6 million carried forward from previous years, and $1.7 million in recoveries). The Fund reported $27.7 million in revenue during FY 1993.

**Objectives.** The objectives of the audit were to determine whether the Fund's FY 1993 financial statements were presented fairly in accordance with Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We evaluated the internal control structure established for the Fund and assessed compliance with applicable laws and regulations that could have a material effect on the financial statements. Also, we identified improvements to the financial statement process that could provide beneficial data to program managers and other users of financial statements and followed up on the conditions noted in our previous audit of the Fund's financial statements.

**Scope and Methodology.** We examined the financial statements of the Defense Homeowners Assistance Fund as of and for the year ended September 30, 1993. The financial statements included the Statement of Financial Position, Statement of Operations (and Changes in Net Position), Statement of Cash Flows, Statement of Budget and Actual Expenses, Footnotes, and Overview. The statements upon which our examination was based were dated March 31, 1994 and are included in Part V. We did not assess compliance with any laws pertaining to employee compensation since those expenses are paid from the USACE Revolving Fund. As part of the audit, we also evaluated the reliability of computer-processed information used in the financial statements and determined it to be reliable.

**Independent Auditor's Opinion.** We are expressing an adverse opinion on the financial statements dated March 31, 1994. The statements and footnote disclosures do not present fairly the Fund's financial position, results of operations, cash flows, or budget and actual expenses in accordance with Office of Management and Budget Bulletin No. 94-01 and DoD guidance. The general ledger used to prepare the FY 1993 financial statements contained inaccurate information. As a result, the Fund's net position was understated by $32.6 million, revenues and financing sources by $34.9 million, and expenses by $8.0 million. Additionally, the asset value of homes acquired by the Fund was overstated.

Although we are expressing an adverse opinion, the Defense Finance and Accounting Service and the U.S. Army Corps of Engineers have taken action to improve the accuracy of the FY 1993 statements. However, the revised statements were not provided within a reasonable time for us to verify the accuracy of the adjusted balances.

**Internal Controls**. Internal control weaknesses existed that had a material effect on the statements. The USACE and the DFAS did not effectively communicate accounting issues pertaining to the Fund, costs were improperly accumulated and reported, inventory records were not maintained, and collection and disbursing procedures were inadequate.

We reviewed the USACE districts' internal control checklists and the FY 1993 Headquarters, U.S. Army Corps of Engineers, Annual Statement of Assurance. Except for inadequate real property inventory records, the conditions noted in this report were not specifically addressed in the assurance statement.

**Compliance with Laws and Regulations**. Except for the following instances, Fund operations generally complied with applicable laws and regulations. The USACE did not comply with DoD Manual 7220.9-M, "DoD Accounting Manual," to record revenue on an accrual basis; conflicting guidance between Office of Management and Budget Bulletin No. 94-01 and "DoD Guidance on Form and Content of Financial Statements for FY 1993 and FY 1994 Financial Activity," caused Appropriations Expensed to be understated; two districts did not comply with the Federal Acquisition Regulation; and the Overview and Footnotes were not prepared in accordance with DoD guidance. Part IV, Appendix A, lists all laws and regulations tested.

**Followup on Prior Audit Issues.** Most of the findings in the audit of the FY 1992 financial statements remain unresolved. Those issues involve classifying and reporting costs, maintaining comprehensive inventory records, classifying and valuing homes, using accrual accounting, omitting performance indicators in the Overview, having inadequate footnote disclosure, and using small purchase regulations. The USACE did implement procedures for processing accounting transactions in sequence and maintaining records for distributing labor costs.

**Management Comments.** We received comments from the Comptroller of the Department of Defense (DoD Comptroller), the USACE, and the DFAS. The DoD Comptroller nonconcurred with the findings on classifying homes, Appropriations Expensed, and Footnotes. Both the DFAS and the USACE generally concurred with the findings. The DFAS, however, did not concur with the finding on Appropriations Expensed. The complete text of managements' comments is in Part VII.

**Audit Response.** We agreed with most of the comments we received and revised our report accordingly. Specifically, we deleted the finding on classifying the homes as inventory, but advised that the homes should not be treated as fixed assets. We changed our finding on Appropriations Expensed to include the cost of the homes sold instead of acquisition cost, and deleted part of our comments on Footnote 2.

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

# Part I - Independent Auditor's Opinion on the Financial Statements

# Adverse Opinion

The general ledger used by the Defense Finance and Accounting Service (DFAS) to prepare the Defense Homeowners Assistance Fund FY 1993 Financial Statements contained inaccurate information. That information was inaccurate because the U. S. Army Corps of Engineers (USACE) submitted inaccurate trial balances and the DFAS did not routinely verify financial data received from the USACE. As a result, the FY 1993 financial statements contained material misstatements and errors in reporting assets. Net Position was understated by $32.6 million (15 percent of the line-item total), revenues and financing sources were understated by $34.9 million (242 percent), and expenses were understated by approximately $8.0 million (51 percent). In addition, assets were not correctly valued.

The Net Position and Revenue and Financing Sources accounts were materially misstated on the FY 1993 financial statements. Net Position was computed using a transfers-out account, even though the Fund did not transfer any assets to other Government agencies. As a result, Net Position was understated by $32.6 million. The Revenue and Financing Sources account, specifically Appropriations Expensed, was understated by $34.9 million because it excluded the costs of the homes sold in FY 1993.

Other material misstatements resulted from the USACE reporting abnormal account balances to the DFAS. Two USACE districts reported over $4.0 million in negative operating expenses, which contributed to understating operating expenses by $4.7 million. The USACE also reported a negative $1.2 million balance for interest expense, even though there was no activity in the interest account in FY 1993. In addition, the USACE did not record $3.6 million of losses on FY 1993 Department of Housing and Urban Development (HUD) sales and neglected to close out the FY 1992 losses account, which contained $1.5 million. Those reporting errors caused expenses to be understated by approximately $8.0 million.

Although the amounts were not material, assets were not correctly valued on the FY 1993 financial statements. Homes were reported as Property Held for Sale on the Statement of Financial Position and valued at acquisition cost. Since the primary criteria for participating in the Homeowners Assistance Program is that the market value of the homes must be less than the original cost, using acquisition costs overstates assets. While no material misstatement resulted, continuing that practice may result in a material error in future years.

In our opinion, because of the effects of matters discussed in the preceding paragraphs, the principal statements do not present fairly, in conformity with the other comprehensive basis of accounting described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, the financial position of the Defense Homeowners Assistance Fund (the Fund) as of September 30, 1993, or the results of its operations, cash flows, or budget and actual expenses for the year then ended.

# Background

The Fund is a DoD revolving fund created to provide financial assistance to eligible DoD civilian, military, and Coast Guard homeowners who incur financial losses when selling their homes in areas where real estate values have declined because of base closures or realignments. The USACE manages and operates the Fund for the DoD. The DFAS prepares the financial reports and financial statements. Headquarters, U.S. Army Corps of Engineers (HQUSACE), and seven USACE districts participated in the Fund in FY 1993.

Based on the Apportionment Schedule, the Fund had a total of $209.3 million available at the beginning of FY 1993 ($133.0 million from appropriations, $74.6 million carried forward from previous years, and $1.7 million in recoveries.) During FY 1993, the Fund also reported $27.7 million in revenue from the sale of 450 homes and disbursed $37.8 million to acquire 642 homes.

The Chief Financial Officers Act requires an annual audit of the financial statements of funds such as the Defense Homeowners Assistance Fund. Our responsibility is to express an opinion on those statements based on our examination.

# Scope and Methodology

We examined the Principal Statements, Notes to the Principal Statements, Overview, and Supplemental Financial and Management Information of the Defense Homeowners Assistance Fund as of and for the year ended September 30, 1993. The principal statements include the Statement of Financial Position, Statement of Operations (and Change in Net Position), Statement of Cash Flows, and Statement of Budget and Actual Expenses. The statements upon which our opinion is based were dated March 31, 1994. The financial statement are in Part V of this report.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements, including the accompanying notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement presentation.

This financial statement audit was made during the period July 1993 through April 1994 and we believe our audit efforts provide a reasonable basis for our results. A complete list of the locations we visited or contacted is in Part IV, Appendix B.

**Scope of the Review of Internal Controls.** We updated our FY 1992 client profile and cycle memorandums and assessed the internal control structure for the Fund for funds control, disbursements, administrative (direct and indirect labor) expenses, revenue, inventory, procurement, and financial reporting.

We also performed a followup review of internal control weaknesses that were identified in our audit of the FY 1992 financial statements. Those weaknesses existed because procedures were not in place to accurately accumulate and report costs; classify, value, and maintain inventory records; safeguard checks; process transactions; and distribute labor costs.

**Scope of the Review of Compliance With Laws and Regulations.** As part of obtaining reasonable assurance about whether the Fund's financial statements were free of material misstatements, we performed tests of compliance with provisions of the laws and regulations listed in Part IV, Appendix A. We reviewed the USACE's compliance with DoD Directive 5010.38, "Internal Management Control Program," by comparing the districts' internal control checklists and USACE's FY 1993 Annual Statement of Assurance with our evaluation of the Fund's operations, and other information presented to us. It was not our objective, however, to provide an opinion on overall compliance with such provisions.

We reviewed transactions at the USACE to determine whether the transactions were valid, accurate, properly classified, and recorded in the proper accounting period. We also reviewed the districts' trial balances and summary reports that were transmitted to the DFAS-Indianapolis Center to determine whether transactions were summarized to the proper accounts. At the DFAS-Indianapolis Center, we evaluated certified reports, line-item account balances, and related adjustments pertaining to the Statement of Financial Position, the Statement of Operations, and the Footnotes. We also included a review of the corrective actions taken in response to our FY 1992 financial statement audit of the Fund.

We also evaluated corrective actions taken on compliance issues identified in our audit of the FY 1992 financial statements. That audit showed that revenue were not recorded on an accrual basis, the Overview to the principal statements was inadequate, and contractual services were not procured in compliance with the Federal Acquisition Regulation.

**Limitations on Scope of Review.** The scope of our review was limited by several factors. We performed various reviews to determine the reliability of computer-processed data provided to us. The USACE used the Corps of Engineers Management Information System, a standard cost accounting system, to generate the information in the financial statements. Since that system is expected to be replaced within the next few years, we limited our review of general and application controls for computer-processed data to tracing selected transactions through the system, observing operations, conducting interviews, and verifying balances to DFAS-certified reports and Treasury reports. To the extent that we reviewed the computer-processed data, we concluded that they were sufficiently reliable to be used in meeting the audit objectives.

We used judgmental sampling to evaluate internal controls and verify whether transactions were properly posted. Last year's audit indicated there were site-specific problems that could not be generalized easily over the entire universe without a substantial increase in sample size. We decided not to increase coverage this year.

We did not assess compliance with laws pertaining to employee compensation, since those expenses are paid from the USACE Revolving Fund. The USACE charged the Fund variable indirect cost rates to cover those expenses.

## Auditing Standards

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

## Accounting Principles

Accounting principles and standards for the Federal Government remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General; who are principals of the Joint Financial Management Improvement Program (JFMIP). Specific standards agreed on by those three officials are issued by the Director, OMB, and the Comptroller General.

Until accounting standards that will govern all aspects of financial statement reporting have been issued, which will constitute "generally accepted accounting principles for the Federal Government," agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements." The hierarchy constitutes an "other comprehensive basis of accounting" to be used for preparing Federal agency financial statements. A summary of the hierarchy defined and approved by the JFMIP Principals, follows:

- standards agreed to and published by the JFMIP Principals,
- form and content requirements of the OMB,
- accounting standards contained in agency accounting policy guidance, and
- accounting principles published by other authoritative sources.

To date, three accounting standards have been published by the JFMIP Principals, so most accounting standards for the DoD's "other comprehensive basis of accounting" are contained in DoD accounting policy guidance. The DoD accounting guidance is primarily in the DoD 7220.9-M, "DoD Accounting Manual" (DoD Accounting Manual). During FY 1993, the DoD Comptroller updated portions of the DoD Accounting Manual and incorporated those sections into a new regulation, DoD 7000.14-R, "DoD Financial Management Regulation" (DoD Financial Regulation).

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

# Additional Information

**Overview.** The Overview to the Fund's FY 1993 principal statements did not contain adequate information on the operations and the condition of the Fund. DoD guidance requires that the Overview provide a clear and concise description of the Fund's operations, performance measures, and suggestions for improvement. The Overview described the purpose of the Fund and basic FY 1993 activity, but it did not include special initiatives such as implementation of the Homeowners Assistance Program Management Information System and other financial management improvements. In addition, the four program performance indicators identified in the FY 1993 Overview were not implemented until FY 1994; no program performance indicators were measured in FY 1993. Performance indicators are essential because they measure whether management accomplished its objectives as planned.

**Advisory Memorandum.** During the audit, we reported deficiencies to the DFAS and the USACE in an advisory memorandum dated April 8, 1994 (see Part VI of this report). The material deficiencies described in that memorandum are presented in this report. Management comments to our draft report were also responsive to our advisory memorandum. The text of those comments is in Part VII of this report.

**Management Improvements.** Although we are expressing an adverse opinion on the FY 1993 financial statements, both the DFAS and the HQUSACE have taken action to improve the accuracy of the FY 1993 financial information reported for the Fund. The DFAS provided us revised statements, however, we are unable to express an opinion on them because they were not provided within a reasonable time to verify the accuracy of the revised balances. Also, the statements had not been signed by the Chief Financial Officer.

# Part II - Internal Controls

# Introduction

We examined the internal control structure for the Defense Homeowners Assistance Fund (the Fund) as of and for the year ended September 30, 1993.

The U.S. Army Corps of Engineers (USACE) manages the Fund, and the Defense Finance and Accounting Service (DFAS) prepares the financial statements and reports. The USACE and the DFAS are responsible for establishing and maintaining an internal control structure for the Fund. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that the following are met.

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

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

o Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the principal statements and any other laws and regulations that the Office of Management and Budget (OMB), entity management, or the Inspector General, Department of Defense, has identified as being significant for which compliance can be objectively measured and evaluated.

o Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

o Questions are answered as to whether performance measures existed and whether those performance measures were adequate to enable the Fund to fulfill its purpose.

# Objective

The objective of the audit was to determine whether internal controls over the Fund were adequate to ensure that the financial statements were free of material error. In planning and performing our audit of the Fund for the year ending September 30, 1993, we evaluated the Fund's internal control structure, including implementation of the DoD Internal Management Control Program. The purposes of this evaluation were to:

o determine our auditing procedures for expressing an opinion on the financial statements and o determine whether the internal control structure was established to ensure that the statements were free of material misstatements.

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

For the purposes of this report, we have classified the significant internal controls, policies, and procedures into the following categories: funds control, disbursements, administrative (direct and indirect labor) expenses, revenue, inventory, procurement, and financial reporting. We reviewed the districts' internal control checklists and the Headquarters, U.S. Army Corps of Engineers (HQUSACE), Annual Statement of Assurance for FY 1993 required by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Except for inadequate real property inventory records, the conditions noted in this report were not specifically addressed in the October 8, 1993, statement.

# Prior Audit Coverage

The Office of the Inspector General, Department of Defense, issued Audit Report No. 93-140, "Defense Homeowners Assistance Fund Financial Statements for FY 1992," on June 30, 1993. We expressed an adverse opinion because the financial statements did not present fairly the financial position of the Fund. The accounts receivable were understated by $2.3 million, revenues and financing sources by $18.1 million, and expenses by $8.4 million; liabilities were overstated by $1.1 million; and net position and fund balance transfers were not supported by accounting records or otherwise documented. In addition, the USACE and the DFAS did not properly classify and report costs, maintain comprehensive inventory records, or accurately classify and value homes. The USACE did not fully comply with accounting and contracting regulations or OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992. While the USACE agreed to make changes, most of the proposed actions had not been implemented in FY 1993 and, therefore, related findings are repeated in this report.

The Army Audit Agency reviewed the operating procedures at the HQUSACE and the Fort Worth District and issued Information Memorandum SW 91-752, "Review of the Homeowners Assistance Program, U.S. Army Corps of Engineers," March 20, 1991. The review found improvements were needed to ensure effective program administration, proper tracking of costs, and reporting of taxes.

# Results of Audit

**Reportable Conditions.** Internal controls were not adequate to ensure that the financial statements were free of material error. We consider those internal control weaknesses to be material and reportable conditions under standards established by OMB Bulletin No. 93-06. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information to manage and evaluate operational performance. A material weakness is a reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors would be in amounts that would be material to the statements being audited, or material to a performance measure or aggregation of related performance measures, and not be detected within a timely period by employees in the normal course of performing their functions.

**Conditions Noted.** Internal control weaknesses existed that had a material effect on the statements. The weaknesses discussed in this report were presented to the USACE in an advisory memorandum on April 8, 1994 (see Part VI of this report).

The USACE and the DFAS did not effectively communicate accounting issues pertaining to the Fund; costs were improperly accumulated and reported; inventory records were not maintained and the value of the homes were overstated; and collection and disbursing procedures were inadequate.

**Communicating Between Entities.** The USACE and the DFAS did not communicate effectively. As a result, the principal statements did not fairly present the condition of the Fund. As the Fund Manager, the USACE was responsible for ensuring that the financial statements contained reliable financial information so that management could make appropriate decisions regarding the Fund. Consequently, the USACE should increase information sharing with the DFAS so that the DFAS can use correct information to prepare useful financial statements.

The USACE operates and manages the Fund through its divisions and districts and sends the financial data to the DFAS-Indianapolis Center. The DFAS in turn prepares all certified financial reports, principal statements, and footnotes to the principal statements. Even though the two organizations have defined roles, a strong need exists for the organizations to openly communicate about the fair presentation of the financial status of the Fund.

Open communication will prevent obvious discrepancies. For example, had the DFAS-Indianapolis Center understood how the Fund operated, the following would have occurred.

o Negative program expenses totaling over $4.0 million would not have been erroneously included in the Statement of Operations. Each participating district charged program expenses for operating the Fund; therefore, each district should have had a positive balance.

o The transfers-out account would have been zero and not $32.6 million. The USACE used "transfers-out" as a holding account to move the homes from the districts' account to the HQUSACE account. The DFAS believed the transfers-out account represented transfers to the Department of Housing and Urban Development (HUD). However, since the HQUSACE maintained title and accountability for the homes transferred to the HUD, the account balance should have been zero.

o The Footnotes to the Financial Statements would have more clearly explained the composition of the specific line items. Note 3 would not have stated that "Obtaining appraisals . . . is not cost effective . . . ." Actually, the USACE obtained three separate appraisals at the time homes were acquired. The DFAS was unaware that the USACE obtained appraisals for each home.

Recently, some strides have been made by the two organizations to reach agreement on how information is presented in the financial statements and the certified reports. Such interaction should continue throughout the year to ensure that transactions are properly recorded and reported on future financial statements.

**Accumulating and Reporting Costs.** The internal control structures at the DFAS and the USACE were not sufficient to accumulate and report the condition of the Fund. Specifically, the general ledger the DFAS used to prepare the FY 1993 financial statements contained inaccurate information. As a result, the FY 1993 financial statements contained material misstatements: net position was understated by $32.6 million (15 percent of the line-item total), revenues and financing sources were understated by $34.9 million (242 percent), and expenses were understated by approximately $8.0 million (51 percent).

The internal controls for both the USACE and the DFAS were insufficient to detect and correct reporting errors in the general ledger. During FY 1993, the USACE had neither the controls nor the oversight needed to ensure that accurate financial information was reported to the DFAS. As a result, districts reported abnormal account balances to the DFAS, the USACE did not close out nominal accounts, and losses were not reported in the correct accounting period. (Details are in Part I.)

The DFAS, on the other hand, did not routinely verify financial data it received from the USACE. Often, the DFAS adjusted the general ledger to match certified reports without reconciling the certified reports to the accounting records. Since the DFAS did not verify the trial balances received from the USACE districts, it reported inaccurate amounts on the financial statements.

We reported this internal control weakness in the report on our prior audit, Report No. 93-140, as well as in the advisory memorandum dated April 8, 1994.

**Inventorying Homes.** Comprehensive inventory records were not maintained and homes were not properly valued. Those weaknesses existed because the HQUSACE did not provide specific guidance to the districts. As a result, the USACE officials could not tell how many homes were acquired and sold during FY 1993, and the value of the homes was overstated.

**Maintaining Records.** Two organizational units at the HQUSACE and two branches at the districts maintained elements for a complete and comprehensive inventory. At the HQUSACE, the Resource and Analysis Branch maintained the inventory in the possession of the HUD and the Finance and Accounting Branch maintained the inventory managed by the USACE districts. Because the Finance and Accounting Branch did not maintain a data base throughout the year, its ending inventory totals did not match the total of the districts' certified amounts.

At the districts, the Real Estate Division purchased, managed, and sold homes for the Fund, and the Resource Management Branch processed and recorded the financial transactions and reported that information to the HQUSACE. Since no specific guidance was issued, no comprehensive inventory records were maintained and no reconciliations were made between the Real Estate Division records and the Resource Management Branch records. Consequently, we could not determine the total number and cost of the homes purchased or the gain or loss on each sale.

**Valuing Homes.** The HQUSACE directed the districts to record the homes at acquisition cost (mortgage liquidation plus the applicants' equity). That valuation method overstated assets.

**Recording Costs.** The districts used inconsistent methods to record acquisition costs for the homes. The Baltimore District reduced the acquisition cost by the amount of the closing costs that the applicant paid; the Savannah District increased the cost by a portion of reimbursable benefits paid to the applicant. The differences for those two districts were not material, but if other districts also use costs other than mortgage liquidation and equity, the aggregate difference could be material. Furthermore, including costs such as reimbursable benefits in acquisition costs understates the program operating costs as defined by the HQUSACE. (All costs except mortgage liquidation and equity payments are considered program operating costs.)

**Reporting Homes.** A more appropriate method to value homes rather than using acquisition costs would be to value the homes at net realizable value; that is, expected selling price less expected costs. Since the "DoD Guidance on Form and Content of Financial Statements for FY 1993 and FY 1994 Financial Activity," January 12, 1994, suggests, but does not specifically require, using net realizable value, the USACE continued to use acquisition costs to report the homes. That caused the value of the homes to be overstated on the FY 1993 financial statements. While we could not estimate the net realizable value for the ending inventory, we determined that the selling price for homes that the HUD and the Savannah and Baltimore Districts sold was less than 90 percent of the acquisition cost.

Reporting homes at net realizable value would not result in additional costs to the Fund because the essential elements for making that determination are currently available. Specifically, appraisals are required before an offer is made to the applicant (homeowner) and can be used for the expected selling price; existing systems capture expenses related to maintenance and repairs and can be used to determine expected cost. Furthermore, two Federal agencies, HUD and the Department of Veterans Affairs, currently use net realizable value to report the homes in their inventories.

**Funds Control.** Checks were disbursed without supervisory approval and unauthorized employees collected reimbursement checks for the Fund. While we did not note any irregularities resulting from those weak controls, such weaknesses could cause inaccurate payments to be made and checks to be misplaced.

**Disbursing Procedures.** Although the Baltimore District disbursed over $7.0 million during FY 1993, many of the checks were issued without supervisory review and approval. Improper disbursement procedures could result in delays for closings and additional costs to the Fund. Also, checks were issued in the name of the title companies instead of the mortgage companies. Those checks included 7 days of additional interest for transit time (that is, to allow the title companies sufficient time to deposit the checks into their accounts and issue their own checks to pay off the mortgages on behalf of the Fund). The district had no control over how long the title companies held the checks.

**Collection Procedures.** Check receipt procedures were not followed at at least two of the districts we visited. Unauthorized employees in the Real Estate Division collected over $3.0 million in reimbursement checks (for sales proceeds, rental income, and refunds from the overpayment of mortgage interest). Those employees did not have proper controls in place to adequately safeguard the checks or make timely deposits.

In addition to using unauthorized employees, the Baltimore District did not have controls for effectively monitoring mortgage interest refund checks resulting from excess interest paid to the mortgage companies. Excess interest paid to the mortgage company was not always returned to the district because no established procedures for collecting those refunds existed. Mortgage companies sometimes mailed interest refund checks to the homeowners or to the title companies, but only on occasion to the Baltimore District. Most times, the mortgage companies returned excess interest to the homeowner because, legally, any overpayment must be returned to the original borrower as a refund of an escrow account. We could not determine how much interest refund was due to the Fund.

**Reportable Conditions Not Noted.** Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. Except for matters noted, we believe there is reasonable assurance that the internal control structure meets the internal control objectives.

# Management Comments

The Deputy Chief Financial Officer responded for the Comptroller of the Department of Defense (DoD Comptroller); the Deputy Director for General Accounting responded for the DFAS, and the Chief of Staff, Corps of Engineers, responded for the USACE. Part VII of the report contains the complete text of the management comments.

**Comptroller of the Department of Defense.** The DoD Comptroller nonconcurred with the finding concerning the classification of homes and did not respond to the valuation issue. The DoD Comptroller stated that homes should not be recorded in an inventory account because the DoD "is not in the business of acquiring homes for sale."

**Defense Finance and Accounting Service.** The DFAS concurred with the findings on communication and accumulating and reporting costs. To correct those findings, the DFAS agreed to execute a memorandum of understanding with the USACE by July 1, 1994. The DFAS also expects the controls on accumulating and reporting costs to improve with better oversight and more diligent scrutiny of trial balance submissions. The DFAS estimates an improvement in controls over accumulating and reporting costs will take effect by September 30, 1994.

**U.S. Army Corps of Engineers.** The USACE concurred with the internal control weaknesses we identified and stated it is working with the DFAS to write a memorandum of understanding that will govern future working and communications relationships. To correct the other findings, the USACE plans to:

o create a general ledger program to analyze and compare the general ledger to the Integrated Command Accounting and Reporting System,

o publish new accounting guidance,

o institute a change to the current automated reporting system to accurately record accounts receivable,

o develop standardized monthly and yearend inventorying reports,

o reissue guidance on the disbursement of funds, and

o change the terms of the title company contracts at a particular district to reduce the time necessary to transfer funds to the title company.

The USACE expects the proposed actions to be complete on or before June 30, 1994.

# Audit Evaluation of Management Comments

Based on the DoD Comptroller's comments and practices of other Federal agencies, we deleted all references to classifying the homes as inventory. It is acceptable to classify the homes as Property Held for Sale; however, the homes should not be treated as fixed assets. Even though the DoD Comptroller stated that the DoD "is not in the business of acquiring homes for sale," buying and selling homes is the business of the Homeowners Assistance Fund. Therefore, the homes should be treated as tangible property and the nature of the account should be fully disclosed in Note 3.

Although the DoD Comptroller did not comment on valuation, acquisition cost is not the appropriate basis to use to value the homes. Net realizable value, as used by HUD and the Department of Veterans Affairs and identified in DoD guidance, would be the preferred basis. The basis used should also be described in Note 3.

We agree with the DFAS comments and the planned actions should correct the conditions noted in our draft report.

The USACE comments show willingness to correct the conditions noted in our draft report, and we agree with their comments except for those on abnormal balances. As of June 8, 1994, the FY 1993 abnormal account balances had not been corrected as stated in the USACE comments. Furthermore, the DFAS-Indianapolis Center indicated that the line items on the financial statements will be changed based on our recommended adjustments, but the changes will not be made to the accounting records. Adjustments should be made to the accounting records as well as to the financial statements.

# Part III - Compliance With Laws and Regulations

# Introduction

We evaluated the Defense Homeowners Assistance Fund (the Fund) for material instances of noncompliance with laws and regulations for the year ended September 30, 1993. The statements upon which our evaluation was based were dated March 31, 1994. The list of laws and regulations we reviewed is in Part IV, Appendix A.

We assessed the transactions at the U.S. Army Corps of Engineers (USACE) to determine whether the transactions were valid, accurate, properly classified, and recorded in the proper accounting period. We also reviewed the districts' trial balances and summary reports that were transmitted to the Defense Finance and Accounting Service (DFAS)-Indianapolis Center to determine whether transactions were summarized to the proper accounts. At the DFAS-Indianapolis Center, we evaluated certified reports, line-item account balances, and related adjustments pertaining to the Statement of Financial Position, Statement of Operations (and changes in net position), and the Footnotes. We also included a review of the corrective actions taken in response to our FY 1992 financial statement audit of the Fund.

To assess compliance with DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, we reviewed the districts' internal control checklists and the Headquarters, U.S. Army Corps of Engineers (HQUSACE), Annual Statement of Assurance for FY 1993.

We did not assess compliance with any laws pertaining to employee compensation since those expenses are paid from the USACE Revolving Fund. The USACE charged the Fund variable indirect cost rates to cover those expenses.

# Objective

The objective of our audit was to determine whether the Fund's activities were in compliance with applicable laws and regulations and whether the financial statements were free of material misstatements. Material instances of noncompliance are failures to follow requirements, or violations of prohibitions in laws or regulations. Such failures or violations are those that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the principal statements or those whose sensitive nature would cause them to be perceived as significant by others.

The Commander, USACE, and the Director, DFAS, are responsible for compliance with laws and regulations applicable to the Fund. As part of obtaining reasonable assurance about whether the principal statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements and other laws and regulations designated by the Office of Management and Budget (OMB) and the Department of Defense.

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by DoD Directive 5010.38. We also compared management's most recent Annual Statement of Assurance report with our evaluation of the Fund's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented to us in the Overview to the Fund's principal statements, as well as supplemental financial and management information. It was not our objective, however, to provide an opinion on overall compliance with such provisions.

# Prior Audit Coverage

The Office of the Inspector General, Department of Defense, issued Audit Report No. 93-140, "Defense Homeowners Assistance Fund Financial Statements for FY 1992," on June 30, 1993. We expressed an adverse opinion because the financial statements did not present fairly the financial position of the Fund. The accounts receivable were understated by $2.3 million, revenues and financing sources by $18.1 million, and expenses by $8.4 million; liabilities were overstated by $1.1 million; and net position and fund balance transfers were not supported by accounting records or otherwise documented. In addition, the USACE and the DFAS did not properly classify and report costs, maintain comprehensive inventory records, or accurately classify and value homes. The USACE did not fully comply with accounting and contracting regulations or OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992. While the USACE agreed to make changes, most of the proposed actions had not been implemented in FY 1993 and, therefore, related findings are repeated in this report.

The Army Audit Agency reviewed the operating procedures at the HQUSACE and the Fort Worth District, and issued Information Memorandum SW 91-752, "Review of the Homeowners Assistance Program, U.S. Army Corps of Engineers," March 20, 1991. The review found improvements were needed to ensure effective program administration, proper tracking of costs, and reporting of taxes.

# Results of Audit

Except for the instances cited below, Fund operations generally complied with applicable laws and regulations.

**Revenue Recorded on Cash Basis.** The USACE recorded revenue transactions using the cash basis of accounting. OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, and DoD 7220.9-M, "DoD Accounting Manual" (DoD Accounting Manual), require accrual accounting. As a result, Accounts Receivable were understated by at least $2.4 million.

The DoD Accounting Manual, chapter 81, requires revenues to be recorded "at the time of sale." Thus, revenue should be recorded when the homes are sold, not when cash is received. The USACE was fully aware of that requirement, but did not provide adequate oversight to ensure that revenues were recorded in the correct accounting period and that accounts receivable were established for proceeds received in subsequent periods.

Over $2.0 million of revenue earned in FY 1992 was included as FY 1993 sales. Excluded was $2.3 million for homes the Department of Housing and Urban Development sold in the last 2 months of FY 1993. Also excluded were the revenues from sales of homes at two USACE districts. Although the FY 1992 sales offset the exclusion of the FY 1993 sales, revenues were not recorded in the proper accounting period. Reporting revenue in the proper accounting period will increase the reliability and usefulness of the financial information reported for the Fund.

The DFAS increased the revenue general ledger account by $1.2 million. That amount represented the write-off of a nonexistent debt. We identified in our prior audit that that "debt" was an accounting error and should have been written off in FY 1992. The write-off should be to Net Position, not to Revenue.

We reported on the requirement to use the accrual method in the Audit Report No. 93-140. The cash basis was used in FY 1992 because the DFAS would not allow the USACE to record revenue until checks were deposited. The DFAS changed that requirement in FY 1993, however, the USACE did not change its practice until after the close of FY 1993.

**Appropriations Expensed.** Because of conflicting guidance between OMB Bulletin No. 94-01 and "DoD Guidance on Form and Content of Financial Statements for FY 1993 and FY 1994 Financial Activity," January 12, 1994, Appropriations Expensed was understated by approximately $34.9 million.

In accordance with the DoD Guidance, the DFAS reported $14.4 million as Appropriations Expensed in FY 1993. That line-item account balance included all program operating costs except the cost of selling the homes. The DoD Guidance on Form and Content says the amount of appropriations used is equivalent to the sum of Operating/Program Expenses. However, OMB Bulletin No. 94-01 defines Appropriations Expensed as "the amount of appropriations used to finance expenses;" this means that the financing sources should be matched against current period expenses funded by appropriations. Based on that definition, all expenses incurred during FY 1993 should be included in Appropriations Expensed. Therefore, the cost of the homes sold should be included in the Appropriations Expensed line-item balance (all homes acquired by the Homeowners Assistance Fund were purchased from annual appropriations).

In FY 1993, the Fund's operating expenses were $19.1 million and the cost of the homes sold was approximately $30.1 million. (Since the USACE did not maintain records on homes sold, we estimated the total cost of the homes sold based on reported sales of $27.7 million and losses of $2.4 million.)

**Procurement Practices.** Two districts used split purchases to acquire title services using small purchase procedures. Those districts made multiple awards to keep each award at less than $25,000, even though the total requirement exceeded that amount by as much as $91,000. The Federal Acquisition Regulation, Part 13, prohibits that practice.

We advised the USACE of this noncompliance issue in memorandums dated March 26, 1993, and April 8, 1994, and in Audit Report No. 93-140. The USACE agreed to take corrective action, but did not aggressively monitor the districts to ensure they initiated the competitive process in a timely manner. For example, although we first noted this condition at the Fort Worth District, that district did not award a competitive contract in FY 1993. In addition, the Baltimore District was not aware of the requirement to compete those services. Those districts have since initiated the competitive process.

**Financial Statement Overview and Footnotes.** The Overview and Footnotes to the Fund's FY 1993 principal statements did not adequately address the operations of the Fund or contain performance measures. DoD Guidance on Form and Content prescribes the criteria for an overview. An overview must provide a clear and concise description of the Fund and should include performance measures.

The Overview described the purpose of the Fund and basic FY 1993 activity, but it did not include special initiatives such as implementation of the Homeowners Assistance Program Management Information System, and other financial management improvements. In addition, the four program performance indicators identified in the FY 1993 Overview were not implemented until FY 1994; no program indicators were measured in FY 1993. Performance indicators are essential because they measure whether management accomplished its objectives as planned.

Although the DFAS prepared the Footnotes to the Financial Statements, those Footnotes did not provide appropriate disclosure to make the principal statements fully informative. That happened because the DFAS did not fully understand the objectives of the Fund or how the USACE recorded transactions. For example, Note 2, Fund Balance with Treasury, did not disclose the differences between the amount on the certified "Year-end Closing Statement," Treasury Report 2108, and the accounting records. Note 3, Property Held for Sale, did not clearly state that that account was composed exclusively of the homes acquired by the Fund or the valuation basis used. Also, the homes were not valued at "net book value" as stated in that Footnote. Again, had there been an open dialogue between the USACE and the DFAS, the Overview and Footnotes would have more accurately described the Fund.

We considered these instances of material noncompliance noted herein in forming our opinion on the Fund's principal statements. With respect to items not tested, nothing came to our attention that caused us to believe that the USACE and the DFAS had not complied, in all material respects, with provisions identified above.

# Management Comments

The Deputy Chief Financial Officer responded for the Comptroller of the Department of Defense (DoD Comptroller); the Deputy Director for General Accounting responded for the DFAS, and the Chief of Staff, Corps of Engineers, responded for the USACE. Part VII of the report contains the complete text of the management comments.

**Comptroller of the Department of Defense.** The DoD Comptroller nonconcurred with the findings on Appropriations Expensed and the Footnotes to the Principal Statements. The DoD Comptroller made the following points.

o It is inaccurate to account for the cost of acquiring homes as Appropriations Expensed. The OMB Bulletin and the parallel U.S. Government Standard General Ledger account define Appropriations Expensed as "a financing source to be matched against current period expenses funded by appropriations." Therefore, disbursements (to acquire homes) should not be included in Appropriations Expensed, as suggested by the Inspector General, Department of Defense.

o Footnote 3 outlines procedures for acquiring and selling homes.

o Footnote 2 identifies the breakout between available and restricted funds and that there is no requirement to reconcile the Fund Balance with Treasury ending balance with the Treasury Report 2108.

**U.S. Army Corps of Engineers.** The USACE concurred with the findings. To correct conditions noted in those findings, the USACE plans to:

o change its automated accounting system to set up Accounts Receivable at yearend;

o develop new reports and documentation forms for standardized use in all the USACE districts to record inventory, acquisitions, foreclosures, and sales;

o institute a change to the current automated reporting system to accurately record accounts receivable;

o make necessary adjusting entries to correct general ledger accounts for revenue and fund balance;

o rewrite the chapter of Engineer Regulation 405-1-12 that pertains to the Homeowners Assistance Program to reemphasize the need to use the appropriate contract type when it is anticipated that services will exceed the small purchase threshold; and o work with the DFAS to ensure that appropriate Overview and Footnotes will be provided with the FY 1994 Principal Statements for the Fund.

All of the USACE proposed actions should be completed on or before October 1, 1994.

**Defense Finance and Accounting Service.** The DFAS concurred with the finding on inaccurate and incomplete footnote disclosure and plans to coordinate with the USACE to ensure the footnotes more accurately describe the Fund. The DFAS expects the corrected footnotes to be completed by June 30, 1994.

The DFAS nonconcurred with the finding concerning Appropriations Expensed. The DFAS stated it accounted for Appropriations Expensed according to the DoD guidance on form and content as required.

# Audit Evaluation of Management Comments

We revised our finding on Appropriations Expensed to correct our error of equating disbursements with expenses pointed out by the DoD Comptroller. Specifically, we changed our analysis to focus on the cost of the homes sold (a current period expense funded by appropriations). The DoD Comptroller's comments disregarded that appropriations were used to acquire those homes that were sold during FY 1993. In addition, Footnote 3 did not "outline" or explain the procedures used to calculate the gains and losses on the sales.

As suggested in the DoD Comptroller's comments and subsequent discussions with that office, we deleted that portion of Note 2 pertaining to the breakdown of funds. However, since OMB Bulletin No. 94-01, as well as the DoD guidance, requires disclosure of any difference between the amounts in the accounting records and Treasury Report 2108, the DFAS should verify the accuracy of those amounts by reconciling the differences.

We agree with the DFAS comments on Appropriations Expensed since DFAS cannot change at line item without approval from the DoD Comptroller.

We agree with the USACE comments except for the debt write-off. The debt should be written off, but as of June 8, 1994, the DFAS-Indianapolis Center had not made the adjusting entries stated in the USACE comments.

# Part IV - Additional Information

# Appendix A. Laws and Regulations Reviewed

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

Public Law 100-496, "Prompt Payment Act of 1988"

Public Law 89-754, Section 1013, "Demonstration Cities and Metropolitan Act of 1966," as amended, codified at 42 U.S.C. 3374

31 U.S.C. 3512, "Budget and Accounting Procedures Act of 1950"

31 U.S.C. 1341, "Anti-Deficiency Act"

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

OMB Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993.

OMB Bulletin No. A-123, "Internal Control Systems," August 4, 1986

DoD 7220.9-M, "DoD Accounting Manual," as amended, June 1991

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

Federal Acquisition Regulation, September 23, 1991

Army Regulation 37-1, "U.S. Army Accounting and Fund Control," April 30, 1991

# Appendix B. Organizations Visited or Contacted

## Office of the Secretary of Defense

Deputy Comptroller of the Department of Defense (Program/Budget), Washington, DC
Deputy Comptroller of the Department of Defense (Management Systems), Washington, DC

## Department of the Army

Assistant Secretary of the Army (Financial Management), Washington, DC
Headquarters, U.S. Army Corps of Engineers, Washington, DC
- New York District, New York, NY
- Baltimore District, Baltimore, MD
- Fort Worth District, Fort Worth, TX
- Huntsville District, Huntsville, AL
- Los Angeles District, Los Angeles, CA
- Savannah District, Savannah, GA
- Humphreys Engineering Center for Support Activities, Fort Belvoir, VA

## Defense Agencies

Headquarters, Defense Finance and Accounting Service, Washington, DC
- Defense Finance and Accounting Service Center, Indianapolis, IN

## Non-Defense Federal Organizations

Office of Management and Budget, Washington, DC
Department of the Treasury, Washington, DC
Department of Veterans Affairs, Washington, DC
Department of Housing and Urban Development, Washington, DC
Federal Accounting Standards Advisory Board, Washington, DC

# Appendix C. Report Distribution

## Office of the Secretary of Defense

Comptroller and Chief Financial Officer of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)
Director for Military Construction, Office of the Deputy Comptroller of the Department of Defense (Program/Budget)

## Department of the Army

Secretary of the Army
Auditor General, Department of the Army
Commander and Chief of Engineers, U.S. Army Corps of Engineers

## Department of the Navy

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

## Department of the Air Force

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

## Defense Agencies

Director, Defense Finance and Accounting Service

## Non-Defense Federal Organizations

Office of Management and Budget
National Security and International Affairs Division, Technical Information Center, U.S. General Accounting Office

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

## **Non-Defense Federal Organizations** (cont'd)

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 V - Principal Statements of the Defense Homeowners Assistance Fund for FY 1993

*Homeowners Assistance Program*

# Annual Financial Report FY 1993

March 31, 1994

## *Homeowners Assistance Program*

*Table of Contents*

# *Homeowners Assistance Program*

## *Overview*

## Overview to the Homeowners Assistance Program

The Homeowners Assistance Program (HAP) is a special relief program authorized by Congress (Public Law 89-754, Section 1013, Demonstration Cities and Metropolitan Development Act of 1966) to provide partial financial assistance to military personnel and civilian employees who suffer financial loss from disposing of their homes when local real estate prices have been depressed because of Department of Defense (DoD) actions The U S Army Corps of Engineers (USACE) executes the HAP as executive agent for DoD

Under HAP there are three types of benefits (1) payment of partial compensation for losses sustained in the private sale of the dwelling, (2) payment of the costs of the mortgage foreclosure, or (3) purchase of the dwelling by the government

In private sale cases, the amount paid by the Government is 95 percent of the value of the dwelling prior to the closure announcement less the fair market value at the time of the sale or the sales price, whichever is greater

In cases of purchase by the Government, the amount paid is 75 percent of the value of the dwelling prior to the closure announcement or the amount of the outstanding mortgage

In fixing the amount of benefits due in either private sale or Government purchase cases, the homes of the applicants are individually appraised to determine their valuation prior to the closure or reduction announcement as well as the valuation at the time of private sale or Government purchase

HAP benefits are available to eligible service members and civilian Federal employee homeowners at overseas bases who sell their on-base or off-base property as a result of the announced closure or reduction in the scope of operations However, since there is no authority to acquire off-base property overseas, Government purchase is not available to owners of off-base property HAP benefits are also available to civilian employees serving overseas and entitled to reemployment at a base ordered to be closed or in the case of a service member who was transferred from an installation within three years prior to public announcement of the closure action and was informed of a future programmed reassignment to the installation

In order for any benefits to be paid under the program, there must first be a determination that

**a.** There has been a public announcement of a base closure or reduction in the scope of operations of the base, and

**b.** The closure or reduction has caused a substantial drop in the real estate market in the area of the base, and

**c.** As a result of such closure or reduction, no present market exists for the sale of property upon reasonable terms and conditions

## Overview

In order to reach this determination, a survey and economic analysis of the area real estate market is made to ascertain the impact of base closure or reduction on the residential real estate market

Both a public announcement and order to close or realign the base is required An announcement or an order of a base closure or realignment study is not sufficient There need not be an actual closure to implement HAP, but there must have been a public announcement, an order to close or realign and the requisite adverse market impact

During FY 93 the Corps of Engineers completed 642 acquisitions, 347 private sales, 33 foreclosures and sold 450 homes Work-in-progress at the end of FY 93 include 89 acquisitions, 28 private sales and 1 foreclosure On-going CONUS programs in FY 93 were Castle AFB, CA, Carswell AFB, IL, Chanute AFB, IL, Chase Field NAS, TX, Eaker AFB, AR, England AFB, LA, Fort Hood, TX, Homestead AFB, FL, Loring AFB, ME, Minot AFB, ND, Myrtle Beach AFB, SC, New London NUSC, CT, Pease AFB, NH, Portsmouth NSY, NH, and Wurtsmith AFB, MI, and one OCONUS program at Bentwaters RAF, UK Management and disposal functions are occurring at the aforementioned CONUS installations as well as Columbus AFB, MS, and Dyess AFB, TX During FY 93, 450 were sold and the inventory on-hand 30 September 1993 is 422 homes

While it is not necessary for a BRAC announcement to implement HAP, with the advent of the Base Closure and Realignment Commission (BRAC) method of determining which installations to close or realign, HAP has had a resurgence For a number of years, HAP was a relatively small program because few bases were being closed At the start of FY 1992, there were three approved programs and by 30 September 1992, ten additional programs were approved and FY 1993 saw four more program approvals The BRAC 1993 announcement is expected to add seven programs to the 1994 and 1995 workload

Since the inception of the program, the managing, marketing, and resale of HAP properties has been accomplished by the Department Housing and Urban Development, Federal Housing Administration (HUD, FHA) under an agreement between HUD and OSD, authorized by the Metropolitan Development Act of 1966 As of 31 December 1992, this agreement was terminated by HUD and all properties acquired after this date under the Act are now managed and resold by the Corps of Engineers HUD sold 287 homes and the Corps of Engineers sold 163 homes in FY 1993

Furthermore, Congress, through Section 2822 of the National Defense Authorization Act for FY 1993 directed DoD evaluate the use of a national relocation contractor for the management and resale of homes acquired under HAP In essence, the legislation requires a comparison of three alternatives in the administration of the management and resale of HAP acquired homes by (1) a national contractor, (2) local contractors, and (3) the Corps of Engineers Delays in contracting for national contractor support will postpone the comparison

## Overview

The Corps of Engineers applies one of the three alternative disposal methods at each active program, and at new programs as approved The choice of method will depend upon that particular District's capabilities, based primarily on their manpower resources The Baltimore District is the only district directed to use a national contractor for the management and resale of acquired properties

There are four primary performance indicators developed during FY 1993 for the HAP, and will be implemented in FY 1994 These performance indicators measure performance based upon timeliness of providing benefits to HAP applicants, reselling homes at prices comparable to what HUD received in selling HAP acquired homes, and accuracy of quarterly budgeting HAP performance indicators are

a Private Sale Provide payment checks to private sale benefit applicants within 85 days of receiving their applications The time counted in this measurement does not include periods during which applicants are responsible for processing progress, e g , when they are trying to sell their homes, or deciding to accept or reject the government's appraised value of their home

b Government Acquisition Provide payment checks to private sale benefit applicants within 125 days of receiving their applications The time counted in this measurement does not include periods during which applicants are responsible for processing progress, e g , when they are trying to sell their homes, or deciding to accept or reject the government's appraised value of their home

c Resale of Homes Resell HAP acquired homes for at least 75% of the fair market value on the day of government purchase

d Quarterly Budgeting Project quarterly HAP costs and execute program so that expenditures do not fall below 90% of planned amount

# *Homeowners Assistance Program*

# *Principal Statements*

## Principal Statements

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Financial Position**
**as of September 30, 1993**
**(Dollars)**

| ASSETS | 1993 | 1992 |
|---|---|---|
| **1. Financial Resources:** | | |
| a Fund Balances with Treasury (Note 2) | $189,641,589 | $89,293,780 |
| b Cash | | |
| c Foreign Currency | | |
| d Other Monetary Assets | | |
| e Investments, Non-Federal | | |
| f Accounts Receivable, Net - Non-Federal | | |
| g Inventories Held for Sale, Net | | |
| h Loans Receivable, Net - Non-Federal | | |
| i Property Held for Sale (Note 3) | 26,379,813 | 16,266,800 |
| j Other Non-Federal | | |
| k Intragovernmental Items: | | |
| (1) Accounts Receivable Federal (Note 4) | 31,048 | |
| (2) Loans Receivable, Federal | | |
| (3) Investments, Federal | | |
| (4) Other Federal | | |
| **l. Total Financial Resources** | $216,052,450 | $105,560,580 |
| **2 Non-Financial Resources:** | | |
| a Resources Transferable to Treasury | | |
| b Advances and Prepayments, Non-Federal | | |
| c Inventories Not Held for Sale | | |
| d Property Plant and Equipment Net | $0 | $0 |
| e Other | | |
| **f. Total Non-Financial Resources** | $0 | $0 |
| **3 Total Assets** | $216,052,450 | $105,560,580 |
| **LIABILITIES** | | |
| **4. Funded Liabilities** | | |
| a Accounts Payable Non-Federal (Note 5) | $1,019,008 | $90,226 |
| b Accrued Interest Payable | | |
| c Accrued Payroll and Benefits | | |
| d Accrued Entitlement Benefits | | |
| e Lease Liabilities | | |
| f Liabilities for Loans Guarantees | | |
| g Deferred Revenue- Non-Federal | | |
| h Pensions and Other Actuarial Liabilities | | |

The accompanying notes are an integral part of these statements. 9

## Principal Statements

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Financial Position**
**as of September 30, 1993**
**(Dollars)**

| **LIABILITIES Continued** | **1993** | **1992** |
|---|---|---|
| i Other Funded Liabilities, Non-Federal | | $1,210,890 |
| j Intragovernmental Liabilities | | |
| (1) Accounts Payable Federal (Note 5) | $484,412 | 561,513 |
| (2) Debt | | |
| (3) Deferred Revenue | | |
| (4) Other Funded Liabilities, Federal | | |
| k. **Total Funded Liabilities** | $1,503,420 | $1,862,629 |
| 5. **Unfunded Liabilities:** | | |
| a Accrued Leave | | |
| b Lease Liabilities | | |
| c Debt | | |
| d Pensions and Other Actuarial Liabilities | | |
| e Other Unfunded Liabilities | | |
| f. **Total Unfunded Liabilities** | $0 | $0 |
| 6. **TOTAL LIABILITIES** | $1,503,420 | $1,862,629 |
| **NET POSITION** | | |
| 7 **Fund Balances:** | | |
| a Revolving Fund Balances (Note 6) | $214,549,030 | $103,697,951 |
| b Trust Fund Balances | | |
| c Appropriated Fund Balances | | |
| d **Total Fund Balances** | $214,549,030 | $103,697,951 |
| 8 **Less Future Funding Requirements** | 0 | 0 |
| 9. **Net Position** | $214,549,030 | $103,697,951 |
| 10. **Total Liabilities and Net Position** | $216,052,450 | $105,560,580 |

The accompanying notes are an integral part of these statements. 10

**Principal Statements**

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Operations (and Changes in Net Position)**
**for Period Ended September 30, 1993**
**(Dollars)**

| | 1993 | 1992 |
|---|---|---|
| **REVENUES AND FINANCING SOURCES** | | |
| 1 Appropriations Expensed | $14,394,236 | $2,013,982 |
| 2 Revenues from Sales of Goods | | |
| a To the Public | | |
| b Intragovernmental | | 11,909,949 |
| 3 Interest and Penalties, Non-Federal | | |
| 4 Interest, Federal | | |
| 5 Taxes | | |
| 6 Other Revenues and Financing Sources | | 10,000 |
| 7 Less Taxes and Receipts Returned to the Treasury | | |
| **8. Total Revenues and Financing Sources** | $14,394,236 | $13,933,931 |
| **EXPENSES** | | |
| 9 Program or Operation Expenses (Note 7) | $14,394,236 | |
| 10 Cost of Goods or Services Sold | | |
| a To the Public | | |
| b Intragovernmental | | $11 155,520 |
| 11 Depreciation and Amortization | | |
| 12 Bad Debts and Write-offs | | |
| 13 Interest | | |
| a Federal Financing Bank/Treasury Borrowing | | |
| b Federal Securities | | |
| c Other | (1,213 833) | 1 248,118 |
| 14 Other Expenses (Note 8) | 2,442,510 | 1,530,293 |
| **15 Total Expenses** | $15,622,913 | $13,933,931 |
| 16 Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Adjustments | ($1,228,677) | $0 |
| 17 Plus (Minus) Adjustments: | | |
| a Extraordinary Items | | |
| b Prior Period Adjustments | | |
| 18 Excess (Shortage) of Revenues and Financing Sources over Total Expenses | ($1,228,677) | $0 |
| 19 Plus: Unfunded Expenses | | |
| **20 Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses** | ($1,228,677) | $0 |

The accompanying notes are an integral part of these statements. 11

## Principal Statements

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Operations (and Changes in Net Position)**
**for Period Ended September 30, 1993**
**(Dollars)**

| **EXPENSES Continued** | **1993** | **1992** |
|---|---|---|
| 21. **Net Position, Beginning Balance** | $103,697,951 | $22,587,152 |
| 22 Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | (1,228,677) | 0 |
| 23 Plus (Minus) Equity Transfers | 112,079,756 | 81,110,799 |
| 24 **Net Position, Ending Balance** | $214,549,030 | $103,697,951 |

The accompanying notes are an integral part of these statements.

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## Principal Statements

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Cash Flows (Indirect)**
**for the Period Ended September 30, 1993**
**(Dollars)**

| | | 1993 | 1992 |
|---|---|---|---|
| **Cash Flows from Operating Activities:** | | | |
| 1 | Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | ($1,228,677) | $0 |
| **Adjustments affecting Cash Flow:** | | | |
| 2 | Appropriations Expensed | ($14,394,236) | ($2,013,982) |
| 3 | Decrease (Increase) in Accounts Receivable | (31,048) | 1,458 |
| 4 | Decrease (Increase) in Loans Receivable | | |
| 5 | Decrease (Increase) in Other Assets | | |
| 6 | Increase (Decrease) in Accounts Payable | 851,681 | 332,587 |
| 7 | Increase (Decrease) in Debt | | (1,370,018) |
| 8 | Increase (Decrease) in Other Liabilities | (1,210,890) | |
| 9 | Depreciation and Amortization | | |
| 10 | Other Unfunded Expenses | | |
| 11 | Other Adjustments | (6,526,007) | (875,219) |
| 12 | **Total Adjustments** | ($21,310,500) | ($3,925,174) |
| 13 | **Net Cash Provided (Used) by Operating Activities** | ($22,539,177) | ($3,925,174) |
| **Cash Flows from Non-Operating Activities:** | | | |
| 14 | Proceeds from Sales of Investments | | |
| 15 | Proceeds from Sales of Property, Plant and Equipment | $27,727,277 | |
| 16 | Purchases of Investments | | |
| 17 | Purchases of Property Plant and Equipment | (37,840,290) | ($7,431,134) |
| 18 | **Net Cash Provided (Used) by Non-Operating Activities** | ($10,113,013) | ($7,431,134) |
| **CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES** | | | |
| 19 | Appropriations (Current Warrants) | $133,000 000 | $84,000,000 |
| 20 | Add: | | |
| | a Restorations | | |
| | b Transfers of Cash from Others | | |
| 21 | Deduct: | | |
| | a Withdrawals | | |
| | b Transfers of Cash to Others | | |
| 22 | Net Appropriations | $133,000,000 | $84,000,000 |

The accompanying notes are an integral part of these statements.

## Principal Statements

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Cash Flows (Indirect)**
**for the Period Ended September 30, 1993**
**(Dollars)**

| | 1993 | 1992 |
|---|---|---|
| 23 Borrowing from the Public | | |
| 24 Repayments on Loans to the Public | | |
| 25 Borrowing from the Treasury and the Federal Financing Bank | | |
| 26 Repayments on Loans from the Treasury and the Federal Financing Bank | | |
| 27 Other Borrowings and Repayments | | |
| 28 Net Cash Provided (Used) by Financing Activities | $133,000,000 | $84,000,000 |
| 29 Net Cash Provided (Used) by Operating, Non-Operating and Financing Activities | $100,347,810 | $72,643,692 |
| **30. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning** | 89,293,780 | 16,650,088 |
| **31. Fund Balance with Treasury, Cash, and Foreign Currency, Ending** | $189,641,590 | $89,293,780 |

**Supplemental Disclosure of Cash Flow Information:**

32 Total Interest Paid

**Supplemental Schedule of Financing and Investing Activity:**

33 Property and Equipment Acquired Under Capital Lease Obligations

34 Property Acquired Under Long-term Financing Arrangements

35 Other Exchanges of Noncash Assets or Liabilities

The accompanying notes are an integral part of these statements. 14

## Principal Statements

**Department/Agency: Homeowners Assistance Program**
**Reporting Entity: Principal Statements**
**Statement of Budget and Actual Expenses**
**for the Period Ended September 30, 1993**
**(Dollars)**

| Program Name(s) | BUDGET Resources | OBLIGATIONS Direct | OBLIGATIONS Reimbursed | ACTUAL Expenses |
|---|---|---|---|---|
| Homeowners Assistance Program | $241,659,529 | $64,283,590 | | $15,622,913 |
| Totals | $241,659,529 | $64,283,590 | $0 | $15,622,913 |

**Budget Reconciliation**

| | |
|---|---|
| A Total Expenses | $15,622,913 |
| B Add: | |
| (1) Capital Acquisitions | 37,840,290 |
| (2) Loans Disbursed | 1 210,890 |
| (3) Other Expended Budget Authority | 5,315,117 |
| C Less: | |
| (1) Depreciation and Amortization | |
| (2) Unfunded Annual Leave Expense | |
| (3) Other Unfunded Expenses | |
| D Expended Appropriations | $59,989,210 |
| E Less Reimbursements | 27,727,277 |
| F Expended Appropriations, Direct | $32,261,933 |

The accompanying notes are an integral part of these statements.

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# *Homeowners Assistance Program*

# *Footnotes to the Principal Statements*

## Footnotes to the Principal Statements of the Homeowners Assistance Program

**Note 1** ***Significant Accounting Policies***

**A. Reporting Entity**

The U S Army Corps of Engineers (USACE) manages and executes engineering and construction programs for the Army and serves as the Army's real property manager In this capacity, USACE executes the Homeowners Assistance Program as executive agent for the Army

These financial statements are based upon a consolidation of data processed by the Corps of Engineers Management Information System, a cost accounting system USACE extracts information from the system into a data file and sends it to DFAS-IN to meet requirements for both status and general ledger reporting

The accompanying audited financial statements account for the Homeowners Assistance Program funds for which the Army is responsible

**B. Accounting Standards**

These financial statements are presented in accordance with reporting requirements in the Office of Management and Budget Bulletin 93-02 and guidance from the Office of the DoD comptroller To the extent that accounting issues are not fully covered by the preceding, the Army follows guidance promulgated by GAO, the Department of the Treasury, or the Federal Accounting Standards Advisory Board (FASAB)

**C. Budgets and Budgetary Accounting**

This Army account is financed primarily through annual and revolving appropriations provided by Congress The following Treasury accounts are used to fund, execute, and report on total financial activity for the Army

1) General funds are used to record financial transactions arising under congressional appropriations These accounts are used to acquire or construct technology, property, infrastructures, research and development, and investments, and to maintain operation

2) Revolving funds operate under the direction of 10 U S C 2208 They are designed to provide an effective means of financing, budgeting, accounting for, and controlling inventory and the costs of providing goods and services Revolving funds support the operating and investment accounts by providing a coordinated focus, efficiencies of operations, and economies of scale

## Footnotes

**D. Basis of Accounting**

Transactions are recorded on an accrual accounting basis and a budgetary basis Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds

**E. Revenues and Other Financing Sources**

Congress provides financing sources for the Homeowners Assistance Program through annual appropriations These appropriations are, when authorized, supplemented by revenues generated by sales of goods through a reimbursable order process However, no reimbursable order is actually processed for the Homeowners Assistance Program

**Note 2** ***Fund Balances with Treasury***

The Homeowners Assistance Program's funding resources are maintained in Treasury receipt and expenditure accounts The account balance with Treasury represents the aggregate of all unexpended Army appropriations

| | Revolving Funds | Appropriated Funds |
|---|---|---|
| Unobligated Balance Available | | |
| Available | | $145,015,270 |
| Restricted | $26,516,387 | 5,844,282 |
| Reserve For Anticipated Resources | | |
| Obligated (but not expensed) Balance | 11,380,519 | 885,131 |
| Unfunded Contract Authority | | |
| Unused Borrowing Authority | | |
| Treasury Balance | $37,896,906 | $151,744,683 |

**Note 3** ***Property, Held for Sale***

Property Held for Sale includes property acquired by the Defense Homeowners Assistance Fund As of September 30, 1993, the Homeowners Assistance Fund had homes on hand valued at a net book value of $26 4 million Sale of such Property will be recorded by a reduction to the general ledger account and a gain or loss on disposition of fixed assets

## Footnotes

**Note 4** ***Accounts Receivable***

As presented in the statement of financial position, accounts receivable includes federal receivables in the amount of $31,048

**Note 5** ***Accounts Payable***

Accounts payable for goods and services are recognized based upon receipt of a receiving report providing notification of delivery of goods or services In accordance with DoD policy, fiscal stations may record an obligation, accrual, and expense simultaneously when preparing obligation documents for travel, transportation, or for documents with small amounts (i e , $1,000 or less) under the assumption that receipt will take place within 30 days of obligation

**Note 6** ***Equity***

Equity consists of invested capital, cumulative results of operations, and unexpended appropriations less unfunded liabilities Homeowners Assistance Program equity is classified as a revolving fund for which cumulative results of operations are reported in the amount of $214 5 million Cumulative results of operations for working capital funds represent the excess of revenues over expenses since the funds inception, less refunds to customers and returns to the U S Treasury

| **Note 7** ***Program or Operating Expenses*** | **1993** | **1992** |
|---|---|---|
| Operating Expenses by Object Classification | | |
| (1) Personal Services and Benefits | | |
| (2) Travel and Transportation | | |
| (3) Rental, Communication, and Utilities | | |
| (4) Printing and Reproduction | | |
| (5) Contractual Services | $14,061,627 | |
| (6) Supplies and Materials | 7,726 | |
| (7) Equipment not Capitalized | | |
| (8) Grants, Subsidies, and Contributions | (34,870) | |
| (9) Insurance Claims and Indemnities | 359,753 | |
| (10) Other | | |
| (11) Total Expenses by Object Class | $14,394,236 | $-0- |

## Footnotes

| **Note 8** ***Other Expenses*** | **1993** | **1992** |
|---|---|---|
| Other Expenses | | |
| (1) Losses on disposition of Assets | $2,442,510 | $1,530,293 |

**Note 9** ***Other Disclosures***

Property acquired by the fund reported in fiscal year 1992 were reclassified from Property Plant and Equipment to Property Held for Sale in accordance guidance issued by the DoD Comptroller

# *Homeowners Assistance Program*

## *Supplemental Financial And Management Information*

# Supplemental Financial and Management Information of the Homeowners Assistance Program

## Financial Statement Attributes

Financial statement attributes represent core DoD financial performance measures used to analyze financial results and trends affecting the overall health of the Homeowners Assistance Program Four attributes analyze specific variables in Homeowners Assistance Program's principal statements indicating trends, current conditions and future impacts to the program The measures are identified below and represent key indicators of program costs, results, health and future obligations

**Operating Cost** -- The operating cost attribute displays the costs to operate a program and is useful for planning, budgeting, and cost control purposes This attribute can also be used to evaluate overall program operating economy and efficiency, comparing program costs with benefits, and assessing alternatives to reduce costs

**Operating Results** -- The operating results attribute combines a program's revenues and appropriated funds used less expenses to identify if sufficient revenues were available to cover costs The information relating to an activity's operating results is important for assessing the financial risks of the program, its needs for financial assistance, and the potential cost to taxpayers

**Financial Obligation** -- The financial obligation attribute is an indicator of an agencies ability to pay its obligations and liabilities A program incurs liabilities in two ways when it borrows money from the Treasury, other agencies, or from the public, and when it incurs costs or losses under a financial commitment that will be paid in the future The information relating to a program's financial obligations is important because financial obligations represent a future demand for resources and costs to taxpayers

**Financial Condition** -- The financial condition attribute defines the financial health of a program and its inherent ability to generate financial resources to maintain its operations and meet financial obligations without further financial assistance The attribute also gives an understanding in future funding requirements for a program

The financial statement attributes for the Homeowners Assistance Program are presented on the following pages

## Supplemental

### OPERATING COSTS ATTRIBUTE

| | FY 1993 | FY 1992 |
|---|---|---|
| Current Dollars | | |
| Total Costs and Expenses | $15,622,913 | $13,933,931 |
| Revenues and Reimbursements | | (11,919,949) |
| Net Operating Costs | $15,622,913 | $2,013,982 |
| Annual Percentage Change | -675 7% | |
| 1992 Constant Dollars | | |
| Net Operating Costs | $15,265,148 | $2,013,982 |
| Annual Percentage Change | -658.0% | |

### OPERATING RESULTS ATTRIBUTE

| | FY 1993 | FY 1992 |
|---|---|---|
| Revenues | | |
| Federal Sources | | $11,909,949 |
| Public Sources | | |
| Other | | 10,000 |
| Total Revenue | $0 | $11,919,949 |
| Expenses and Losses | 15,622,913 | 13,933,931 |
| Net Operating Income (Deficit) | ($15,622,913) | ($2,013,982) |
| Additional Appropriations | 14,394,236 | 2,013,982 |
| Operating Surplus (Deficit) | ($1,228,677) | $0 |

## Supplemental

### FINANCIAL OBLIGATIONS ATTRIBUTE

| | FY 1993 | FY 1992 |
|---|---|---|
| 1 Total Current Assets | $189,672,637 | $89,293,780 |
| 3 Total Current Liabilities | $1,503,420 | $1,862,629 |
| Current Ratio | 126 | 48 |
| 2 Total Quick Assets | $189,672,637 | $89,293,780 |
| 3 Total Current Liabilities | $1,503,420 | $1,862,629 |
| Acid Test Ratio | 126 | 48 |

1 Total Current Assets consist of fund balance with Treasury, cash, accounts receivable and inventories

2 Total Quick Assets consist of fund balance with Treasury cash, and accounts receivable

3 Current Liabilities include accounts, notes, and other obligations payable within a year

### FINANCIAL CONDITION ATTRIBUTE

| | FY 1993 | FY 1992 |
|---|---|---|
| Available Sources of Cash | $189,641,589 | $89,293,780 |
| Future Requirements for Cash | $1,503,420 | $1,862,629 |
| Cash Surplus (Shortfall) | 126 | 48 |
| Total Assets | $216,052,450 | $105,560,580 |
| Total Liabilities | $1,503,420 | $1,862,629 |
| Debt to Asset Ratio | 0 01 | 0 02 |

# Part VI - Other Issuances Related to This Audit

# Advisory Memorandum - April 8, 1994

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

MEMORANDUM FOR COMMANDER, U.S. ARMY CORPS OF ENGINEERS

SUBJECT: Audit of the Defense Homeowners Assistance Fund FY 1993 Financial Statements (Project No. 3FH-2012)

This memorandum discusses issues raised during the ongoing subject audit that concern financial reporting practices and internal controls and compliance issues at the U.S. Army Corps of Engineers (USACE). This memorandum is not subject to the provisions of DoD Directive 7650.3, but is being provided to give management an opportunity to correct the conditions noted and to mitigate the potential effect on the FY 1993 financial statements.

Our reviews at the U.S. Army Corps of Engineers Headquarters (HQUSACE), Baltimore District, Fort Worth District, Savannah District, Humphreys Engineer Center Support Activity (HECSA), and Defense Finance and Accounting Service-Indianapolis Center (DFAS) disclosed that issues reported during our previous audit of the Defense Homeowners Assistance Fund (the Fund) FY 1992 Financial Statements (Project No. 2FH-2002) continued to exist throughout FY 1993. Specifically, we reported on the requirement to use the accrual basis of accounting and to maintain comprehensive inventory records in a memorandum dated December 3, 1992. The improper use of multiple small purchase awards to procure title and appraisal services was discussed in a separate memorandum dated March 26, 1993. In both instances, the USACE management advised us that corrective action had been taken.

The conditions discussed in this memorandum were noted at HQUSACE or at one or more of the districts and are presented here because we believe other districts may also use similar practices and procedures.

**Financial Reporting Practices.** The USACE should change its method for recording and reporting financial information to ensure that the financial statements fairly present the condition of the Fund.

**Cash Basis Method.** The USACE recorded revenue transactions on the cash basis; i.e., upon receipt of sales proceeds. That practice is contrary to OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, and DoD 7220.9-M, "DoD Accounting Manual," as amended June 1991, which require accrual accounting. Using the cash basis caused accounts receivable to be understated by at least $2.5 million and revenue to include FY 1992 transactions.

We addressed the cash basis accounting methodology in our December 3, 1992, memorandum to the USACE and in Audit Report No. 93-140 "Defense Homeowners Assistance Fund Financial Statements for FY 1992," June 30, 1993. While the USACE agreed to use the accrual basis to report sales revenue, the accounting method did not change during FY 1993. Our review showed that:

o Accounts receivable were not recorded for the homes the Department of Housing and Urban Development (HUD) sold during August and September 1993 and at least two homes that the districts sold during September 1993. The HUD collected $2.3 million and the Baltimore and Savannah Districts collected $.14 million for homes sold during that period. However, those amounts were not reported on the FY 1993 Statement of Financial Position. Accounts receivable may be greater than the $2.5 million we identified since the other districts also used the cash basis.

o Revenue reported on the general ledger included $2.3 million from FY 1992 HUD sales and $1.2 million from the write-off of a non-existent debt. Excluded from that account was the $2.5 million from homes sold during August and September. Although the FY 1992 sales offset the exclusion of the FY 1993 sales, procedures are needed to ensure that revenue is reported in the proper accounting period. (The write-off is discussed in the "Increase in Revenue" section.)

We recognize that the HECSA was partially responsible for causing the repeat condition (by incorrectly recording the yearend entry to establish a receivable for HUD sales); however, since the HQUSACE did not issue specific guidance, the accrual basis was not used to report revenue. HQUSACE should issue specific instructions to ensure that revenue is recorded on the accrual basis. Such instructions should detail the transaction codes for recording accounts receivable and revenue when proceeds are collected in an accounting period other than when the homes are sold. Reporting revenue in the proper period will increase the reliability and usefulness of the financial information reported for the Fund.

**General Ledger Account Balances.** The general ledger used to prepare the financial statements contained inaccurate information. As a result, line-item account balances on the FY 1993 financial statements may be materially misstated.

**Losses on Sales of Homes.** The following improper transactions were included in the loss account and caused DFAS to understate losses on the FY 1993 Statement of Operations.

o The $2.4 million that DFAS reported on the statement included $1.5 million of losses HECSA carried forward from FY 1992. FY 1992 losses were inadvertently included because HECSA did not close this nominal account as required by AR 37-1, Chapter 4.

o The USACE did not record any losses on homes HUD sold during FY 1993.

Although the USACE did not record any losses, we determined the losses on FY 1993 HUD sales to be approximately $3.6 million ($20.1 million of acquisition costs less $16.5 million of sales revenue).

**Abnormal Account Balances.** Negative expense account balances were reported to the DFAS and included in the FY 1993 financial statements. USACE caused the negative interest expense balance when it attempted to reclassify FY 1992 interest expense as program expense. Because USACE did not make the adjustment until FY 1993, the adjustment caused a negative $1.2 million to be reported on the statements. We determined that no interest expenses should be reported in FY 1993 since none were incurred.

Negative operating expenses were reported for the New York District ($3.2 million) and the Fort Worth District ($.8 million). Since each of these districts had active programs throughout FY 1993, their operating expenses should exceed $2.9 million. We estimate that the Fund's total operating expenses for FY 1993 were about $19.1 million.

**Yearend Adjustments to Inventory Account.** The HECSA pre-closing general ledger trial balance for FY 1993 showed a negative $6.6 million for inventory (1730-Buildings Account). That negative balance existed because the districts submitted inconsistent cost data on the homes transferred to HUD, HECSA made recording errors, and neither HECSA nor HQUSACE periodically reconciled the accounting records to the property records. As a consequence, HECSA had to make a $10 million adjustment to bring the general ledger into agreement with USACE's property records. The adjustment was made without supporting documentation.

**Increase in Revenue.** USACE increased FY 1993 revenue by $1.2 million, the amount of the non-existent debt we reported in our previous audit. At that time, we identified that the $1.2 million represented an accounting error resulting from mortgage assumptions. Since all mortgages were liquidated or transferred, the Fund had no outstanding loans at the end of FY 1992. To write off this prior period adjustment, an equity account, not revenue, should be used as an offset.

Closer oversight by the HQUSACE Director of Resource Management and more direct communication with the DFAS-Indianapolis Center are essential for ensuring that appropriate financial reporting practices are implemented and that the financial statements are free of material misstatements and present fairly the condition of the Fund. At a minimum, HQUSACE should advise the DFAS of any adjustments described in this memorandum so that the account balances can be revised and correcting entries made to the general ledger.

**Internal Controls and Compliance Issues.** The USACE should strengthen its controls over inventory and use appropriate contracting procedures to acquire services.

**Maintaining Inventory Records.** The USACE did not maintain comprehensive inventory records or consistently record acquisition costs for homes acquired by the Fund. As a result, neither the HQUSACE nor the districts could give us the total number and cost of the homes on-hand at the time of our site visits.

**Headquarters, USACE.** Two organizational elements at the HQUSACE were responsible for maintaining the inventory. The Directorate of Real Estate maintained the HUD inventory and the Directorate of Resource Management maintained the inventory of homes in the districts' possession. However, since the Directorate of Resource Management did not maintain a data base throughout the year to show FY 1993 activity, the totals did not match the certified amounts submitted by the districts.

**Districts.** Two organizational elements at each district share responsibility for the inventory. The Real Estate Division handles the acquisition, management, and disposal of homes and keeps data on the applicant, address, acquisition and sales dates, and the number of homes acquired and sold. The Resource Management Office processes and records all transactions related to buying and selling the homes and maintains actual costs and revenue totals. However, since specific guidance was not issued for maintaining inventory records, no comprehensive records were maintained.

At the Baltimore and Savannah Districts, we used records from the Acquisition Section and the Management and Disposal Section of the Real Estate Division, as well as the Resource Management Office, to develop a comprehensive data base of FY 1993 activity and to verify the accuracy of the balance reported in the 1730-Buildings Account. We found inconsistencies in the methods used to record acquisition costs. For example, the Baltimore District reduced the acquisition costs by the amount of closing costs the applicants owed (interest, property taxes, and mortgage life insurance); and the Savannah District included a portion of reimbursable benefit payments made to applicants. As a result, the cost of the homes these two districts showed on the 1730-Buildings Account was incorrectly reported.

The Baltimore District took action to correct the number and cost of homes in inventory on September 30, 1993; however, the conditions at that district are discussed here to apprise HQUSACE of the inconsistent practices used at the districts and to emphasize the need to designate someone to record all purchases and sales and to reconcile those inventory records to the official accounting records. The HQUSACE should also clearly define what should be included in acquisition costs and distinguish those costs from program operating costs.

Maintaining comprehensive inventory records is more important now because HUD discontinued managing and disposing of homes on December 31, 1993; the districts now have those responsibilities.

**Procurement Practices.** During FY 1993 the Baltimore and Fort Worth Districts used blanket purchase agreements (BPAs) to obtain title services, even though the total requirement for title services exceeded the $25,000 limitation for small purchases. Also, prices quoted by one of the four selected title companies were not in the competitive range of the other companies. Using BPAs and higher priced companies could result in the Fund paying excessive prices for services.

**Blanket Purchase Agreements.** The Baltimore District awarded BPAs to several title companies at Loring Air Force Base, Portsmouth Naval Shipyard, and the Naval Underseas Warfare Center. Each of the awards we reviewed was for less than $25,000 and was made using the small purchase procedures. However, funding levels for title services at those three installations were $78,000, $116,000, and $46,000, respectively. The practice of making multiple awards when the total requirement is expected to exceed the small purchase threshold violates the Federal Acquisition Regulation (FAR). The FAR, Part 13, Section 103(b) states:

> . . . Requirements aggregating more than the small purchase dollar limitation shall not be broken down into several purchases that are less than the limit merely to permit negotiation under small purchase procedures.

While we understand that estimating the total cost requirements for services may be difficult, we believe that experience at other installations supports the requirement to award competitive contracts for title and appraisal services. We would also like to emphasize that requiring competitive contracts should not preclude making small purchase awards during the initial phases of a program. However, since the competitive process takes several months, the process should begin as soon as an installation is approved for the Homeowners Assistance Program (HAP).

We described the multiple small purchase award practices used at the Fort Worth District in our March 26, 1993, memorandum. At that time, the HQUSACE stated that "In the initial stages of implementation of a program, we plan to use a purchase order to get started . . . . Subsequently, the use of competitive contracts will be utilized." The Fort Worth District had initiated the competitive process for obtaining title and appraisal services but did not award a competitive contract in FY 1993. The Baltimore District was unaware of that requirement prior to our site visit, but advised us during our exit briefing that it would award competitive contracts for title services in FY 1994.

HQUSACE needs to take more aggressive action to ensure that each district initiates timely competitive contracting procedures to acquire title and appraisal services. The competitive process should begin as soon as an installation is approved for HAP. That timely process will allow the Fund to receive the most advantageous price for services.

**Price Differences.** One of the four title companies the Baltimore District selected to provide services at Loring Air Force Base quoted prices that were not in the competitive range. For example, the price difference between the lowest and highest quote for ordering titles was over $500. Procuring services from companies that charge much higher prices could cause the Fund to incur excessive costs without receiving any additional benefits.

**Collection Procedures.** At least two of the districts we visited allowed unauthorized employees to collect over $3 million in reimbursement checks.

Reimbursement checks were received for revenue earned from selling and renting HAP-acquired homes and for refunds from the overpayment of mortgage interest. Real Estate Division employees at each district received the reimbursement checks related to HAP transactions, prepared the collection voucher, and sent the check to the Disbursing Section, Resource Management Office. Checks sent to the districts are generally required to be submitted directly to the Disbursing Section where an appointed "agent officer" records the checks in a remittance register and processes the checks for deposit.

The Real Estate employees collecting the reimbursement checks at the Baltimore and Fort Worth Districts were not designated "agent officers" or finance officers as required by AR 37-103. As a result, those employees may not have exercised proper controls to safeguard the checks or to make timely deposits. Since revenue is expected to exceed $11 million, each district should follow prescribed collection procedures when receiving checks.

**Conditions at the Baltimore District.** The Baltimore District should strengthen its controls over disbursements. These internal control issues are presented here because other districts may have similar practices.

**Disbursing Procedures.** The teller in the Disbursement Section prepared and distributed checks without supervisory review or approval. We realize that the position of Chief of the Disbursing Section was vacant, but failure to obtain supervisory review and approval could result in inaccurate disbursements and additional costs to the Fund. For example, checks issued to the wrong mortgage company would inadvertently delay the closing date and would result in additional interest being charged to the Fund. As of June 30, 1993, disbursements totaling over $7 million had been issued without being reviewed and approved by a supervisor.

**Issuing Checks.** Checks to liquidate mortgages were written to the title company when the Baltimore District acquired homes for the Fund. Such a practice could result in excessive interest costs being charged to the Fund.

Once a sales contract had been signed and a closing date set, the Baltimore District's attorney requested a check to cover closing costs. The check, issued in the name of the title company and not the mortgage company, included the mortgage pay-off amount plus an additional 7 days of interest. We were advised that the additional 7 days was needed to allow the title company sufficient time to deposit that check into its own account and then issue its own check to pay off the mortgage on behalf of the Fund. By doing this, the district lost control over the funds when checks were issued to the title company.

**Mortgage Interest Refunds.** Excess interest paid (by the title company) to the mortgage company was not always returned to the district because there were no established procedures for collecting these refunds. The mortgage companies sometimes mailed the interest refund check to the homeowner, sometimes to the title company, and, on occasion, to the Baltimore District. Most times, the mortgage companies returned the excess interest to the homeowner because, legally, any overpayment must be returned to the original borrower as a refund of an escrow account.

In order to correct the deficiency, the Baltimore District must establish procedures for collecting the excess interest paid to mortgage companies. In addition, to ensure that the monies owed to the district are returned to the district, procedures should also be established for reconciling the collections to supporting documents.

**Suggested Actions.** Specific actions to correct issues discussed in this memorandum follow.

1. We suggest that the Director of Resource Management, U.S. Army Corps of Engineers:

a. Use the accrual basis of accounting to record revenue from the sale of homes.

b. Issue instructions detailing the transaction codes to use when recording homes acquired or sold.

c. Reconcile the property records (for homes acquired and sold by the Homeowners Assistance Fund) to the accounting records.

d. Research all abnormal account balances the districts report on their trial balances.

e. Review the financial statements and provide the Defense Finance and Accounting Service-Indianapolis Center with adjusting entries and appropriate supporting documentation to accurately report costs incurred during FY 1993. At a minimum, adjustments should be made for Accounts Receivable, Revenue, and Losses.

f. Establish procedures for collecting, verifying, and reconciling mortgage interest refunds.

2. We suggest that the Director of Real Estate, U.S. Army Corps of Engineers:

a. Designate someone to maintain a comprehensive inventory listing of homes acquired and sold by the Homeowners Assistance Fund. The listing should include the applicant's name, acquisition and sale dates, acquisition costs, and sales revenue.

b. Identify costs to be used in calculating the total acquisition costs.

c. Evaluate the practice of issuing mortgage pay-off checks in the name of the title companies and adding additional days of interest to the pay-off amount.

3. We suggest that the Chief of Contracting at each district award competitive contracts for title and appraisal services at each installation approved for the Homeowners Assistance Program.

4. We suggest that the Chief, Resource Management Office, at each district:

a. Allow only designated "agent officers" to collect reimbursement checks for the Homeowners Assistance Fund.

b. Obtain supervisory approval prior to disbursing checks.

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We would appreciate receiving your comments on the issues discussed and a description of planned actions within 30 days of the date of this memorandum. The issues, if not adequately addressed, will affect the auditor's opinion on the financial statements. If you have any questions or wish to discuss this memorandum, please contact Mr. Raymond D. Kidd, Program Director, at (703) 614-1682 or Mrs. Saundra G. Elion, Project Manager, at (703) 693-0469.

Terry L. McKinney
Acting Director
Financial Management Directorate

# Part VII - Management Comments

# Comptroller of the Department of Defense Comments

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

JUN 7 1994

MEMORANDUM FOR ACTING DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DOD

SUBJECT: Draft Audit Report on Internal Controls and Compliance with Laws and Regulations for the Defense Homeowners Assistance Fund Financial Statements for FY 1993 (Project No. 3FH-2012)

This responds to your memorandum of April 29, 1994, which requested comments on Parts II and III of the subject draft audit report. The following comments are provided:

- Part II - Internal Controls

●● On page 8, under the section titled "Classifying Homes," the audit states that "homes should be classified as inventory." This office does not agree that those homes should be recorded in an inventory account since the Department is not in the business of acquiring homes for sale. In addition, the Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," states that "inventory" is tangible personal property...." Homes are real property, not personal property.

- Part III - Compliance with Laws and Regulations

●● On page 14, under the section titled "Appropriations Expensed," the DoDIG suggests that the cost of acquiring homes be accounted for as an expense in the period in which the homes were acquired. The DoDIG supports its suggestion by reference to a statement in OMB Bulletin No. 94-01 that defines "appropriated capital used" as the amount of appropriations used to finance expenses. The DoDIG states that the OMB definition means all disbursements made to accomplish the program objective are an appropriation expense. A complete reading of the definition in the cited OMB Bulletin reveals that it is inaccurate to equate disbursements with expenses. (For example, the definition mentions depreciation of fixed assets and consumption of inventory acquired in a prior year.) Furthermore, the parallel U.S. Government Standard General Ledger account ("Appropriated Capital Used") is defined as a financing source to be matched against current period expenses funded by appropriations. In view of the above facts and statements included in the audit report, the DoDIG suggestion is puzzling. The DoDIG, in this audit report, recognizes that acquired homes are assets. The DoDIG further states in its audit report that revenue from the sale of these homes should be recognized in the period sold. Yet, the DoDIG suggests that amounts paid from appropriated sources be expensed when the disbursements are made, even though the underlying assets (homes) may be held for some time before final disposition. Footnote 3 to the principal statements outlines the procedure for recording acquisitions and gains and losses from the sale of homes under this program.

•• On page 15, under the section "Financial Statement Overview and Footnotes," the audit report states that "Note 2 'Fund Balance with Treasury,' did not show a breakdown of available and restricted funds or reconcile the amount on the certified 'Year-end Closing Statement,' Treasury Report 2108, to the accounting records." Note 2 to the principal statements clearly identifies the breakout between available and restricted funds. There is no requirement to reconcile the "Fund Balance With Treasury" ending balance with the Treasury Report 2108. This comment should be deleted from the final audit report.

The opportunity to comment on this draft audit is appreciated. Mr. John Glover is my point of contact on this matter. He may be reached on (703) 697-0537.

Alvin Tucker
Deputy Chief Financial Officer

# Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

MAY 19 1994

DFAS-HQ/GC

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE
INSPECTOR GENERAL, DOD

SUBJECT: Management Comments on the DoDIG Draft Report on Internal Controls and Compliance with Laws and Regulations for the Defense Homeowners Assistance Fund Financial Statements for FY 1993 (Project No. 3FH-2012)

The attached management comments to the subject report are provided for inclusion in the final audit report. We concur with most findings with the exception of our nonconcurrence with the appropriations expensed finding. Defense Finance and Accounting Service and United States Army Corps of Engineers have made significant progress, working together, toward improving the Homeowners Assistance Fund financial reports.

My point of contact for this matter is Mr. Tom Tresslar, (703) 607-1120.

Arnold R. Weiss
Deputy Director for General Accounting

Attachment

SUBJECT: DoDIG Report on Internal Controls and Compliance with Laws and Regulations for the Defense Homeowners Assistance Fund Financial Statements for FY 1993 (Project No. 3FH-2012)

The following comments are provided in response to conditions noted during the DoDIG review on internal controls and compliance with laws and regulations.

Part II, Internal Controls

Finding: Communication Between Entities. The USACE and the DFAS did not communicate effectively. As a result, the Principal Statements did not fairly present the condition of the Fund. As the fund manager, the USACE was responsible for ensuring that the financial statements contained reliable financial information so that management could make appropriate decisions regarding the Fund. Consequently, the USACE should increase information sharing with the DFAS so that the DFAS can use correct information to prepare useful financial statements.

DFAS Response: Concur. DFAS-IN agrees that closer oversight by USACE and more direct communication between the entities are essential for ensuring that appropriate financial reporting practices are implemented, and that the financial statements are free of material misstatements and present fairly the condition of the Fund. To aid in this effort, a formal initiative, akin to a memorandum of agreement/understanding, and/or partnering agreement, has been drafted that commits both USACE and DFAS to improve communications and joint responsibility for ensuring that the financial position of the Homeowners Assistance Fund is accurately presented.

Estimated Completion Date: July 1, 1994

Finding: Accumulating and Reporting Costs. The internal control structures at the DFAS and the USACE were not sufficient to accumulate and report the condition of the Fund. Specifically, the general ledger the DFAS used to prepare the FY 1993 financial statements contained inaccurate information. The internal controls for both the USACE and the DFAS were insufficient to detect and correct reporting errors in the general ledger. During FY 1993, the USACE had neither the controls nor the oversight needed to ensure that accurate financial information was reported to the DFAS.

DFAS Response: Concur. DFAS-IN is only partially responsible for the internal control structure related to the Fund. DFAS-IN is responsible for departmental reporting for the Fund, but not responsible for the installation level accounting for the Fund, establishing related applicable internal control procedures at the installation, or day to day operations of the Fund. In complying with the form and content reporting requirements for FY 1993 financial statements DFAS-IN utilized the USACE provided general ledger account balances and validated this data to certified accounting reports to the extent possible. In instances when the data was not compatible DFAS-IN adjusted the general ledger to agree with certified accounting reports. We expect the controls on accumulation and reporting of cost to improve with better oversight and more diligent scrutiny of trial balance submissions as jointly agreed to by USACE and DFAS-IN.

Estimated Completion Date: September 30, 1994

Part III, Compliance with Laws and Regulations

Finding: Appropriations Expensed. Because of conflicting guidance between OMB Bulletin No. 94-01 and "DoD Guidance on Form and Content of Financial Statements for FY 1993 and FY 1994 Financial Activity," January 12, 1994, "Appropriations Expensed," a misstatement of $44.7 million was made on the financial statements. In accordance with the DoD Guidance, the DFAS reported $14.4 million as Appropriations Expensed in FY 1993. The DoD Guidance on Form and Content says the amount of appropriations used is equivalent to the sum of Operating/Program Expenses. However, OMB Bulletin No. 94-01 defines appropriations expenses as "the amount of appropriations used to finance expenses."

DFAS Response: Nonconcur. DFAS-IN accounted for Appropriations Expensed in accordance with form and content guidance as prescribed by the Office of the Comptroller of the Department of Defense.

Finding: Financial Statement Overview and Footnotes. Although the DFAS prepared the Footnotes to the Financial Statements, those Footnotes did not provide appropriate disclosure to make the Principal Statements fully informative. That happened because the DFAS did not fully understand the objectives of the Fund or how the USACE recorded transactions.

DFAS Response: Concur. Footnotes to the Principal Statements were prepared by DFAS-IN and coordinated with various representatives for USACE. Several footnote disclosures were, as the auditors stated, more descriptive of conditions related to the Army than to specific operations of the Fund, but not because "...DFAS did not fully understand the objectives of the Fund or how the USACE recorded transactions." A better dialogue between USACE and DFAS would have ensured that the footnotes more accurately describe the Fund. This open dialogue has begun and will continue between the two entities.

Estimated Completion Date: June 30, 1994

# U.S. Army Corps of Engineers Comments

**DEPARTMENT OF THE ARMY**
U S Army Corps of Engineers
WASHINGTON, D C 20314-1000

REPLY TO
ATTENTION OF:

CEAO (36-5d) 19 May 1994

MEMORANDUM FOR PROGRAM DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Internal Controls and Compliance with Laws and Regulations for the Defense Homeowners Assistance Fund Financial Statements for FY 1993 (Project No. 3FH-2012)

1. The Army Corps of Engineers welcomes the opportunity to review and respond to the draft report of subject audit. We do have a few comments, which are at the enclosure.

2. The Commander and his staff appreciate the energy and professionalism that your team brought to the audit of the Homeowners Assistance Fund Financial Statements for FY 1993. Your efforts have helped us to focus on those areas where we can--and will--continue to make improvements.

FOR THE COMMANDER:

William D. Brown

Enclosure

WILLIAM D. BROWN
Colonel, Corps of Engineers
Chief of Staff

CF:
CERM-ZA
CERE-ZA
CEPR-ZA
CECC-ZA

COMMENTS ON DRAFT AUDIT REPORT OF
DEFENSE HOMEOWNERS ASSISTANCE FUND FINANCIAL STATEMENTS
FOR FY 1993

Part II - Internal Controls

1. Page 3:

Extract of Draft Report: "The conditions in this report were not specifically addressed in the USACE Annual Statement of Assurance for FY 1993, October 8, 1993."

USACE Comment: The USACE Annual Assurance Statement for FY 1993, dated 8 October 1993, noted as a material weakness of the Homeowners Assistance Program (HAP) that comprehensive real property records for homes purchased and resold under HAP were not maintained. Part of the remedy identified was (a) the manual reconciliation of inventory records of the Department of Housing and Urban Development (HUD) and USACE, (b) the establishment of a master list of inventory records to be maintained by USACE Real Estate staff that will be reconciled to the financial records, and (c) the fielding of the HAP Management Information System (HAPMIS) Management and Disposal module that will replace the manual inventory and give a real-time capability to track inventory. The reconciliation of all inventory for FY 1993 has been completed. The planned time frame for completing the fielding of HAPMIS was March 1994, and this has substantially occurred, with final testing and implementation at one remaining site now underway. [We provided you a copy of this section of our Annual Assurance Statement on 20 April 1994.]

2. Page 4:

Extract of Draft Report: "We visited...three of seven USACE districts;...."

USACE Comment: You might want to re-phrase this to say: "We visited...three of seven USACE Districts having HAP responsibilities;...." The command actually has thirty-eight Districts, but only seven have HAP responsibilities.

3. Page 4:

Extract of Draft Report: "We have not received management representation letters from the Commander, USACE, the Director, DFAS, and the legal counsel at the USACE."

USACE Comment: We provided to you copies of the USACE management representation letter and the legal representation letter on 11 May 1994.

4. Page 5:

Extract of Draft Report: "The USACE and the DFAS did not communicate effectively. As a result, the Principal Statements did not fairly represent the condition of the Fund."

ENCL

USACE Comment: The DFAS and USACE staffs have initiated positive actions to improve communications. Currently we are working with DFAS to write a Memorandum of Understanding (MOU) that will govern our future working and communications relationships. This MOU should be completed by the end of May 1994. As part of the new commitment, we have jointly agreed to work together to improve accounting and reporting accuracy and to coordinate year-end financial statements. We have researched and corrected all abnormal account balances for FY 1993 and have provided corrections to DFAS.

5. Page 6:

Extract of Draft Report: "The internal control structures at the DFAS and the USACE were not sufficient to accumulate and report the condition of the Fund."

USACE Comment: Until the full deployment of our new Corps of Engineers Financial Management System (CEFMS), with its transaction driven, fully compliant general ledger, we agree that USACE and DFAS do not have adequate controls to detect and correct all reporting errors. Since full deployment is currently scheduled for November 1996, we are undertaking some interim steps to improve the financial reporting abilities of our current systems. We have created a general ledger (GL) program that contains adequate data to compare to the Integrated Command Accounting and Reporting (ICAR) System. Through a special query routine, we will be able to analyze and compare the GL to the ICAR. We expect to have this completed by end of May 1994, so we can reconcile the ICAR to the GL for the May 1994 accounting period. This will help preclude errors on the FY 1994 Homeowners Assistance Fund Financial Statements.

Additionally, the command's HAP and Finance and Accounting staffs are meeting in Norfolk later this month to discuss methods of reconciling the real estate income and inventory to the accounting records. Following that meeting, we will publish for the field new HAP accounting guidance. Then, we will conduct monthly finance and accounting reconciliations--at both field and Headquarters levels--on inventory, revenue, and expense.

Also, we have taken steps to adjust the General Ledger account 1730 (as of 30 September 1993) to reflect accurately the Inventory of Homes balances. We have instituted a change to our current automated reporting system, the Corps of Engineers Management Information System (COEMIS), that will allow us to record accurately accounts receivable at year's end, which should correct the previously occurring income accrual problem. This change to COEMIS will be effective for the reporting month ending 31 May 1994.

6. Page 7:

Extract of Draft Report: "Comprehensive inventory records were not maintained and homes were not properly valued and classified."

USACE Comment: Your critique of this issue, which you shared with us in advance of publication of the draft report, led us to ask for a more in-depth review of the matter by our own internal auditors. The latter review has resulted in our developing standardized monthly and year-end inventorying

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reports. These reports address on-hand and sold inventory, and revenue earned, collected, and uncollected. We anticipate that these new reports will be incorporated as part of the Management and Disposal module of HAPMIS by end of June 1994. For the interim, we have directed our HAP Districts to prepare the reports manually, beginning with the month ending 30 April 1994. Headquarters representatives have already visited each HAP District and trained the Resource Management and Real Estate personnel in the preparation and use of the new reports.

The "valuing" issue (your recommendation that we value the homes at net realizable value) and the "classifying" issue (your view that it is inappropriate to classify homes as "Property Held for Sale") cannot be resolved at our level. The Corps of Engineers is in compliance with DoD guidance in these areas. We are separately communicating these issues to the Assistant Secretary of the Army (Financial Management), and asking for her assistance in taking them to higher level for resolution.

7. Page 8:

Extract of Draft Report: "Checks were disbursed without supervisory approval, and unauthorized employees collected reimbursement checks for the Fund. While we did not note any irregularities resulting from those weak controls, such weaknesses could cause inaccurate payments to be made and checks to be misplaced."

USACE Comment: The disbursing problem that you noted at one of our HAP Districts occurred during the vacancy of a key supervisory position. That position has since been filled; this fact, along with additional local management oversight, has corrected the problem. The collection problem should not have occurred, as the command has published very clear guidance on this matter. We are reissuing the guidance, however, to ensure that the policy is better understood by all; this will be done by end of June 1994.

8. Page 8:

Extract of Draft Report: "Also, checks were issued in the name of the title companies instead of the mortgage companies. Those checks included 7 days of additional interest for transit time (that is, to allow the title companies sufficient time to deposit the checks into their accounts and issue their own checks to pay off the mortgages on behalf of the Fund)."

USACE Comment: At the District where this matter was noted, we are limited by the terms of the contract with the title company that require us to deposit funds with that company in advance for the settlement costs. We have already reduced the time of check holding until mortgage liquidation from seven days to four days, however, and we are further exploring a way whereby we might use an electronic funds disbursement process so that we can further reduce the time to twenty-four hours. We also plan to change the terms of this contract when it comes up for renewal. In the interim, we have initiated procedures to provide written notification to the homeowner, to the title company, and to the mortgage company that any additional interest refunded at the time of settlement is owed to the Government, not to the homeowner.

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Part III - Compliance With Laws and Regulations

9. Pages 13-14:

Extract of Draft Report: "The USACE recorded revenue transactions using the cash basis of accounting. OMB Bulletin 94-01 and DoD Manual 7220.9-M (the DoD Accounting Manual) require accrual accounting. As a result, accounts were understated by at least $2.4 million and revenues were incorrectly reported."

USACE Comment: We are changing our automated accounting system, COEMIS, to set up Accounts Receivable at year's end. We will then be able to recognize revenue at the time of settlement (when it actually occurs) rather than when funds are received, in accordance with requirements for accrual accounting. We have developed new reporting and documentation forms for standardized use across USACE Districts to record inventory, acquisitions, foreclosures, and sales. Using these forms, we will perform monthly reconciliations of acquisitions, resales, inventory, and revenue. At year's end, we will also reconcile these items as well as private sales, losses, foreclosures, and work-in-process on acquisitions, private sales, and foreclosures. Our staff members recently received training on use of the new forms. We anticipate that the new reporting systems will be operational by the end of May 1994.

10. Page 14:

Extract of Draft Report: "The DFAS increased the revenue general ledger account by $1.2 million. That amount represented the write-off of a nonexistent debt. We identified in our prior audit that that 'debt' was an accounting error and should have been written off in FY 1992. The write-off should be to an equity account, not to revenue."

USACE Comment: DFAS has made the necessary adjusting entries to correct the General Ledger accounts for revenue and equity.

11. Page 15:

Extract of Draft Report: "Two districts used split purchases to acquire title services using small purchase procedures. Those districts made multiple awards to keep each at less than $25,000, even though the total requirement exceeded that amount by as much as $91,000. Federal Acquisition Regulation, Part 13, prohibits that practice."

USACE Comment: We are currently rewriting the chapter of our Engineer Regulation 405-1-12 that pertains to the Homeowners Assistance Program, and in this publication we will re-emphasize the need to use an appropriate contract type when it is anticipated that the cost of appraisal and title services will exceed the small purchase threshold. These contracts will be awarded considering the requirements at FAR Part 6. We anticipate having this guidance republished by 1 October 1994. In addition, the procurement of appraisal and title services will be made an item of review during forthcoming contracting policy assistance visits to our Districts.

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12. Page 15:

Extract of Draft Report: "The Overview and Footnotes to the Fund's FY 1993 Principal Statements did not adequately address the operations of the Fund or contain performance measures."

USACE Comment: The USACE and DFAS staffs have discussed this weakness and are working together to ensure that appropriate Overview and Footnotes will be provided with the FY 1994 Principal Statements for the Fund. In addition, we have developed and are using performance factors, and they will be shown in the FY 1994 Financial Statements.

# Audit Team Members

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