# Audit Report

OFFICE OF THE INSPECTOR GENERAL

**STATEMENT OF FINANCIAL POSITION FOR THE DEFENSE LOGISTICS AGENCY SUPPLY MANAGEMENT BUSINESS AREA OF THE DEFENSE BUSINESS OPERATIONS FUND, AS OF SEPTEMBER 30, 1994**

Report No. 95-195 May 17, 1995

**Department of Defense**

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**Acronyms**

| | |
|---|---|
| DFAS | Defense Finance and Accounting Service |
| DLA | Defense Logistics Agency |
| IG | Inspector General |
| OMB | Office of Management and Budget |

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

May 17, 1995

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

SUBJECT: Audit Report on the Statement of Financial Position for the Defense Logistics Agency Supply Management Business Area of the Defense Business Operations Fund, as of September 30, 1994 (Report No. 95-195)

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," January 8, 1993, requires the Inspector General, Department of Defense, to report on the adequacy of internal controls and compliance with laws and regulations and express an opinion on the fairness of financial statements.

We are unable to render an opinion on the Statement of Financial Position because material internal controls over the accounting processes and systems, while improved, did not ensure accurate and reliable data for the preparation of financial statements. Those internal control weaknesses were recognized and reported in the Department of Defense, the Defense Logistics Agency, and the Defense Finance and Accounting Service Annual Statements of Assurance and in the notes to the financial statements. Our disclaimer of opinion is based on the Statement of Financial Position as of September 30, 1994, but dated January 11, 1995.

This report contains no recommendations and identifies no potential monetary benefits that are subject to resolution in accordance with DoD Directive 7650.3. Accordingly, comments to the report are not required.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Charles F. Hoeger, Audit Program Director, or Mr. Bernard J. Siegel, Audit Project Manager, at (215) 737-3881 (DSN 444-3881). The distribution of this report is in Appendix I. A list of audit team members is on the inside back cover.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

**Office of the Inspector General, DoD**

**Report No. 95-195** **May 17, 1995**
(Project No. 4LD-2006)

# Statement of Financial Position for the Defense Logistics Agency Supply Management Business Area of the Defense Business Operations Fund, as of September 30, 1994

## Executive Summary

**Introduction.** The Chief Financial Officers Act of 1990 requires DoD to prepare financial statements for revolving funds. The Supply Management Business Area of the Defense Logistics Agency (DLA) Defense Business Operations Fund (DLA Supply Management) is a revolving fund established for procuring, storing and selling consumable supply items to DoD Components and other Government agencies. DLA Supply Management reported assets of $12 billion and liabilities of $1.2 billion as of September 30, 1994. The principal asset and liability accounts include accounts receivable ($871 million), accounts payable ($914 million), and inventory ($10 billion).

This audit is one of a series of audits being conducted by the Inspector General, DoD, in response to the Chief Financial Officers Act. The audit was conducted in conjunction with audits of the DLA Distribution Depots Business Area (Project No. 4LD-2007) and the Reutilization and Marketing Business Area (Project No. 4LE-2008). The results of each audit will be provided in separate audit reports. We issued a draft report on March 27, 1995; however, management was not required to provide comments because this report contains no recommendations. No comments were received from management.

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

**Scope and Methodology.** We examined the Statement of Financial Position as of September 30, 1994 and the associated notes to the Principal Statements of the Supply Management Business Area of the DLA Defense Business Operations Fund. The Principal Statements include the Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. Also included are the footnotes, overview, and supplemental information. The statements upon which our disclaimer of opinion is based were dated January 11, 1995.

We examined the internal control structure for the reporting of principal assets and liabilities presented on the DLA Supply Management Statement of Financial Position for the year ended September 30, 1994. The audit entailed the use of computer-processed financial data and reports. Except for our tests of physical inventory observations and selected tests of the other asset and liability accounts reviewed, we did not independently determine the reliability of the computer-processed data.

**Disclaimer of Opinion.** We are unable to render an opinion on the Statement of Financial Position because internal controls over the accounting processes and systems did not provide accurate and reliable data for the preparation of the financial statement. DoD, DLA, and the Defense Finance and Accounting Service recognized and reported those material internal control weaknesses in their Annual Statements of Assurance. Additionally, the notes to the financial statements reiterated those internal control weaknesses and addressed other financial reporting deficiencies and limitations.

**Findings on Internal Controls.** The DLA Supply Management and DFAS-Columbus Center internal control structure over transaction processing and followup procedures did not provide reasonable assurance that the accounts receivable and accounts payable balances were accurate and supported by detailed subsidiary records.

The DLA Supply Management made significant improvements in the valuation, reporting, and disclosure for the inventory; property, plant, and equipment; and fund balances with the Treasury accounts; however, further improvements are needed in the internal control structure over transaction processing and followup procedures for those accounts.

**Findings on Compliance With Laws and Regulations** The results of our tests indicate that with respect to the items tested, except for noncompliance described in Part II.A., management complied in all material respects with the laws and regulations referred to in Appendix C. With respect to items not tested, nothing was disclosed that caused us to believe that management had not complied, in all material respects, with the laws and regulations referenced above.

**Summary of Recommendations.** Because the conditions identified in the report were addressed in prior audits of the DLA financial statements; the overview and notes to the financial statements; and the DoD, the DLA, and the Defense Finance and Accounting Service Annual Statements of Assurance we did not make additional recommendations for corrective action. DLA and the Defense Finance and Accounting Service-Columbus Center have indicated that some corrective actions were implemented during FY 1994 and additional corrective actions are ongoing or planned. We have not tested or verified those claims.

**Management Comments.** Since the report contains no recommendations, comments are not required. Should the Under Secretary of Defense (Comptroller); the Director, DLA; and the Director, Defense Finance and Accounting Service choose to comment, the comments should be received by July 3, 1995.

# Table of Contents


**Executive Summary** i

**Part I - Disclaimer of Opinion**

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

**Part II - Audit Results**

Audit Background 6
Audit Objectives 6

**Part II.A. - Review of Internal Controls**

Introduction 8
Finding A. Accounts Receivable 11
Finding B. Accounts Payable 18
Finding C. Followup on Prior Audit Issues 26

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

Introduction 34
Results of Audit 34

**Part III - Additional Information**

Appendix A. Scope and Methodology 36
Appendix B. Summary of Prior Audits 40
Appendix C. Laws and Regulations Reviewed 44
Appendix D. Summary of Physical Inventory Observations 45
Appendix E. Organizations Visited or Contacted 47
Appendix F. Report Distribution 48

# Part I - Disclaimer of Opinion

## Disclaimer of Opinion

We are unable to render an opinion on the Statement of Financial Position, as of September 30, 1994, for the Supply Management Business Area of the Defense Logistics Agency Defense Business Operations Fund (DLA Supply Management) because internal controls over the accounting processes and systems did not provide accurate and reliable data for the preparation of financial statements. DoD, DLA, and the Defense Finance and Accounting Service (DFAS) recognized and reported those material internal control weaknesses in their Annual Statements of Assurance. Additionally, the notes to the financial statements reiterated those internal control weaknesses and addressed other financial reporting deficiencies and limitations. Our disclaimer of opinion is based on the Statement of Financial Position as of September 30, 1994, but dated January 11, 1995. The findings included in Part II of this report address the specific reasons for the disclaimer.

## 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 (IG), DoD, and Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal 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. Specific standards agreed on by the three principals are issued by the Director, OMB, and the Comptroller General.

Until accounting standards that will govern all aspects of financial statement reporting have been issued, which will constitute "generally accepted accounting principles for the Federal Government," agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. The hierarchy constitutes an "other comprehensive basis of accounting" to be used for preparing Federal agency financial statements. The hierarchy defined and approved by the Joint Financial Management Improvement Program principals, is summarized as:

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

o form and content requirements of OMB,

o accounting standards contained in agency accounting policy guidance, and

o accounting principles published by other authoritative sources.

To date, three accounting standards have been published by the Joint Financial Management Improvement Program principals, so most accounting standards for the DoD "other comprehensive basis of accounting" are contained in DoD accounting policy guidance. The DoD accounting guidance is primarily in DoD Manual 7220.9-M, "DoD Accounting Manual," October 1993. During FY 1993 and FY 1994, the then Comptroller of the DoD (Comptroller, DoD), updated portions of the DoD Accounting Manual and incorporated the published updated information into a new regulation, DoD 7000.14-R, "DoD Financial Management Regulation," May 1993.

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

## Overview

We reviewed the financial information related to selected financial data presented in management's overview. The information presented in the overview is presented for the purpose of additional analysis. We have not examined the supporting documentation for the presented financial data; therefore, we are not expressing an opinion on it.

**Financial Management Initiatives.** During FY 1994, DLA established goals for creating a comprehensive financial management system and undertook several initiatives to identify and assess the financial statement impact of accounting practices. The goals and initiatives enabled DLA to establish milestones to improve financial accuracy and reliability. However, the DLA financial management system, including financial accounting systems and reported financial information, is expected to be noncompliant and inconsistent in the short-term. Those noncompliances and inconsistencies include the following.

o Financial accounting systems are unable to comply with the requirement to recognize unrealized holding gains and losses upon the sale of inventory.

o Financial accounting systems are unable to identify and eliminate intrafund transactions.

o Accounts receivable and accounts payable amounts include "undistributed" amounts that represent the differences between collections and disbursements on the general ledger and those which were reported through the financial network. DoD is currently pursuing corrective actions.

o Inventory intransit, accounts receivable, and accounts payable include overage and negative amounts which are currently under investigation for system and processing deficiencies.

o Property accountability systems do not properly account for all property, plant, and equipment for which the agency is responsible.

# Concurrent Audits

This audit is one of a series of audits being conducted by the IG, DoD, in response to the Chief Financial Officers Act. The audit of DLA Supply Management was conducted in conjunction with audits of the DLA Distribution Depots Business Area (Project No. 4LD-2007) and the DLA Reutilization and Marketing Business Area (Project No. 4LE-2008). The results of each audit will be provided in separate audit reports.

Each of the three audit projects included followup work on accounts that were included in prior audits -- fund balances with Treasury; inventory; and property, plant, and equipment -- that were summarized in IG, DoD, Report No. 94-167, "Selected Financial Accounts on the Defense Logistics Agency Defense Business Operations Fund Financial Statements for FY 1993," June 30, 1994. Results of the followup audit work are being included, as appropriate, in the audit reports for each business area.

# Part II - Audit Results

## Audit Background

The DLA Supply Management is a revolving fund established under the administration and management of the Director, DLA. DLA Supply Management, the largest of the five DLA business areas, is responsible for the management, procurement, and sale of approximately 3.7 million consumable supply items to DoD Components and other Government agencies. Sales proceeds are retained in the fund and are available for the procurement of inventory, the operation and maintenance of the business area, and the reimbursement of support services provided by other business areas.

The Statement of Financial Position shows the worth of DLA Supply Management by presenting the assets and liabilities as of the end of the fiscal year. DLA Supply Management reported assets of $12 billion and liabilities of $1.2 billion as of September 30, 1994. The principal asset and liability accounts include accounts receivable ($871 million), accounts payable ($914 million), and inventory ($10 billion). Financial information included in the DLA Supply Management financial statements is obtained from two general ledger account systems -- stock fund and operations and maintenance accounting -- as well as other financial and nonfinancial reporting systems.

The Chief Financial Officers Act requires an annual audit of funds such as the DLA Defense Business Operations Fund. The DFAS maintains the official accounting records; however, DLA and DFAS are jointly responsible for preparing the DLA Supply Management financial statements. Our responsibility is to express an opinion on those statements based on our examination. Appendix A presents the scope and methodology used to conduct this audit.

## Audit Objectives

The objectives of the audit were to determine whether the Statement of Financial Position, as of September 30, 1994, for the DLA Supply Management Business Area was presented fairly in accordance with OMB Bulletin No. 94-01, to evaluate the internal control structure established for DLA Supply Management, and to assess compliance with applicable laws and regulations for those transactions that could have a direct and material effect on the financial statements. In addition, we followed up on conditions noted in our previous audits of the DLA Defense Business Operations Fund financial statements.

# Part II.A. - Review of Internal Controls

# Introduction

We examined the internal control structure for principal asset and liability accounts presented on the Statement of Financial Position for DLA Supply Management for the year ended September 30, 1994. The statements on which our examination was based were dated January 11, 1995. DLA and DFAS management are jointly responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control review (United States Code, title 31, section 3512) are to provide management with reasonable but not absolute assurance that the following are met.

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

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

o Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and any other laws and regulations that the OMB, entity management, or the IG, DoD, have identified as being significant for which compliance can be objectively measured and evaluated.

For the purposes of this report, we have classified the significant internal controls, policies, and procedures into the following categories: accounts receivable and collections, accounts payable and disbursements, inventories, capital assets, and other revenues and expenses.

**Reportable Conditions.** Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to effectively control and manage its resources and ensure accurate and reliable financial information needed to manage and evaluate operational performance. A material weakness is a reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low 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.

**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 that are also considered to be material weaknesses.

**Annual Statements of Assurance.** In their Annual Statements of Assurance, DoD, DLA and DFAS identified material weaknesses in their system of internal accounting and administrative controls and other mechanisms. We have identified many of those same conditions. Those conditions include the following.

**Department of Defense.** In its Annual Statement of Assurance, December 29, 1994, DoD identified the following material weaknesses.

o Financial data were inadequately maintained within the DoD accounting systems.

o Financial records for inventory and property were inadequately maintained.

**Defense Logistics Agency.** In its Annual Statement of Assurance, November 28, 1994, DLA identified the following material weaknesses.

o Backlogs in matching unmatched disbursements indicated inadequate maintenance of financial data.

o Backlogs in generating billings for receivables earned against Interservice Support Agreements and Military Interdepartmental Purchase Requests.

o Automated payment systems required manual interface between the DFAS-Columbus Center and DLA entities to operate properly.

o Management controls were inadequate to maintain accountability and visibility of excess items intransit to disposal and for other than stock on hand inventories.

o Cash collections and disbursements in the general ledger were not reconciled with the Appropriation Control and Reporting System.

o Internal controls for property, plant, and equipment and associated depreciation were inadequate to ensure accurate reporting.

**Defense Finance and Accounting Service.** In its Annual Statement of Assurance, October 13, 1994, DFAS identified the following material weaknesses.

o Backlogs in processing accounting vouchers resulted in financial transactions being recorded untimely and being reflected inaccurately in the financial reports.

- Supporting reports for intransit inventories were not reconciled to general ledger control accounts.

- Required reconciliations and analysis procedures with the U.S. Treasury were either untimely or nonexistent.

- A lack of internal controls in processing accounts payable transactions contributed to overpayments to vendors.

- A lack of appropriate internal controls over property accountability.

# Finding A. Accounts Receivable

The DLA Supply Management and DFAS-Columbus Center internal control structure over transaction processing and followup procedures did not provide reasonable assurance that the accounts receivable balance was accurate and supported by detailed subsidiary records. The condition existed because:

o Accounts receivable balances included transactions that were already collected,

o Accounts receivable balances were not billed to customers and other supported activities because authorized funding documentation was not obtained as required, and

o Overage accounts receivable subsidiary records and unmatched collection documents were not researched, validated, and followed up with delinquent customers and other supported activities.

As a result, the internal control structure over accounts receivable transactions was compromised and the balances reported in the financial statements, including the related footnotes, were not fully representative of the transactions that made up the reported accounts receivable balance.

## Analysis of Accounts Receivable

**Composition of Accounts Receivable.** Accounts receivable for DLA Supply Management represent reimbursements for goods or services provided to customers. The Statement of Financial Position for DLA Supply Management reported a total of $870.7 million in accounts receivable as of September 30, 1994 -- $702.5 million with Federal entities and $168.2 million with non-Federal entities. The reported amounts included accounts receivable and undistributed collections account balances recorded in general ledger accounts, and adjustments that were not recorded in the general ledgers.

Individual transactions are recorded in various receivable accounts maintained in two separate general ledgers -- the stock fund general ledger and the operations and maintenance general ledger. Receivables that are due from customers for consumable items purchased from supply centers are recorded in the stock fund general ledger. Receivables from tenants and other supported activities for common supplies and services and DLA Supply Management operations and maintenance costs are recorded in the operations and maintenance general ledger. Customers include the Military Departments, other DLA business areas, civilian agencies, local and state governments, and the general public. Table 1 details the source and scope of the amounts included in the reported accounts receivable balances.

**Table 1. Composition of the Accounts Receivable Balances as of September 30, 1994**
(million)

| Transactions with Federal Entities | Stock Fund | Operations and Maintenance | Total |
|---|---|---|---|
| General ledger balances | | | |
| Accounts receivable | $562.1 | $236.6 | $798.7 |
| Undistributed collections | (187.6) | 0.0 | (187.6) |
| Adjustments | 0.0 | 91.4 | 91.4 |
| **Subtotal** | **374.5** | **328.0** | **702.5** |
| Transactions with non-Federal Entities | | | |
| General ledger balances | | | |
| Accounts receivable | 168.1 | 0.1 | 168.2 |
| **Subtotal** | **168.1** | **0.1** | **168.2** |
| **Total** | **$542.6** | **$328.1** | **$870.7** |

**General Ledger Balances.** A receivable is recognized when a Federal entity establishes a claim against other entities, either based on legal provisions, such as payment due dates, or when goods and services are provided. When the exact amount is unknown, a reasonable estimate of the amount due should be made. Receivable transactions are recorded in general ledger accounts and reported as either transactions with Federal entities or transactions with non-Federal entities.

Collection transactions for the reimbursement of accounts receivable are posted directly either to the accounts receivable account or to a clearing account (undistributed collections) until matched to the appropriate accounts receivable transactions. Although unmatched collection transactions remain in the clearing account until reviewed and matched, those collections represent a reduction in outstanding accounts receivable.

**Adjustment Balances.** As noted in Table 1, the reported accounts receivable balance for transactions with Federal entities included adjustments of $91.4 million. The adjustments represent accounts receivable transactions that were already collected before the end of FY 1994. However, the financial network (the U.S. Treasury) had not yet recorded those transactions as complete. DFAS-Columbus Center added back those accounts receivable transactions so that the accounts receivable balance would agree with the Treasury balance. Consequently, the reported accounts receivable balance was overstated by $91.4 million because those collections were already recorded by DFAS-Columbus Center against the appropriate accounts receivable transactions and no longer due to DLA Supply Management. In effect, DLA Supply Management and DFAS had received and recorded the reimbursement from customers but the Treasury had not reported the collection amount through the financial network.

Additionally, the difference between the collections on the general ledger and those reported by the financial network include current year timing differences and prior period adjustments. DoD requires that all prior year adjustments be made on the current year Report of Budget Execution. As a result of that requirement and a requirement that the financial statements must agree with the Statement of Budget Execution, the reported accounts receivable balance will not represent the actual accounts receivable balance as of yearend.

**Financial Disclosure.** The overview and notes to the DLA Supply Management financial statements disclosed those differences and stated that the reported amounts were determined in accordance with guidance issued by the Comptroller, DoD. The differences were attributed to the untimely reconciliation of the collection information from the financial network and the DLA Supply Management statement of transactions. As a result of its transfer of accounting and management responsibilities, DLA has had limited capability to reconcile those differences.

## Review of Accounts Receivable Transactions

We judgmentally selected a sample of 74 overage and large dollar value transactions, totaling $92.7 million, to determine whether the accounts receivable was valid as of September 30, 1994. Those transactions were selected from the stock fund and operations and maintenance subsidiary transaction records for most DLA Supply Management commodities. We did not include all commodities in the sampling process because DFAS-Columbus Center was unable to provide all subsidiary transactions for all commodities. The stock fund transactions did not include the clothing and textile, medical, or subsistence commodities. The operations and maintenance transactions did not include the clothing and textile, industrial, medical, and subsistence commodities.

The results of our review are summarized in Table 2 and discussed in detail below.

**Table 2. Review of Accounts Receivable Transactions**

| Reason | Number | Dollar Value (million) |
|---|---|---|
| Valid | 43 | $42.8 |
| Collected | 10 | 9.5 |
| Unbilled | 15 | 33.3 |
| Other not valid | 5 | 6.5 |
| Undetermined | 1 | 0.6 |
| **Total** | **74** | **$92.7** |

## Collected Accounts Receivable

**Stock Fund Collections.** Accounts receivable balances reported on the Statement of Financial Position were overstated because they included transactions that were already collected but not posted to the general ledger. The DFAS-Columbus Center did not establish sufficient internal controls to ensure that all collection transactions were recorded in the subsidiary accounts receivable general ledger for stock fund transactions. All collection vouchers are sent to the Disbursing and Collecting Division, which distributes them to the appropriate accounts receivable sections for update to the financial management systems. Those financial management systems include the Standard Automated Materiel Management System (all commodities except fuel and subsistence), the Defense Fuel Automated Management System, and the DLA Integrated Subsistence Management System.

By updating the financial management system, the collection is recorded in the clearing account (undistributed collections). When the collection is matched to an outstanding accounts receivable subsidiary record, the amount in the clearing account is transferred to the appropriate accounts receivable account. When the collection is not matched to an outstanding accounts receivable subsidiary record, the amount remains in the clearing account until further research can be performed.

**Management Oversight of Collections.** The DFAS-Columbus Center personnel did not have sufficient controls over the collection posting process to ensure that all collections were posted to the appropriate subsidiary general ledger accounts. Additionally, DFAS-Columbus Center personnel could not identify what was causing the delay in posting collection transactions. During FY 1994, collection vouchers were received by DFAS-Columbus Center and distributed to the general ledger section for transmission to appropriate accounts receivable sections. That process was not always successful and collections vouchers were not always received by the accounts receivable sections. DFAS-Columbus Center personnel were aware of the problem but did not know how many collection transactions were not processed to the financial management systems. We were unable to determine the extent of the unprocessed transactions.

**Corrective Actions Taken.** During the first quarter of FY 1995, DFAS-Columbus Center management took action to address the unprocessed transactions condition. The Disbursing and Collecting Division established a batch control process for collection vouchers before forwarding them to the accounts receivable section so that the financial management systems could be updated. The batch control process verified that the number of transactions updating the financial management systems equal the number of collection vouchers processed. DFAS-Columbus Center personnel stated that the process appeared to be working, and they were assured that all collection vouchers were being posted.

The DFAS-Columbus Center personnel had not identified collection vouchers that were received by the Disbursing and Collecting Division but not posted to the general ledger accounts receivable records. Consequently, the general ledger accounts receivable records included transactions that were already received and the accounts receivable balance was overstated by that amount. For example, for 10 of the 74 cases tested, valued at $9.5 million, the collection was made before the end of the fiscal year -- 8 of the 10 cases, valued at $3.5 million, were received before May 1994. However, the collection was not posted to the financial management systems and was not recorded in the general ledger accounts resulting in the open accounts receivable. We identified those transactions to DFAS-Columbus Center personnel so that they could update the financial management systems.

## Unbilled Accounts Receivables

**Unbilled Operations and Maintenance Receivables.** Accounts receivable balances were understated because customers were not billed for services performed by DLA Supply Management. The DFAS-Columbus Center did not bill customers and other supported activities for reimbursable charges because they had not received authorized funding documents. DLA Supply Management provided common supplies and services to tenants and other supported activities as agreed to in support agreements. Funding for the requested support was provided by authorized funding documents -- Military Interdepartmental Purchase Requests. Those funding documents delineate the services that DLA Supply Management will perform and the amount that customers will reimburse for those services. However, those authorized funding documents were not always provided to DFAS-Columbus Center by the DLA Supply Management liaison offices.

**Management Oversight of Billed Account Receivables.** The DLA Supply Management and DFAS-Columbus Center did not establish procedures to ensure that all funding documents were received from DLA Supply Management liaison offices. DLA Supply Management liaison offices established the accounts receivable transactions for all reimbursements; however, DFAS-Columbus Center did not always receive the authorized funding document from the budget offices needed to bill the customers. Consequently, accounts receivable transactions existed for amounts that would never be received because they were not billed to customers. DFAS-Columbus Center personnel were aware of the problem but did not know how many accounts receivable transactions were never billed to customers. Because of the lack of available documentation, we were unable to determine the extent of the unbilled accounts receivable transactions.

**Corrective Actions Taken.** During the first quarter of FY 1995, DFAS-Columbus Center personnel began reviewing all open support agreements to determine whether an authorized funding document was required and whether a receivable transaction remained unbilled. DFAS-Columbus Center personnel requested authorized funding documents, in the form of Military Interdepartmental Purchase Requests, from their customers as the only authorized funding document. The actions were principally directed to current and future support agreements. Those actions could eliminate future unbilled receivable transactions.

During FY 1994, DFAS-Columbus Center took no action to identify accounts receivable transactions that were not billed because they did not have a funding document. Until those unbilled receivables are identified and bills are sent to customers, the accounts receivable balances will include transactions that will never be collected. That condition was identified in the notes to the financial statements.

For example, for 15 of the 74 cases tested, valued at $33.3 million, the receivable transaction was never billed to the customer because the funding document was never received. Those cases were from 1 month to 2 years old. We contacted those customers and they provided us copies of the funding documents. Customers stated that, in the past, DFAS-Columbus Center personnel had never requested copies of funding documents. We provided those funding documents to DFAS-Columbus Center personnel so that they could update the financial management systems and bill customers for outstanding receivables.

## Overage and Unmatched Accounts Receivables

The DFAS-Columbus Center personnel did not research, validate, or follow up on overage accounts receivable subsidiary records and unmatched collection documents. The stock fund general ledger identified $187.6 million in undistributed collections. That amount actually included $349.4 million at DLA Headquarters and a negative $161.8 million at other DLA Supply Management entities; a condition that has existed since FY 1991. DLA Supply Management and DFAS-Columbus Center personnel could not provide us detailed records supporting the undistributed balances or explain why those unreconciled balances have existed for so long.

**Corrective Actions and Disclosures.** The overview and notes to the financial statements state that DLA Supply Management and DFAS-Columbus Center are aware that receivable balances include numerous overage and negative transactions and that those transactions are under investigation. DLA estimated a total of $52 million of overage transactions and $671 million of negative transactions for all DLA entities. Estimates for DLA Supply Management were not available.

The DFAS identified unmatched collection transactions as an internal control weakness in its Annual Statement of Assurance and stated that adequate research and reconciliations were not performed to clear those outstanding transactions. DFAS associated the condition with all stock fund commodities, except fuel. We reviewed the fuel commodity and identified the same conditions.

## Summary

The conditions identified in our discussion of accounts receivable transactions were addressed in prior audits of the DLA financial statements. Additionally, those conditions were addressed in the overview and notes to the financial statements and in the DoD, DLA, and DFAS Annual Statements of Assurance. As reported, DLA and DFAS-Columbus Center have indicated that some corrective actions were implemented during the first quarter of FY 1995 and additional corrective actions are ongoing or planned. Accordingly, we are not making additional recommendations for corrective action in this report.

# Finding B. Accounts Payable

The DLA Supply Management and DFAS-Columbus Center internal control structure over transaction processing and followup procedures did not provide reasonable assurance that the accounts payable balance was accurate and supported by detailed subsidiary records. The condition existed because:

o Accounts payable balances included transactions that were already disbursed,

o Accounts payable balances included unliquidated obligations for travel, services, and other commercial related expenses that were completed and paid for,

o Overage and negative accounts payable subsidiary records and unmatched disbursement documents were not researched, validated, and followed up to resolve those open transactions.

As a result, the internal control structure over accounts payable transactions was compromised and the balances reported in the financial statements, including the related footnotes, were not fully representative of the transactions that made up the reported accounts payable balance.

## Analysis of Accounts Payable

**Composition of Accounts Payable.** Accounts payable for DLA Supply Management represent amounts owed for goods or services provided by vendors or other Federal entities. The Statement of Financial Position for DLA Supply Management reported a total of $913.6 million in accounts payable as of September 30, 1994 -- $437.2 million with Federal entities and $476.4 million with non-Federal entities. The reported amounts included accounts payable and undistributed disbursements account balances recorded in general ledger accounts, and adjustments that were not recorded in the general ledgers.

Individual transactions are recorded in various payable accounts maintained in two separate general ledgers -- the stock fund general ledger and the operations and maintenance general ledger. Accounts payable for stock fund materiel (consumable items purchased for resale to customers) are recorded in the stock fund general ledger. Accounts payable for operating services and supplies (including personnel and travel expenses) are recorded in the operations and maintenance general ledger. Customers include the Military Departments, other DLA business areas, civilian agencies, local and state governments, and the general public.

Table 3 details the source and scope of the amounts included in the reported accounts payable balances.

**Table 3. Composition of the Accounts Payable Balances as of September 30, 1994**
(million)

| Transactions with Federal Entities | Stock Fund | Operations and Maintenance | Total |
|---|---|---|---|
| General ledger balances | | | |
| Accounts payable | $700.5 | $296.2 | $996.7 |
| Undistributed disbursements | (444.6) | 0.0 | (444.6) |
| Total general ledger balances | 255.9 | 296.2 | 552.1 |
| Adjustments | | | |
| Distribution depot accrual | 0.0 | 45.0 | 45.0 |
| Undistributed disbursements | 0.0 | 110.4 | 110.4 |
| Other adjustments | 0.0 | (270.3) | (270.3) |
| Total adjustments | 0.0 | (114.9) | (114.9) |
| **Subtotal** | **255.9** | **181.3** | **437.2** |
| Transactions with non-Federal Entities | | | |
| General ledger balances | | | |
| Accounts payable | 869.9 | 149.9 | 1,019.8 |
| Undistributed disbursements | (543.4) | 0.0 | (543.4) |
| **Subtotal** | **326.5** | **149.9** | **476.4** |
| **Total** | **$582.4** | **$331.2** | **$913.6** |

**General Ledger Balances.** A payable is recognized when a Federal entity accepts title to goods, whether the goods are delivered or intransit. When an invoice was not received and the exact amount is unknown, a reasonable estimate of the amount owed should be made. Payable transactions are recorded in general ledger accounts and reported as either transactions with Federal entities or transactions with non-Federal entities.

Stock fund disbursement transactions are posted either to the accounts payable account or to a clearing account (undistributed disbursements) until matched to the correct accounts payable transactions. Although unmatched disbursements transactions remain in the clearing account until reviewed and matched, those disbursements represent a reduction in outstanding accounts payable. Operations and maintenance transactions are posted to the accounts payable account, whether matched or unmatched. When unmatched, the disbursement transaction appears as a negative accounts payable transaction.

**Adjustment Balances.** As noted in Table 3 the reported balances for accounts payable included a net adjustment of $114.9 million that was not recorded in the general ledger. That amount represents the following three general categories of adjustment.

o Distribution depot accrual of $45 million. The adjustment was the estimated accounts payable amount due to distribution depots for the receipt, storage, and shipment costs attributed to DLA Supply Management for the month of September 1994. Those costs are not normally recorded in the general ledger until mid-October. We identified that condition to DLA and DFAS-Columbus Center personnel who jointly determined the appropriate estimate to accrue.

o Undistributed disbursements of $110.4 million. The amount was the difference between disbursements on the general ledger and those that were reported through the financial network. In effect, DLA Supply Management had received and recorded the disbursement to vendors but the Treasury had not reported the disbursement amount through the financial network. The difference was treated as an "undistributed" amount and added back to the accounts payable balance. Undistributed amounts usually decrease accounts payable; however, that "undistributed" amount increased the reported accounts payable balance.

o Other adjustments of $270.3 million. The amount was principally an adjustment to include the operations and maintenance disbursements for DLA Headquarters. The other adjustments amount was erroneously excluded from the Statement of Budget Execution and was removed from the financial reporting so that the balance reported on the financial statements would agree with the balance on that report.

**Financial Disclosure.** As noted above, the accounts payable balances reported in the financial statements included adjustments to the general ledger account balances. The overview and notes to the DLA Supply Management financial statements disclosed the difference between the accounts payable general ledger balances and the financial statement reported balances and further stated that the reported amounts were determined in accordance with guidance issued by the Comptroller, DoD. The differences were attributed to the untimely reconciliation of the disbursement information from the financial network and the statement of transactions. As a result of the transfer of accounting and management responsibilities to the DFAS-Columbus Center, DLA has had limited capability to reconcile those differences.

## Review of Accounts Payable Transactions

We judgmentally selected a sample of 115 overage and large dollar value transactions, totaling $114.6 million, to determine whether the accounts payable was valid as of September 30, 1994. The transactions were selected from the stock fund and operations and maintenance subsidiary transaction records for most DLA Supply Management commodities. We did not include all commodities in the sampling process because DFAS-Columbus Center was unable to provide all subsidiary transactions for all commodities. The stock fund transactions did not include subsistence. The operations and maintenance transactions did not include the clothing and textile, industrial, medical, and subsistence commodities. The results of our review are summarized in Table 4 and discussed in detail below.

**Table 4. Review of Accounts Payable Transactions**

| Reason | Number | Dollar Value (million) |
|---|---|---|
| Valid | 38 | $ 75.23 |
| Overstated | 19 | 8.76 |
| Unliquidated | 12 | 0.02 |
| Overage/Negative | 24 | 3.84 |
| Undetermined | 22 | 26.77 |
| **Total** | **115** | **$114.62** |

# Overstated Accounts Payable

**Stock Fund Disbursements.** Accounts payable balances reported on the Statement of Financial Position were overstated because they included transactions that were already disbursed but not posted to the general ledger. DFAS-Columbus Center did not establish sufficient internal controls to ensure that all disbursement transactions were recorded in the subsidiary accounts payable general ledger for stock fund transactions. All disbursement vouchers are sent to the Disbursing and Collecting Division from the automated payment processing systems, principally the Mechanization of Contract Administration Services system. Those automated payment files are matched against the accounts payable sections of the financial management systems, including the Standard Automated Materiel Management System (all commodities except fuel and subsistence), the Defense Fuel Automated Management System, and the DLA Integrated Subsistence Management System.

By updating the financial management system, the disbursement is recorded in the clearing account (undistributed disbursements). When the disbursement is matched to an outstanding accounts payable subsidiary record, the amount in the clearing account is transferred to the appropriate accounts payable account. When the disbursement is not matched to an outstanding accounts payable subsidiary record, the amount remains in the clearing account until further research can be performed.

**Management Oversight of Disbursements.** The process that the DFAS-Columbus Center used to match a disbursement transaction to its appropriate stock fund accounts payable transaction was not always successful and some disbursement transactions were lost. DFAS-Columbus Center personnel attributed that condition to a lack of internal controls over the matching process and the consolidation of the accounting functions from the supply centers to the DFAS-Columbus Center. DFAS-Columbus Center personnel could not determine how many disbursement transactions were lost and not properly processed.

**Corrective Actions Taken.** During FY 1994, DFAS-Columbus Center management took action to prevent the loss of disbursement transactions during the matching process. Because unmatched transactions are rarely reviewed, they usually become overage accounts payable transactions. DFAS-Columbus Center personnel instituted internal control procedures that were in existence at the supply centers before that function was transferred to the DFAS-Columbus Center. DFAS-Columbus Center has monitored the matching process to ensure that all transactions were either matched to valid accounts payable transactions, were posted to the clearing account, or were accounted for as rejected transactions. While DFAS-Columbus Center personnel believe the problem was corrected, we did not verify those claims.

The DFAS-Columbus Center personnel have begun reviewing and validating overage stock fund accounts payable transactions when time permits. Overage operations and maintenance accounts payable transactions were not being reviewed. Until unrecorded disbursements are posted, the accounts payable records will include transactions that have been paid. As a result, the accounts payable balance will be overstated by the amount of overage accounts payable transactions.

For example, for 8 of the 115 cases we tested, valued at $4.33 million, the accounts payable balance was overstated because the stock fund disbursement was made before the end of the fiscal year. However, the disbursement was not posted to the financial management systems, resulting in the open accounts payable. We identified those transactions to DFAS-Columbus Center personnel so that they could update the financial management systems.

**Operations and Maintenance Disbursements.** Accounts payable balances were overstated by transactions that were already disbursed. The operations and maintenance accounts payable general ledger balance included transactions that were finalized before September 30, 1994.

For example, 9 of the 115 cases tested, valued at $4.15 million, were for military personnel costs that were overstated. When initially questioned, DLA Headquarters and supply center personnel and DFAS-Columbus Center personnel did not know whether those payable amounts were valid and they could provide no supporting documentation to validate that payable amount.

As a result of our inquiry, DFAS-Columbus Center personnel made a thorough review of military personnel cost transactions and concluded that all of those transactions were already reimbursed and no longer due. We identified a total of $4.3 million in the operations and maintenance accounts payable account for the reimbursement of military personnel costs for FY 1992 and FY 1993. They determined that when the reimbursement was initially processed, the appropriate accounts payable transactions could not be found. Consequently, new accounts payable transactions were created so the reimbursement could be processed. The military personnel accounts payable transactions that remained in the subsidiary records were the original accounts payable transactions that were duplicated.

The remaining 2 cases of the 115 tested, valued at $0.28 million, were overstated because DFAS-Columbus Center personnel made administrative processing errors. One transaction was actually an accounts receivable transaction and the other transaction was deobligated by a contract modification that was never posted to the accounts payable general ledger account.

## Unliquidated Obligations

**Unliquidated Obligations.** The accounts payable general ledger account balance included unliquidated obligation amounts that were no longer due to vendors. Unliquidated obligations represent the difference between the amount of funds that were authorized for disbursement for a particular commercial service and the actual expense for that service.

**Operations and Maintenance Expenses.** The DLA Supply Management and DFAS-Columbus Center established accounts payable amounts for operations and maintenance expenses before receipt of the goods or services that were contracted for. When the contract action was initiated, an expense and a payable for the full obligation amount were recorded. Payments were made for the quantity of the goods or services that were provided; however, the remaining obligated amount (the difference between the expected cost and the actual cost) was never deobligated. Deobligating that amount would remove the erroneous accounts payable and reduce the previously recorded expense by that amount. The major categories, travel costs and other services, that comprise the accounts payable general ledger balances are discussed below.

**Personnel Travel Costs.** Travel vouchers accounted for the largest number of operations and maintenance accounts payable transactions that remained open as of September 30, 1994, because of unliquidated obligation amounts -- almost 80 percent (26,762 of 33,807 transactions). However, those transactions accounted for only about 5 percent of the operations and maintenance accounts payable balance. When processing the final travel voucher, the voucher examiner is required to code the payment as a final payment. Coding the transaction as a final payment will deobligate all remaining funds and remove the unliquidated obligation amount from the accounts payable general ledger. For all travel claims with unliquidated obligation balances, DFAS-Columbus Center personnel either did not know that they had to enter the code or they knew and failed to do so.

For example, 9 of the 115 cases we tested, valued at $19,313, were related to travel vouchers. None of the unliquidated obligation amounts were valid and the accounts payable should have been deobligated.

**Other Services.** Other services include computer services, equipment maintenance, intragovernmental services, and supplies. Other services accounted for the largest dollar value of operations and maintenance accounts payable transactions that remained open as of September 30, 1994, because of unliquidated obligation amounts -- 76 percent ($152 million of $199 million). Almost $26 million of that amount was more than 1 year old.

For example, 3 of the 115 cases we tested, valued at $4,435, were related to base operating supply contracts. None of the unliquidated obligation amounts were valid. Most services contracts we reviewed were either complete or, based on our discussions with DFAS-Columbus Center personnel, will not be completed. However, no one at DFAS-Columbus Center had deobligated the remaining funds and reduced the corresponding accounts payable amount for either category of other services. We provided the results of our review to DFAS-Columbus Center personnel for corrective action.

**Corrective Actions Taken.** Unliquidated obligations for accounts payable transactions were not deobligated because of various processing errors and because personnel were not properly trained. During FY 1994, DFAS-Columbus Center management took action to instruct its personnel to code the payment as a final payment.

## Overage and Negative Accounts Payable

The DFAS-Columbus Center personnel did not research, validate, or follow up on overage and negative accounts payable transactions. DFAS-Columbus Center provided us copies of the accounts payable subsidiary records for most DLA Supply Management organizations as of September 30, 1994. However, it did not provide us the clothing and textile, industrial, medical, subsistence, and selected support activity records. A total of 73,498 accounts payable transactions, totaling $1,088 million were included in the transactions that DFAS-Columbus Center provided. That amount consisted of a large number of overage and negative transactions.

Of the 73,498 transactions, 27,439 (37 percent) were more than 1 year old -- 22,876 with positive balances totaling $407 million and 4,563 with negative balances totaling $28 million. Additionally, 6,397 transactions with negative balances totaling $59 million were less than 1 year old.

A negative balance can occur in one of the following three ways.

o Disbursements are made by DFAS before the materiel or service is received and recorded in the financial management system.

o Disbursements exceed the authorized amount.

o Disbursements are processed without matching the proper funding document.

**Corrective Actions Taken.** The DFAS-Columbus Center personnel were conducting limited validation of payment vouchers to ensure that the disbursement was valid and supported by a valid payable. However, DFAS-Columbus Center personnel did not periodically review, validate, and correct the overage and negative accounts payable transactions. Until DFAS-Columbus Center begins to routinely review and correct overage and negative transactions, the reported accounts payable balances will be questionable.

For example, for 24 of the 115 case we tested, valued at $3.84 million, no receipt or payment activity were available for those contracts. Those 24 cases included overage, negative, and overage negative balance transactions. Meanwhile contracts were closed and retired for those same cases because all receipts were processed. Additionally, we could not review 22 of the 115 cases tested, valued at $26.77 million, because no documentation was available to support the validity of the accounts payable transactions. Neither DLA Supply Management nor DFAS-Columbus Center personnel personnel could locate supporting documentation.

**Disclosures.** The overview to the financial statements reported that not only were DLA Supply Management and DFAS-Columbus Center aware that the payable balances include numerous overage and negative transactions but that those transactions were under investigation. However, DLA did not estimate the total number or dollar value of those overage and negative transactions. We presented our estimates for the tested commodities above. Additionally, DFAS identified unmatched disbursement transactions in its Annual Statement of Assurance and stated that adequate research and reconciliations were not performed to clear those outstanding transactions. That condition existed for the stock fund and operations and maintenance accounts payable transactions we reviewed.

## Summary

The conditions identified in our discussion of accounts payable transactions were addressed in prior audits of the DLA financial statements. Additionally, those conditions were addressed in the overview and notes to the financial statements and in the DoD, DLA, and DFAS Annual Statements of Assurance. As reported, DLA and DFAS-Columbus Center have indicated that some corrective actions were implemented during FY 1994 and additional corrective actions are ongoing or planned. Accordingly, we are not making additional recommendations for corrective action in this report.

# Finding C. Followup on Prior Audit Issues

The DLA Supply Management and DFAS-Columbus Center made significant improvements in the valuation, reporting, and disclosure for the inventory; property, plant, and equipment; and fund balances with the Treasury accounts. However, further improvements are needed in the internal control structure over transaction processing and followup procedures for those accounts. The condition existed because:

o physical inventory procedures and related reconciliations were not properly performed,

o subsidiary records and documentation did not provide adequate support for other than stock on hand inventory accounts,

o property, plant, and equipment general ledger and subsidiary records did not include all reportable assets, and

o fund balances with Treasury were not validated and reconciled to appropriate subsidiary records.

As a result, the internal controls for transactions relating to those asset accounts was compromised; and the balances reported in the financial statements were not fully representative of the transactions that make up the reported account balances.

## Physical Inventory Procedures and Related Reconciliations

**Background.** The DoD Manual 7220.9-M provides that any item purchased by a DoD Component shall be brought under financial accounting control and recorded in the applicable inventory general ledger until issued. DLA uses a perpetual inventory system and manages DLA Supply Management inventory on an item-by-item basis, each item having a unique national stock number. The inventory system maintains a continuous record of inventory, increasing the balance when stock is received and decreasing the balance when stock is issued. DLA Supply Management uses seven general ledger accounts to maintain financial control over inventory. One account is for stock on hand and six accounts are for other than stock on hand.

**Forward Physical Inventory Observations.** We selected a statistical sample of 240 items (forward physical inventory observations) for our evaluation of the physical inventory and related reconciliation process. However, due to high internal variability, the sample results proved insufficient for projection purposes. We limited our presentation to descriptions of the actual sample findings. Our statistical sampling plan is described in Appendix A.

Forward physical inventories verify that on-hand inventory balances agree with the inventory balance on DLA Supply Management's accountable record. The physical count and reconciliation process at storage depots for 240 items, valued at $2.9 million, showed a net loss of $60,313. Of the 240 items, 45 items showed gains of $137,074, 46 items showed losses of $197,387, and 149 items showed no quantity difference. Appendix D contains a summary of the forward physical inventory results.

We evaluated the physical inventory process at five storage depots operated by DLA, including the actual count process, the adjustment of the count quantity for in-float transactions, and the reconciliation of the adjusted count to the supply center's accountable record quantity. In-float transactions are receipts for materiel received at the storage depot that were not yet posted to the supply center records, and issues that were posted to supply center records but not yet shipped by the depot at the time of the physical inventory count. Physical inventory results, whether quantity adjustments existed, should be posted to the financial and distribution records to validate that the physical inventory count was completed, to record the results of the observed count balances, and to minimize recounting the same items.

**Forward Physical Inventory Reconciliations.** Physical inventory procedures and related reconciliations were not properly performed. Physical inventory count quantities were not always reported to supply centers; were reported with different quantities than the observed counts and reconciliations; and were canceled and not reported and posted to the accountable records.

Physical inventory results were not posted or were posted in error to the financial and distribution subsystems because the reconciliation process and depot inventory systems were not functioning properly. Of the 240 physical inventory counts, 140 were posted to the accountable records (10 with differences other than observed), 96 were not sent to supply centers, and 4 were canceled and not reported but were completed by depot personnel before the cancellation notice.

o For the 96 items that were not sent to supply centers, we attributed the condition for 95 items to errors in two non-DLA computer systems located at the Oklahoma City Distribution Depot and the Norfolk Distribution Depot. We could not determine why the remaining item, located at the Columbus Distribution Depot, was not reported to the supply center.

- Oklahoma City Distribution Depot. The Oklahoma City distribution depot did not report the physical inventory results for 30 items. Distribution depot personnel could not explain why the physical inventory results were not reflected on the supply center records. The physical inventory results were posted to the depot accountable record (a non-DLA computer system) but were never reported to the supply centers. As a result, the supply center balance for those items did not reflect the actual on-hand balance. Of the 30 items, 8 items showed gains totaling $2,555, and 3 items showed losses totaling $1,567. The remaining 19 items had no quantity adjustment.

- Norfolk Distribution Depot. The Norfolk distribution depot did not report the physical inventory results for 65 of the 90 items inventoried to the supply centers. The 65 items included 3 items with gains totaling $45,663, 9 items with losses totaling $59,726, and 53 items with no quantity adjustment. Recent modifications to the Norfolk computer system did not include procedures to report physical inventory results with no quantity adjustment; however, all inventory adjustments with quantity differences should have been reported. The modifications also included procedures that reported only the adjustment quantity, not the actual quantity on hand.

We identified the computer system errors to distribution depot personnel who informed us that corrective actions were being taken to report all physical inventory adjustment quantities. The corrective action will not include the actual quantity on hand. DLA distribution personnel did not know when the corrective actions would be completed. Those corrective actions should result in the reporting of all physical inventory adjustments; however, they will not always result in accurate reporting of physical inventory results.

o For the 10 items that were posted with differences other than observed, the difference of the count and reconciliation was a net gain of $8,983 -- $34,076 in gains and $25,093 in losses. The difference posted to the supply records was a net gain of $9,563 -- $32,860 in gains and $23,297 in losses. We attributed the differences to incompatible computer systems, manual input errors, and errors made during the reconciliation process.

For example, the inventory balance for one item we reviewed was 123 items on the Norfolk distribution depot records and 115 items on the supply center records. The actual quantity on hand was 84 items. Because the record balances were different, the losses were different -- 39 items based on distribution depot records or 31 items based on supply center records. The supply center records were decreased by 39 items, reducing the on-hand balance to 76 items instead of the actual on-hand balance of 84 items.

o For the four requests for physical inventory that were canceled and not reported to the supply center, we counted the items and performed the reconciliation using available records. Physical inventories can be canceled for many valid reasons. Because there was no in-float or retail stocks for those items we were able to reconcile the quantity on hand to the accountable record quantity balance. Consequently, we included the results of our count and reconciliation in our summary.

**Reverse Physical Inventory Observations.** In addition to the forward physical inventory observations, we selected a judgmental sample of 227 items (reverse physical inventory observations) from storage locations to determine whether the item was included on the accountable records of the distribution depots and the supply centers. Of the 227 items reviewed, 22 were not recorded on both the distribution depot and supply center records. The discrepancies were reported to DLA distribution depots and supply management personnel for corrective action.

**Corrective Actions Planned.** The DLA personnel stated that distribution depot and supply center records will be matched on a quarterly basis to determine whether the records are in balance. The matching process is designed to determine whether an item on one accountable record is also on the other accountable record. The matching process is also designed to identify differences in quantities between the distribution depot and supply center records. Differences between the records will be reviewed and the supply center records will be updated with the balances recorded on the distribution depot records. That quarterly matching process is scheduled for implementation during the last half of FY 1995.

# Inventory, Other Than Stock On Hand Accounts

**Subsidiary Records.** Stock fund subsidiary records and documentation did not provide adequate support for other than stock on hand inventory accounts. The Statement of Financial position for DLA Supply Management reported a total of $399.4 million in FY 1994 for other than stock on hand inventory. Other than stock on hand inventories are not identified directly on the financial statement but are included as part of the net inventory balance (Statement of Financial Position, Line 1.d.). Table 5 details the account title for the individual subsidiary inventory accounts and the related account balances.

**Table 5. Inventory Other Than Stock On Hand Account Balances**
(million)

| Account Title | Value |
|---|---|
| With contractors/test agencies | $76.2 |
| In process of assembly/disassembly | 71.3 |
| Temporarily in use | 0.5 |
| Intransit between storage locations | 131.9 |
| Intransit from procurement | 116.6 |
| Intransit from customers | 2.9 |
| **Total** | **$399.4** |

The dollar value of subsidiary records for inventory, other than stock on hand, did not reconcile to the general ledger account balances or to the amounts reported on the financial statement. Additionally, those accounts included numerous overage and negative amounts. We identified those conditions in each of the DLA Supply Management financial statement audits conducted during the last 3 years. The notes to the FY 1994 financial statements disclosed that those weaknesses still exist and that those transactions are under investigation for system and processing deficiencies. The notes reported about $98 million of inventory transactions over 180 days and about $56 million with negative balances. The reported amounts did not include all commodities. We did not separately validate those reported amounts.

The annual statements of assurance issued by DLA and DFAS reported the material weaknesses and further indicated that corrective action was underway. However, the process to review and validate all the transactions will take time and is not expected to be completed until FY 1996.

## Property, Plant, and Equipment

Property, plant, and equipment general ledger and subsidiary records did not include all reportable assets. The Statement of Financial Position for DLA Supply Management reported a total of $177 million in FY 1994 for property, plant, and equipment. Because capital assets were not always reflected on the accounting records, DLA Supply Management believes that the reported balance are understated by a material amount. DLA Supply Management is taking actions to reflect all capital assets on the financial statement.

The DLA initiated corrective action during FY 1994 in response to IG, DoD, Report No. 94-149, "Property, Plant, and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994. The value of reportable property, plant, and equipment for DLA Supply Management increased from $140 million to $177 million to more accurately reflect the value of that account. Full implementation and accurate reporting of DLA Supply Management property, plant, and equipment and the related depreciation is not anticipated until the end of FY 1995.

## Fund Balances With Treasury

Fund balances with Treasury, consisting of collection and disbursement transactions, were not validated and reconciled to appropriate subsidiary records. As discussed in Findings A and B of this report, the account balance differences were attributed to the untimely reconciliation of collection and disbursement information from the financial network and the statement of transactions. As a result of the transfer of accounting and management responsibilities to the DFAS-Columbus Center, DLA has had limited capability to reconcile those differences.

The DLA did not correct the weaknesses to the fund balances with the Treasury accounts that were identified in IG, DoD, Report No. 94-159, "Fund Balances with the Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund," June 30, 1994. In the Annual Statement of Assurance, DLA reported that there were material weaknesses in the fund balances with the Treasury account.

The notes to the financial statements further disclosed those weaknesses. In accordance with guidance issued by the Comptroller, DoD, DLA only reported cash collections and disbursements information that was provided by the financial network. Those amounts were not reconciled to the DLA statements of transactions on a timely basis and the amounts reported contained differences from the amounts recorded in the general ledger. Those differences are being included as "undistributed" amounts in the accounts receivable and accounts payable balances reported on the financial statements.

## Summary

The conditions identified in our discussion of inventory; property, plant, and equipment; and fund balances with the Treasury were addressed in prior audits of the DLA financial statements. Additionally, those conditions were addressed in the overview and notes to the financial statements and in the DoD, DLA, and DFAS Annual Statements of Assurance. As reported, DLA and DFAS-Columbus Center have indicated that some corrective actions were implemented during FY 1994 and additional corrective actions are on-going or planned. We have not tested or verified those claims. However, since the actions are in process, we are not making additional recommendations for corrective action in this report.

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

## Introduction

We evaluated material accounts on the Statement of Financial Position for DLA Supply Management Business Area for material instances of noncompliance with laws and regulations for the year ended September 30, 1994. The statement on which we based our evaluation was dated January 11, 1995. Such tests are required by the Chief Financial Officers Act of 1990. The list of laws and regulations we reviewed is in Appendix C. 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 of a sensitive nature that would cause them to be perceived as significant.

Compliance with laws and regulations is the responsibility of DLA Supply Management managers. As part of obtaining reasonable assurance on whether the Statement of Financial Position is free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statement and other laws and regulations designated by OMB and DoD.

## Results of Audit

The results of our tests indicate that with respect to the items tested, except for noncompliance described in Part II.A. of this report, "Review of Internal Controls," management complied in all material respects with the laws and regulations referred to in Appendix C. We considered the instances of material noncompliance in forming our disclaimer of opinion on the selected financial data included in DLA Supply Management's financial statements. With respect to items not tested, nothing was disclosed that caused us to believe that management had not complied, in all material respects, with the laws and regulations referenced above.

# Part III - Additional Information

# Appendix A. Scope and Methodology

We examined the Statement of Financial Position, as of September 30, 1994, and associated notes to the Principal Statements of the DLA Supply Management Business Area of the Defense Business Operations Fund. The Principal Statements include the Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. Also included are the footnotes, overview, and supplemental information. The statements provided financial information as of September 30, 1994, but were dated January 11, 1995.

## Scope

The audit evaluated the reasonableness of DLA Supply Management general ledger account balances and adjustments made to those account balances for presentation on the Statement of Financial Position. We limited our assessment to selected asset and liability accounts and reviewed procurement and supply records, receipt and issue data, inventory adjustments and reports, and financial transactions and summaries occurring principally during FY 1994. Those accounts include the accounts receivable and accounts payable accounts and the related collection and disbursement accounts. Additionally we followed up on the inventory; property, plant, and equipment; and fund balances with the Treasury accounts that were reported on in prior year reports.

**Universe.** The DLA Supply Management and DFAS-Columbus Center use general ledger accounts to maintain the financial balances for the assets, liabilities, and equity accounts. General ledger account balances are the initial source of financial data used in developing the FY 1994 financial statements. Balances that are maintained in non-financial records are added to the general ledger account balances and, in the case of inventory, revalued to reflect appropriate cost or market value.

According to the Statement of Financial Position, as of September 30, 1994, for DLA Supply Management, major assets and liabilities included the following reported lines.

| | |
|---|---|
| o Accounts receivable (net of collections) | $ 871 million |
| o Accounts payable (net of disbursements) | $ 914 million |
| o Inventory (all reported categories) | $10,299 million |
| o Property, plant and equipment (net of depreciation) | $ 177 million |
| o Fund balance with Treasury | $ 572 million |

**Samples.** For accounts receivable and accounts payable, we judgmentally selected transactions that were over 180 days old, and transactions with large dollar values to determine whether the transactions were valid as of September 30, 1994.

For inventory stock on hand we selected a statistical sample of items to determine whether the quantity on hand was substantially different from the quantity on the accountable records, and whether the year end valuation method was representative of the latest acquisition cost or other appropriate cost method. Our tests were limited to DLA Supply Management inventories (excluding subsistence and fuel) stored in the continental United States.

We did not select transactions for other than stock on hand inventory accounts; property, plant, and equipment; and fund balances with the Treasury accounts. We followed up on the conditions that were reported in prior audit reports to determine whether management implemented the corrective actions agreed to in those reports.

## Methodology

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 financial statement presentation.

In planning and performing our audit of DLA Supply Management for the year ended September 30, 1994, we evaluated the internal control structure of the DLA Supply Management and DFAS-Columbus Center, including implementation of the DoD Internal Management Control program. The purposes of this evaluation were to determine:

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

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

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

**Computer-Processed Information.** We analyzed the data available from computer reports, records, and statistics that were used by DLA to manage contracting, financial, and supply records. Except for our tests of physical inventory observations and selected tests of the other asset and liability accounts reviewed, we did not independently determine the reliability of the computer-processed data.

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

## Sampling Plans

**Accounts Receivable.** We judgmentally selected overage and large dollar value items from the stock fund and operations and maintenance accounts receivable transactions that were included in the subsidiary general ledger as of September 30, 1994. The universe of transactions did not include all subsidiary general ledger transactions. The universe of items reviewed did not include the stock fund subsistence commodity and the operations and maintenance clothing and textile, construction, industrial, medical, and subsistence commodities. Additionally, no detailed transactions were provided for the base operating supply system used by all DLA Supply Management activities.

The DFAS-Columbus Center personnel provided us automated files for the accounts receivable commodities included in our universe. Additionally, we reviewed a limited sample of operations and maintenance items that we selected from computer-generated listings. The results of our tests are included in Finding A.

**Accounts Payable.** We judgmentally selected overage and large dollar value items from the stock fund and operations and maintenance accounts payable transactions that were included in the subsidiary general ledger as of September 30, 1994. The universe of transactions did not include all subsidiary general ledger transactions. The universe of items reviewed did not include the stock fund subsistence commodity and the operations and maintenance clothing and textile, industrial, medical, and subsistence commodities. Additionally, no detailed transactions were provided for the base operating supply system used by all DLA Supply Management activities.

The DFAS-Columbus Center personnel provided us automated files for the accounts payable commodities included in our universe. The results of our tests are included in Finding B.

**Physical Inventories.** We used statistical sampling for inventory stock on hand to provide quantitative evidence to support an audit determination that the value of inventory reported on the financial statements was presented fairly in accordance with generally accepted accounting principles. Our tests were limited to inventory stock on hand, excluding subsistence and fuel inventory, under the control and management of DLA that was stored at DLA distribution depots and other storage facilities. However, due to high internal variability, the sample results proved insufficient for projection purposes so we limited our presentation to descriptions of the actual sample findings.

The total universe included all DLA managed items in inventory stock on hand, excluding subsistence and fuel inventory, as of June 30, 1994, with a total dollar value of $9.7 billion, valued at latest acquisition cost. The inventory was located at 90 storage facilities. We subsequently eliminated 61 storage facilities because the amount of inventory stock on hand accounted for less than 1 percent of the total DLA inventory. The total dollar value of inventory for the remaining 29 storage facilities, our sample universe, was $9.6 billion. The sample universe was used in selecting the audit site and audit sample.

**Audit Site Selection.** For the selection of audit sites we employed random sampling with replacement and selected eight sample sites. The eight sample sites consisted of five storage facilities -- two storage facilities were selected more than once.

**Audit Sample Selection.** We stratified the total dollar value of inventory for the five storage facilities by the dollar value for each sample item. A sample item was defined as a national stock number stored at a depot. Low dollar value items (less than $100) were excluded from the sampling process. The remaining items were stratified into two strata -- under $10,000, and $10,000 and over. We selected a random sample of 30 sample items for each of the 8 sample sites, 15 from each strata. For audit sites that were selected more than once, separate samples of 30 each were selected for each instance.

# Appendix B. Summary of Prior Audits

During the last 4 years, 11 audit reports relating to the Chief Financial Officers Act reviews were issued on various elements of the DLA Defense Business Operations Fund. The reported conditions, recommendations, and management comments are summarized below.

o IG, DoD, Report No. 94-167, "Selected Financial Accounts on the Defense Logistics Agency Defense Business Operations Fund Financial Statements for FY 1993," June 30, 1994, identified that the $1 billion Fund Balance with Treasury account, $16.5 billion in Inventory accounts, and $196.3 million in Property, Plant, and Equipment account were not presented in accordance with generally accepted accounting principles for Federal entities. Internal controls were not in compliance with standards established by OMB.

Those weaknesses resulted in inadequate audit trails, incomplete support documentation, and mismatch of accounting transactions to the proper accounting period. In addition, controls were not effective to ensure that physical inventory counts were accurate and posted to the accountable records; that general ledger account balances were reconciled with related subsidiary records periodically; and that property, plant, and equipment and associated depreciation accounts were complete and fully supported. No recommendations were made; however, we reported that the information presented on the financial statements, particularly the inventory balances, were materially misstated. Management nonconcurred with the adverse opinion on the selected financial accounts reviewed.

o IG, DoD, Report No. 94-164, "Financial Statements of the Defense Reutilization and Marketing Service for FY 1993," June 30, 1994, stated that the FY 1993 financial statements for the Defense Reutilization and Marketing Service were not prepared in accordance with generally accepted accounting principles, and key asset, revenue, and expense accounts were not adequately supported or compiled in the financial records. As a result, the financial statements cannot be relied upon for assessing the financial position, results of operations, or performance. The report contained several recommended improvements to make the financial statements more accurate. DLA responded to all recommendations, partially concurring with developing a fee structure for services. DLA also agreed to make accounting changes, restate value of inventory, report the cost of goods sold at net realizable value, and make necessary changes in the Internal Management Control Program.

o IG, DoD, Report No. 94-159, "Fund Balances with the Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund," June 30, 1994, concluded that Treasury accounts on the FY 1993 financial statements for the DLA business areas were not prepared in accordance with generally accepted accounting principles for Federal agencies. Statements of financial position, cash flow, and related footnotes were misleading and could not be relied upon by users of the financial statements. Controls were not in place to ensure that the amounts recorded as fund balances with the Treasury were reported in accordance with generally accepted accounting principles.

Recommendations were made to rescind guidance related to fund balances because they were not in accordance with generally accepted accounting principles, that procedures and controls be issued to establish adequate audit trails, that sublimits be established for business areas, and that discrepancies be disclosed in the statement of cash flow and footnotes. DLA concurred with the recommendation to establish appropriate sublimits for business areas, and partially concurred with the recommendation to disclosed discrepancies in the statement of cash flows and footnotes.

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

o IG, DoD, Report No. 94-150, "Inventory Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994, reported that general ledger accounts, non-financial records, and year end accounting adjustments did not reflect the correct value of inventory reported in the financial statements. Internal controls were not adequate to ensure that the results of physical inventory counts were accurate and posted to the accountable records, and that general ledger account balances were reconciled with related subsidiary records to periodically verify the accuracy of subsidiary records with related support documents.

The report recommended that procedures and controls be established to ensure that general ledger accounts, nonfinancial records, and yearend accounting adjustments reflect the correct value; that inventory procedures and related reconciliations be properly performed; that subsidiary records and documentation provide adequate support for inventory accounts; and that a method be developed to value reutilization and disposal inventory held by supply centers that accurately reflects the best estimate of net realizable value. Management concurred with the recommendations to establish procedures and controls to ensure that account balances reflect the correct value and that account balances and adjustments have adequate documentation to support the reported balances. However, DLA stated that the account balances on the FY 1994 financial statements would not be changed to reflect the audit findings.

o IG, DoD, Report No. 94-149, "Property, Plant, and Equipment Accounts of the Financial Statements of the Defense Logistics Agency Business Areas of the Defense Business Operations Fund for FY 1993," June 28, 1994, reported that property, plant, and equipment account acquisition costs were materially understated by at least $229.4 million. In addition, at least $24.5 million in equipment assets were inaccurately reflected in the financial records. Also depreciation of software programs did not properly match period expense with revenues and overstated the cost of the DLA Defense Business Operations Fund operations. Internal controls were not effective to provide reasonable assurance that material misstatements in the property, plant, and equipment and associated depreciation accounts would be prevented or detected in a timely manner.

Management concurred with the recommendation to identify and report real property on its financial statements and the need to periodically reconcile property, plant, and equipment financial data with property records. However, management did not agree to revise the financial statements until the following fiscal year because the statement were already certified and published. The Deputy Comptroller, DoD, agreed in principle to revise the capital asset guidance for depreciation of software programs.

o IG, DoD, Report No. 94-128, "Management Data Used to Manage the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund," June 14, 1994, stated that the unit cost reports provided to the Division's managers and the Comptroller, DoD, were inaccurate and untimely. Also, inaccurate data were not corrected in the reports and the automated system used to generate the reports. Internal controls were not effective to ensure the accuracy of the unit cost management data.

Recommendations were made to establish internal controls to verify that unit cost reports are accurate and timely; and that procedures be developed to assign responsibilities to accumulate, evaluate, and report unit cost data. Management generally concurred with the recommendations. In response to management's comments the recommendation was revised to have procedures established to require that the DLA accounting and budget divisions coordinate the development of unit cost goals.

o IG, DoD, Report No. 94-082, "Financial Management of the Defense Business Operations Fund - FY 1992," April 11, 1994, stated that the Defense Business Operations Fund had significant internal weaknesses relating to cash management and accounting systems. Internal controls were not in place to ensure that cash transactions were correctly recorded and accounted for, that intrafund transactions were properly identified or eliminated, and that the Defense Business Operations Fund was not operating in compliance with all existing laws and regulations. Recommendations were made that management establish internal reconciliation procedures for collections and disbursements, procedures to separate Defense Business Operations Fund suspense accounts, to better support accounting adjustments, improved audit trails, revised capital asset guidance, and comply with the applicable laws and regulations. Management generally concurred with the recommendations.

o IG, DoD, Report No. 94-035, "Financial Procedures for Defense Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund," February 8, 1994, stated that the distribution depot asset and liability accounts contained material inaccuracies, and that needed improvements identified by prior audits were not implemented. No recommendations were made because of the outstanding corrective actions that were underway, but not implemented.

o IG, DoD, Report No. 93-164, "Financial Statements of the Defense Logistics Agency Supply Management Division of the Defense Business Operations Fund (Defense Fuel Supply Center Financial Data) for FY 1992," September 2, 1993, stated that the inventory financial data were generally accurate; however, data in the financial statements were not properly supported, and information in the notes, overview, and supplemental financial and management information portions of the financial statements were incomplete and inaccurate.

Recommendations were made to develop procedures to ensure that financial data are reconciled, supported and accurate; that the financial statements are revised to include all required notes and supplemental information; and that the financial statements are reliable and accurate. Management nonconcurred with some of the noninventory findings and recommendations and stated that adjustments and disclosures identified would not be made to the FY 1992 comparative data presented in the FY 1993 financial statements and related notes.

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

# Appendix C. Laws and Regulations Reviewed

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

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

Office of Management and Budget, "Statement of Federal Financial Accounting Concepts, Number 1, Objectives of Federal Financial Reporting" September 2, 1993

Office of Management and Budget, "Statement of Federal Financial Accounting Standards, Number 1, Accounting for Selected Assets and Liabilities," March 30, 1993

Office of Management and Budget, "Statement of Federal Financial Accounting Standards, Number 3, Accounting for Inventory and Related Property," October 27, 1993

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

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

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

Office of Management and Budget Circular No. A-127, "Financial Management Systems," December 19, 1984

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

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

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

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

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

Defense Logistics Agency Manual 7000.1, "Accounting and Finance Manual," August 1980

# Appendix D. Summary of Physical Inventory Observations

We selected a multistage stratified random sample of 240 items for physical inventory observations at 5 storage depots. During the DLA counting process, four inventory counts were canceled because of outstanding disposal and receipt transactions. However, we counted and reconciled the four items to the balance on the accountable records and included the results in our summary. Table D-1 shows the 240 items for which we were able to make a determination of the adjustment quantity. Table D-2 provides a summary of the 45 items with gains, Table D-3 is a summary of the 46 items with losses, and Table D-4 is a summary of the 149 items with no adjustment.

Three items that were inventoried had assets with multiple condition codes. For presentation on the tables below, we classified the sample item by the net difference for each item. The adjustments for two of the three items were only partly processed and are categorized as such in the tables. The adjustments for the remaining item were processed and the net difference was a gain.

**Table D-1. Total Items Reviewed**

| | Sample Items | Adjustment Dollar Value |
|---|---|---|
| Adjustment processed | 130 | ($46,485.52) |
| Processed with a difference | 8 | 17,713.77 |
| **Subtotal - transactions processed** | **138** | **(28,771.75)** |
| **Subtotal - partial adjustment processed** | **2** | **(8,730.18)** |
| Inventory canceled | 4 | (1,490.00) |
| Not received or processed | 96 | (21,321.03) |
| **Subtotal - transactions not processed** | **100** | **(22,811.03)** |
| **Total** | **240** | **($60,312.96)** |

### Table D-2. Items With Gains

| | Sample Items | Adjustment Dollar Value |
|---|---|---|
| Adjustment processed | 29 | $54,779.37 |
| Processed with a difference | 5 | 34,076.16 |
| **Subtotal - transactions processed** | **34** | **88,855.53** |
| **Subtotal - partial adjustment processed** | **0** | **0.00** |
| Inventory canceled | 0 | 0.00 |
| Not received or processed | 11 | 48,218.48 |
| **Subtotal - transactions not processed** | **11** | **48,218.48** |
| **Total** | **45** | **$137,074.01** |

### Table D-3. Items With Losses

| | Sample Items | Adjustment Dollar Value |
|---|---|---|
| Adjustment processed | 28 | ($101,264.89) |
| Precessed with a difference | 3 | (16,362.39) |
| **Subtotal - transactions processed** | **31** | **(117,627.28)** |
| **Subtotal - partial adjustment processed** | 1 | **(8,730.18)** |
| Inventory canceled | 1 | (1,490.00) |
| Not received or processed | 13 | (69,539.51) |
| **Subtotal - transactions not processed** | **14** | **(71,029.51)** |
| **Total** | **46** | **($197,386.97)** |

### Table D-4. Items With No Adjustments

| | Sample Items |
|---|---|
| Adjustment processed | 73 |
| Processed with a difference | 0 |
| **Subtotal - transactions processed** | **73** |
| **Subtotal - partial adjustment processed** | 1 |
| Inventory canceled | 3 |
| Not received or processed | 72 |
| **Subtotal - transactions not processed** | **75** |
| **Total** | **149** |

# Appendix E. Organizations Visited or Contacted

## Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Under Secretary of Defense (Comptroller), Washington, DC

## Defense Logistics Agency

Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Construction Supply Center, Columbus, OH
Defense Electronics Supply Center, Dayton, OH
Defense Fuels Supply Center, Alexandria, VA
Defense General Supply Center, Richmond, VA
Defense Industrial Supply Center, Philadelphia, PA
Defense Personnel Supply Center, Philadelphia, PA
Defense Distribution Region East, New Cumberland, PA
- Defense Distribution Depot Columbus, OH
- Defense Distribution Depot Richmond, VA
- Defense Distribution Depot Norfolk, VA

Defense Distribution Region West, Stockton, CA
- Defense Distribution Depot San Joaquin, CA
  - Sharpe Facility, Stockton, CA
  - Tracy Facility, Tracy, CA
- Defense Distribution Depot Oklahoma City, OK

## Defense Finance and Accounting Service

Defense Finance and Accounting Service, Columbus Center, OH
- Liaison Office, Dayton, OH
- Liaison Office, Philadelphia, PA
- Liaison Office, Richmond, VA

# Appendix F. Report Distribution

## Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Under Secretary of Defense (Comptroller/Management)
  Deputy Under Secratary of Defense (Comptroller/Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

## Department of the Army

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

## Department of the Navy

Assistant Secretary of the Navy (Financial Management)
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 Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service, Columbus Center
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Central Imagery Office

## Non-Defense Federal Organizations and Individuals

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

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

  Senate Committee on Appropriations
  Senate Subcommittee on Defense, Committee on Appropriations
  Senate Committee on Armed Services
  Senate Committee on Governmental Affairs
  House Committee on Appropriations
  House Subcommittee on National Security, Committee on Appropriations
  House Committee on Government Reform and Oversight
  House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
  House Committee on National Security

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