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

REPORT
NO. 90-091

June 29, 1990

MEMORANDUM FOR THE DIRECTOR, NATIONAL SECURITY AGENCY/CHIEF, CENTRAL SECURITY SERVICE
CHIEF, MENWITH HILL STATION

SUBJECT: Report on the Audit of the Morale, Welfare, and Recreation Fund, Menwith Hill Station, United Kingdom (Project No. 0FA-5001)

Introduction

This is our final report on the Audit of the Morale, Welfare, and Recreation Fund (the Fund), Menwith Hill Station (the Station), United Kingdom. The objectives of the audit were to determine whether the financial statements presented fairly the financial condition and results of operations of the Fund, and to determine whether internal control deficiencies identified in our prior reports had been corrected.

Scope of Audit

We reviewed the financial statements and operations of the Fund for the period October 1, 1988, to September 30, 1989. We made judgmental samples and other selective tests of financial records, accounting procedures, and internal controls to establish the reliability of data used by Menwith Hill Station for internal purposes and external reporting. We also examined the bylaws and minutes of both the Consolidated Open Mess (the Club) Council's meetings and the Morale, Welfare, and Recreation Council's meetings. We examined the bylaws and minutes to determine whether the rules and policies pertaining to the Fund were effectively implemented. A charter for the consolidated Fund had not been established. However, we reviewed the individual charters for the Club and the Central Base Fund. Items we tested were generally in compliance with applicable directives and regulations, and there was no indication that items we did not test were not in compliance. The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. This financial and compliance audit was made during September and November 1989, in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary.

Background

Prior to October 1, 1988, Menwith Hill Station operated two Nonappropriated Fund Instrumentalities, the Central Base Fund and the Consolidated Open Mess. On October 1, 1988, these funds were consolidated into the Morale, Welfare, and Recreation Fund (the Fund). No charter had been established to outline the Fund's purpose, membership provisions, and types of activities. However, we noted several programs designed to improve the quality of life for all Station personnel. Those programs included a library, child development center, visiting officers' quarters, bowling center, fast food service, teen center, arts and crafts center, athletic programs, travel service, and officers' club. The Fund is authorized by DoD Directive 1015.1, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities"; Air Force Regulation (AFR) 176-1, "Morale, Welfare, and Recreation, Basic Responsibilities, Policies and Practices"; AFR 215-11, "Morale, Welfare, and Recreation, Air Force Open Mess Program"; and NSA Headquarters Regulation 12-1, "The NSA/CSS Morale, Welfare and Recreation (MWR) Program."

Prior Audit Coverage

In 1983, the Inspector General, DoD, audited the two funds that preceded the Fund.

Audit Report No. 84-085, "Report on the Audit of Central Base Fund, Menwith Hill Station," was issued on May 14, 1984. This report stated that the Central Base Fund's financial statements presented fairly the financial condition and results of operations of the Central Base Fund as of June 30, 1983.

Audit Report No. 84-086, "Report on the Audit of Consolidated Open Mess, Menwith Hill Station," was issued on May 14, 1984. This report stated that the Club's financial statements presented fairly its financial condition as of June 30, 1983.

Both prior reports identified internal control deficiencies as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD directive 5010.38.

We found that corrective actions had been implemented for all except one recommendation in the prior reports. In our Audit Report No. 84-086, we recommended that aggressive action be taken to collect overdue accounts, and that penalties be assessed when members' accounts were overdue for longer than a period established by the directors. Our current audit showed that Fund managers continued to extend credit to members with overdue accounts. In addition, management did not assess penalties on overdue accounts.

Discussion

We believe that the Balance Sheet (except for the accumulated depreciation on fixed assets) in Enclosure 1, subject to the findings above and those cited below, presents fairly the financial condition of the Fund as of September 30, 1989. Because we were not present to observe the inventories taken as of October 1, 1988, and did not have alternative methods of confirming the inventory balances, we expressed no opinion on the Income Statement and the Statement of Cash Flows. These statements are also presented in Enclosure 1.

- Fund managers were not evaluated on their responsibilities for internal management controls. DoD Directive 5010.38, "Internal Management Control Program," requires all managers to be evaluated on their duties and responsibilities for internal management controls. These performance standards should be tailored to managers' individual responsibilities.

- A charter establishing the Menwith Hill Station Morale, Welfare, and Recreation Fund had not been executed in accordance with Air Force Regulation (AFR) 176-1. A charter is needed to establish the Fund's purposes, authority, and membership provisions.

- We found no evidence that Fund management was performing the unannounced cash counts required by Station and Air Force instructions. Station operating procedures required monthly unannounced cash counts. AFR 176-2, "Financial Operations and Control of Assets," required unannounced cash counts at least every 60 days.

- The audit revealed that Club members had received unauthorized credit of approximately $16,000 as of September 30, 1989. Club management allows the extension of credit to members whose accounts are 60 and 90 days past due. AFR 176-10, "Financial Operations and Accounting Procedures," paragraph 14-1.e., states, "Accounts are due and payable on the first day after the statement date of the month in which credit was extended." Paragraph 14-5.c. states, "Charges and bills are delinquent as of the next billing cutoff date." Management should assess a late payment charge and change billing cutoff dates to conform to the AFR 176-10. Undue credit extended to Club members reduces the Fund's ability to make investments and increases the potential for bad debts.

- Management presented no evidence to show that Fund investments were insured and protected in accordance with AFR

176-2. The Fund invested primarily with two financial institutions, Merchants National Bank and Tower Federal Credit Union. Merchants National Bank, the military banking facility on station, had issued a $300,000 certificate of deposit to the Fund. In addition, the Fund's checking account with Merchants National Bank had a balance of over $300,000. At the Tower Federal Credit Union, the Fund had three certificates of deposit for $100,000 each and a share draft account with a balance of almost $19,000. Each of these institutions insured deposits up to $100,000. Consequently, over $700,000 in Fund assets was at unnecessary risk. AFR 176-2 permits nonappropriated funds to place excess cash on deposit with the Air Force Central Investment Program (the Central Investment Program). We believe that the Central Investment Program would be an appropriate alternative investment for the Fund's excess cash. The Central Investment Program was established so that nonappropriated fund instrumentalities could have their assets managed professionally to earn higher interest rates. The Central Investment Program is invested in U.S. Government securities.

- Fund spoilage and breakage expense increased from $6,753 in FY 1988 to $11,261 in FY 1989. Management had not determined why the increase occurred and whether additional controls were needed.

- Fund management made improper accounting entries each month by debiting sinking fund expense and crediting sinking fund liability for replacement of fixed assets. This entry equaled the amount of depreciation expense for the month. This entry was improper because neither an expense nor a liability had been incurred. As a result, liabilities and expenses were overstated, and net income and fund equity were understated by $38,067.24. We have adjusted our financial statements accordingly.

- Our sample of disbursement vouchers disclosed that merchandise was received on 8 of 29 purchase orders (28 percent) before the order was executed. This indicated that the Fund was committing to purchases without proper authority. In five cases, the liability was not accrued in the correct month. The monthly financial statements, therefore, were inaccurate. Proper accruals were made for the month ended September 30, 1989.

- When local national employees were asked to work on short notice, a local taxi service provided transportation. Management told us that if this taxi service were not available, the Club would be unable to furnish needed services. The taxi service was on a retainer that cost about $1,980 a month. Fund management could not provide a copy of a contract for the service.

- On September 30, 1989, accounting entries were made to reduce accounts receivable by the amount of appropriated fund receivables and reduce accounts payable by the same amount. We have adjusted our financial statements by $15,381.83 to add this amount back to accounts receivable and accounts payable.

- Fund management was paying a slot machine repair person $400 a month. Fund management had not officially hired the repair person, and there was no contract to support the payment. The only document on file was a memorandum from the Acting Chief of the Fund that authorized the payment. Fund management kept time records for the repair person, but did not give these records to the accounting department. The repair person should have been hired officially or retained under a legally executed contract.

- The financial statements in the enclosure have been adjusted by $2,339.10 to cover unemployment and worker's compensation premiums for FY 1989. Fund management received bills for these premiums during our audit; therefore, the premiums were not included when the accounting records were closed.

- Fund management did not account for accrued interest receivable on a $300,000 certificate of deposit issued on May 13, 1989. We computed $10,235 in interest receivable as of September 30, 1989. In addition, the Fund's other certificates of deposit had accrued interest of $5,761 that was not reflected on the financial statements. We have adjusted the enclosed financial statements by a total of $15,996.

- Guest checks were not being accounted for when they were given to the central cash office. Cashiers' copies of the guest checks should be reconciled with the kitchen's copies for dining room sales. The Station's operating procedures and AFR 215-11 require this reconciliation to show whether all guests are paying for services provided and whether established controls are effective.

- For the Fund's fixed assets, management used depreciation methods that did not comply with generally accepted accounting principles and AFR 176-10. Fund management depreciated all fixed assets over an expected life of 6 years and 6 months. Depreciation should be based on the expected life of the individual assets or type of assets.

- Club cashiers were not using imprint machines for charge cards. The use of imprint machines facilitates the accurate billing of customer charges and is required by AFR 215-11.

Recommendations

We recommend that the Director, National Security Agency/ Chief, Central Security Service, direct the Menwith Hill Station Fund Custodian to:

1. Incorporate internal control responsibilities in the performance standards for all Fund managers, tailor these standards to each manager's responsibilities, and evaluate managers using these standards.

2. Document the Fund's charter following the provisions of AFR 176-1, paragraph 4-1.d.

3. Conduct unannounced cash counts, document all unannounced cash counts, and place the results in a permanent file.

4. Comply with the provisions of AFR 176-10 for extension of credit to club members; assess late payment charges and change billing cutoff dates as required by regulation.

5. Ensure that all Fund investments are properly safeguarded and explore the possibility of depositing excess funds in the Air Force Central Investment Program.

6. Determine the reasons for the increase in spoilage and breakage expense and modify internal controls as required.

7. Terminate the sinking fund account for the purpose of replacing fixed assets and discontinue entries that increase sinking fund expense and sinking fund payables.

8. Comply with procurement regulations that require management's approval on purchase orders; match receiving invoices with purchase orders to ensure that the Fund receives only authorized purchases.

9. Execute a contract with the local taxi service or terminate the service.

10. Discontinue entries that credit accounts receivable and debit accounts payable for appropriated fund reimbursement receivables.

11. Officially employ the slot machine repair person or execute a formal contract for the repair person's services.

12. On a monthly basis, accrue interest receivable on certificates of deposit and any other Fund investments.

13. Reconcile cashiers' copies of guest checks with the kitchen's copies for dining room sales.

14. Establish realistic estimates for the expected useful life of fixed assets; make these estimates effective October 1, 1989; recompute accumulated depreciation; and adjust the general ledger accordingly.

15. Use an imprint machine for charge sales.

Comments on Operations

The Fund showed a profit of $246,398 in its first year of consolidation. In addition, Fund equity is over $1 million. Management should evaluate the need for the $1 million of appropriated fund support provided to the Fund and attempt to reduce taxpayer support.

Discussion with Interested Officials

On November 21, 1989, we discussed the results of the audit with the Chief, Menwith Hill Station, and the Fund Custodian.

Weaknesses in Internal Controls

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Controls were not established or effective to adequately protect Fund assets and did not provide for accurate financial reporting. All recommendations in this report, if implemented, will correct the weaknesses. A copy of this report will be provided to the senior official responsible for internal controls for your Agency.

Management Comments

The NSA Comptroller nonconcurred with the one repeat finding cited in the draft report. The repeat finding asked that penalties be assessed when members' accounts were overdue for longer than a period established by the directors. Management stated that Menwith Hill had taken action to collect overdue accounts; ". . . however, they realize more aggressive steps must be taken and have decided to assess monetary penalties as needed." Management further stated, ". . . monetary penalties were not assessed since other (nonmonetary penalties) were believed sufficient at the time, and monetary penalties are not mandatory under AFR 176-10."

Management disagreed with our suggestion to evaluate the need for the $1 million of appropriated fund support and attempt to reduce taxpayer support.

Management concurred with the 15 recommendations in the report, and provided dates for the implementation of corrective actions.

Audit Response to Management Comments

In its response to a recommendation made in Report No. 84-086, "Report on the Audit of the Consolidated Open Mess, Menwith Hill Station," issued on May 14, 1984, management agreed to assess penalties for overdue accounts. During our audit, we determined that penalties were not assessed against Club members' with overdue accounts. We believe that Recommendation 4. is still warranted for reasons discussed on page 2 of the report. We request that the NSA Comptroller state the internal control measures that will be taken to ensure that members' overdue accounts are assessed penalties.

The NSA Comptroller also disagreed with our suggestion to evaluate the amount of appropriated fund support and attempt to reduce that support. We recognized Menwith Hill Station's needs and plans for capital expenditures. Our suggestion was made in view of increased Congressional emphasis on making all nonappropriated fund activities self-sustaining and eliminating appropriated support. No further management action is required. The full text of management comments is in Enclosure 2. We did not identify any monetary benefits in this report, as noted in Enclosure 3. However, the recommendations are intended to improve internal controls over Morale, Welfare, and Recreation Fund operations and to improve the accuracy of the Fund's financial statements.

Conclusion

We request the Director, National Security Agency/Chief, Central Security Service, provide final comments to Recommendation 4., relating to assessing penalties against Club members with overdue accounts. The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. David R. Stoker at (202) 694-1692 (AUTOVON 224-1692) or Mr. Frank W. Gulla, Jr., at (202) 693-0338 (AUTOVON 223-0338). A list of activities visited or contacted is in Enclosure 4. Copies of the final report are being provided to the activities listed in Enclosure 5. A list of audit team members is in Enclosure 6.

E. Jones

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc:
Comptroller of the Department of Defense,
Deputy Comptroller (Management Systems)
Assistant Secretary of Defense (Force Management and Personnel)
Assistant Secretary of the Air Force (Financial
Management and Comptroller)

MORALE, WELFARE, AND RECREATION FUND
MENWITH HILL STATION
BALANCE SHEET
AS OF SEPTEMBER 30, 1989

Assets

Current Assets		
Cash	$353,808	
Accounts Receivable	95,228 2/ 3/	
Inventories	124,024	
Investments	650,151	
Prepayments	289	
Total Current Assets		$1,223,500
Fixed Assets		
Property and Equipment	$339,011	
Less Accumulated Depreciation	211,866	127,145
Total Assets		$1,350,645

Liabilities and Fund Equity

Current Liabilities		
Accounts Payable	$117,304 3/	
Accrued Accounts	80,291 1/ 4/	
Accrued Wages	19,472	
Other Liabilities	3,733	
Total Current Liabilities		$ 220,800
Fund Equity		1,129,845 1/
Total Liabilities and Fund Equity		$1,350,645

MORALE, WELFARE, AND RECREATION FUND
MENWITH HILL STATION
INCOME STATEMENT
FOR THE PERIOD ENDED SEPTEMBER 30, 1989

Sales	$1,332,304	
Less Cost of Goods Sold	637,109	
Gross Income from Sales		$ 695,195
Income from Other Activities		
Amusement Machines	$312,649	
Bowling Center	47,442	
Dues	71,606	
Child Development Center	85,683	
Visitor Quarters	60,776	
Recreation and Teen Center	22,761	
Ticket Sales	22,386	
Athletic Programs	15,090	
Other Revenue	16,140	
Total Activity Revenue		654,533
Other Income		
Interest Income	$58,447 2/	
Travel Service	24,447	
Fund Allocations Received	37,742	
Other Income	20,398	
Total Other Income		141,034
Gross Income from Operations		$1,490,762
Operating Expenses		
Personnel Expense	$898,481 4/	
Entertainment	129,057	
Other Expenses	156,420 1/	
Depreciation Expense	38,067	
Total Operating Expenses		1,222,025
Net Operating Profit		268,737
Non-Operating Expenses		22,339
Net Profit		$ 246,398

MORALE, WELFARE, AND RECREATION FUND
MENWITH HILL STATION
STATEMENT OF CASH FLOWS
FOR THE PERIOD OCTOBER 1, 1988, TO SEPTEMBER 30, 1989

Net Cash Flow from Operating Activities		
Net Income	$246,398	
Add (or Deduct) Items to Convert Net Income to Cash Basis		
Depreciation Expense	38,067	
Increase in Accounts Receivable	(49,921)	
Increase in Inventories	(10,888)	
Increase in Accounts Payable	62,518	
Increase in Accrued Wages Payable	6,201	
Increase in Other Accrued Payables	16,521	
Decrease in Other Liabilities	(7,364)	
Loss on Disposal of Fixed Assets	1,232	
Decrease in Prepaid Expenses	662	
Net Cash Flow from Operating Activities		$303,426
Cash Flows from Investing Activities		
Purchase of Fixed Assets	$ 43,657	
Investment in Securities	222,391	
Net Cash Used by Investing Activities		(266,048)
Net Increase in Cash		$ 37,378

MORALE, WELFARE, AND RECREATION FUND
MENWITH HILL STATION
FOOTNOTES TO THE FINANCIAL STATEMENTS

1/ Fund management established a sinking fund to replace fixed assets. The transaction created a liability and an expense for an amount equal to the monthly depreciation. The net income and fund equity were understated by $38,067.24. We have adjusted the financial statements accordingly.

2/ Interest Receivable and Interest Income were adjusted by $15,996 to reflect accrued interest on the Fund's certificates of deposit as of September 30, 1989.

3/ Accounts Receivable and Accounts Payable have been adjusted to reflect the amount of appropriated funds to be reimbursed to the Fund. The total amount reimbursed was $15,381.83.

4/ Accrual Accounts and Personnel Expense have been adjusted by $2,339.10 to reflect a liability and an expense for unemployment and worker's compensation premiums. This bill was received during the audit; therefore, management did not include it when the accounting records were closed.

(During FY 1989, the Fund received $1.0 million in Appropriated Fund support, including $268,681 in reimbursements for appropriate manpower billets to support MWR operations. The balance of the expenses was paid with appropriated funds).