Audit Report

OFFICE OF THE INSPECTOR GENERAL

NATIONAL SECURITY EDUCATION TRUST FUND ACCOUNTING RECORDS

Report No. 94-007 October 19, 1993

Department of Defense

Acronyms

ASD(C3I)	Assistant Secretary of Defense (Command, Control, Communications and Intelligence)
DFAS	Defense Finance and Accounting Service
DIA	Defense Intelligence Agency
DISA	Defense Information Systems Agency
OSD	Office of the Secretary of Defense

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

October 19, 1993

MEMORANDUM FOR ADMINISTRATOR, NATIONAL SECURITY EDUCATION PROGRAM

SUBJECT: Audit Report on the National Security Education Trust Fund Accounting Records (Report No. 94-007)

We are providing this final audit report for your information and use. The report discusses the need to establish internal controls to facilitate complete and accurate accounting and subsequent reporting of expenses incurred in the administration of the National Security Education Program.

A draft of this report was provided to the Administrator for comment on May 28, 1993. Comments on the draft were provided on June 8, 1993. The Administrator nonconcurred with the finding and the recommendation to revise the FY 1992 financial statements to reflect the costs of administering the Program. The basis for the Administrator's position was a legal opinion rendered by the Office of General Counsel that, in effect, stated that the Program could not take on an operational status because required authorization and appropriation provisions were not enacted. Therefore the costs incurred were categorized as "preoperational" and funded from other sources. The Administrator agreed with the recommendation to establish a system of controls to record obligation and liabilities in the accounting records.

Based on the opinion that legal precedent exists for funding necessary "preoperational" expenses from other sources we reported, in Audit Report No. 93-143, Principal Financial Statements of the National Security Education Trust Fund - FY 1992 dated June 30, 1993, that the financial statements were presented fairly, except for the nondisclosure of the "preoperational" accounting procedure and the extent of its use. We believe that the abnormal accounting procedure warrants disclosure in the financial statements of the Fund, including a full description of the extent to which the Program benefited from the procedure. Therefore, we have revised Recommendation 2. in this report to provide for the disclosure in future financial statements. It is requested that the Administrator comment on the revised recommendation in response to this final report. It is also requested that the Administrator describe the control system and provide the completion date of actions to implement Recommendation 1.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. Comments on the final report are requested by December 17, 1993.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Harrell D. Spoons at (703) 692-2846 or Ms. Dianna J. Pearson at (703) 692-2851. The distribution of this report is listed in Appendix D.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-007
Project No. 3RF-2005

October 19, 1993

NATIONAL SECURITY EDUCATION TRUST FUND ACCOUNTING RECORDS

EXECUTIVE SUMMARY

Introduction. The National Security Education Trust Fund (the Fund) is a DoD trust fund administered by the Assistant Secretary of Defense for Command, Control, Communications and Intelligence during FY 1992. The Defense Finance and Accounting Service maintained the FY 1992 accounting records for the Fund. The Fund was established with a corpus of $150 million to provide scholarships, fellowships, and grants to support undergraduate and graduate studies in foreign languages and international fields critical to the nation's interest. As of the time of the audit, the Fund had not started disbursing monies to students or to educational institutions.

Objectives. The audit objective was to determine whether the Fund's FY 1992 financial statements were presented fairly in accordance with generally accepted accounting principles for Federal entities. We also evaluated the internal controls established for the Fund and assessed compliance with applicable laws and regulations that could have a material effect on the financial statements.

Audit Results. The Fund's financial records did not show administration expenses, and the Fund's financial statements did not disclose the existence of and source of funding for expenses incurred during FY 1992. As a result, "preoperational" expenses totaling $418,487 for FY 1992 were not reflected in the accounting records and were not disclosed in the financial statements for the National Security Education Program (the Program).

Internal Controls. The lack of accounting for preoperational expenses of the Fund constitutes a material internal control weakness. Details on the internal control weakness are in Part II of the report.

Potential Benefits of Audit. Implementation of the recommendations will ensure that expenses incurred by the Fund are recorded in the financial accounts and disclosed in the Program's financial statements. Accounting for the "preoperational" expenses will facilitate accurate and timely reimbursement to the activities that funded the expenses as well as ensure compliance with the self-sustaining provisions of the David L. Boren National Security Education Act of 1991.

Summary of Recommendations. We recommended that the Administrator, National Security Education Program, establish a system to record expenses incurred by the Program and in future financial statements disclose the extent to which "preoperational" expenses are incurred and financed by the Fund.

Management Comments. The Administrator, National Security Education Program, nonconcurred with the draft report finding and the recommendation to amend the FY 1992 financial statements to show incurred administration costs as liabilities of the Fund. Management concurred that a system of controls should be established to account for administration costs of the Program. The complete text of management's comments is in Part IV.

Audit Response. We modified the finding to acknowledge that legal precedent exists for funding "preoperational" expenses from other sources. Also, we revised the recommendation to require disclosure of preoperational expenses and the source of funding in the Notes to future financial statements. We request that the Administrator, National Security Education Program, provide a completion date for establishing a system of controls to record expenses and provide comments on the revised recommendation by December 17, 1993.

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This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate (703) 614-6303 (DSN 224-6303).

Part I - Introduction

Background

The Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576) requires the DoD to prepare financial statements on substantial commercial functions, revolving funds, and trust funds of the DoD. Financial statements are expected to provide information to DoD program managers, the Congress, and the public to facilitate the effective allocation of resources and assessment of management performance and stewardship.

The National Security Education Trust Fund (the Fund) was established by the David L. Boren National Security Education Act of 1991 (the Act). The purpose of the Fund is to provide scholarships, fellowships, and grants to support studies by U.S. citizens in foreign languages and international fields that are critical to the nation's interest. The National Security Education Board, comprised of Federal Government officials and private citizens, will determine which countries are critical to U.S. interests for the purposes of the Fund. Thus, studies focused on those countries and their languages will be eligible for assistance from the Fund.

The Fund will award scholarships to enable undergraduate students to study abroad, for at least one academic semester, in critical foreign languages or area studies. The Fund will also award fellowships to enable graduate students to pursue studies in the United States in foreign languages, area studies, and other international fields that are critical to national interests. Recipients of fellowships will be required to agree to work for an agency or office of the Federal Government or in the field of education in the area of study for which the fellowship was awarded. The Fund will award grants to institutions of higher education to enable such institutions to establish, operate, or improve programs in foreign languages, area studies, and other international fields.

The Act makes the Secretary of Defense responsible for the administration of the Fund. That responsibility was delegated to the Assistant Secretary of Defense for Command, Control, Communications and Intelligence (ASD[C3I]) during FY 1992. The operation and administration of the Fund have been further delegated to the Administrator, National Security Education Program (the Program). The authorities of the Secretary of Defense with respect to the Fund were transferred to the Under Secretary of Defense for Policy on May 18, 1993. The Program Administrator continues to be responsible for administering the Fund.

The Act authorized the Fund a corpus of $150 million and directed that amount to be transferred from existing DoD appropriations. The corpus may be invested only in interest-bearing obligations of the United States or in obligations guaranteed by the United States for both interest and principal. Interest earned accrues to the Fund.

The Act requires that obligations from the Fund be made in accordance with annual authorizations and appropriations. For FY 1992, the Congress authorized the Fund to obligate such amounts, not to exceed $35 million, as

may be provided in appropriation acts. However, no funds were appropriated in an annual appropriations act. As a result, expenses incurred during FY 1992 for the support of the Program were funded by other sources.

Objectives

The overall objective of the audit was to determine whether the Fund's financial statements present fairly the financial position of the Fund, in accordance with generally accepted accounting principles for Federal entities. Specific objectives included an evaluation of whether internal controls for the Fund can adequately detect or prevent errors that would have a material effect on the financial statement balances of the Fund and an assessment of compliance with applicable laws and regulations that could have a material effect on the financial statements.

Scope

This financial statement audit was made from March 1993 through May 1993 in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. The audit included examining, on a test basis, evidence supporting the amounts and disclosures in those statements, including the Notes on the financial statements. The audit also included assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the statements. The activities visited or contacted are listed in Appendix C.

Internal Controls

In performing our audit, we considered the internal control structure related to the Fund. We reviewed internal control policies and procedures for the receipt, investment, and disbursement of funds. We also reviewed the policies and procedures associated with preparing financial statements.

We noted conditions in the internal control structure and its operation that we consider to be a material internal control weakness as defined in Public Law 97-255, Office of Management and Budget Circular A-123, and DoD

Directive 5010.38. Specifically, we found that procedures had not been established to account for and record the administration expenses incurred by the Fund. Details on the weakness are presented in Part II of the report. The recommendations in this report, if implemented, will correct the weakness. No potential monetary benefits are identified in the report.

Prior Audits and Other Reviews

Inspector General, DoD, Audit Report No. 93-143, "Principal Financial Statements of the National Security Education Trust Fund - FY 1992," June 30, 1993, states that the Principal Statements presented fairly, in all material respects except one, the assets, liabilities, and net financial position of the Fund as of September 30, 1992. The exception was the nondisclosure of an accounting procedure that categorized expenses incurred in doing the business of the Program as preoperational expenses.

Part II - Finding and Recommendation

Accounting for Administration Expenses

The Program's accounting records did not show "preoperational" administration expenses, and the Fund's financial statements did not disclose the existence and source of funding for expenses incurred in support of the Program during FY 1992. The Program Administrator did not establish controls to ensure that "preoperational" expenditures made to support the Program were reported to the Defense Information Systems Agency (DISA) or to the Defense Finance and Accounting Service (DFAS) for inclusion in the Fund's accounting records and reporting in the financial statements. As a result, "preoperational" expenses of $418,487 were not reflected in the accounting records and were not disclosed in the Fund's FY 1992 financial statements.

Background

DoD Directive 5200.35, "National Security Education Program," January 13, 1993, delegates the authority of the Secretary of Defense under the Act to the ASD(C3I). The Directive provides that the Program shall consist of an Administrator designated by the ASD(C3I) and subordinate elements as established by the ASD(C3I). Paragraph D.2. of the Directive states that the Program shall be financed from the Fund as provided by law.

DoD Instruction 5200.36, "Administrator, National Security Education Program," January 19, 1993, provides that the Administrator shall administer, direct, and manage the resources of the Program. Also, the Instruction states that the Administrator will establish an international education center (the Center) to assist in administering and managing the Program. The Center is to be staffed by personnel subject to Defense Intelligence Agency (DIA) personnel management procedures. Paragraph C.2. of the Instruction states that the cost to the DIA for those personnel will be reimbursed from the Fund.

The corpus of the Fund was established in August 1992. The DFAS manages the investment of the corpus and provides accounting service and financial reporting. Although DFAS is capable of satisfying the Fund's accounting needs, the Administrator has negotiated an agreement with the DISA to provide obligation and expenditure accounting for the Fund. The DFAS will continue to account for the Fund's corpus, investments, and interest income.

Administration Expenses

In FY 1992, the Program incurred $418,487 in administration expenses (see Appendix A). The Program Administrator did not report the administration expenses to either DFAS or DISA; therefore, DFAS did not record expenses in

the accounting records or disclose expenses in the Fund's FY 1992 financial statements. Furthermore, the Program Administrator did not maintain records of expenses. We compiled the amounts shown in Appendix A through examining available source documents, such as personnel records, travel vouchers, and purchase requests. In our opinion, the Administrator should establish controls to ensure that all administration expenses are recorded in the Fund's accounting records by either the DFAS or DISA, as appropriate. Accounting for these "preoperational" expenses will also facilitate the accurate and timely reimbursement to the activities that funded the expenses as well as ensure compliance with the self-sustaining provisions of the Act.

Program Status

Program officials stated that the Fund will not award scholarships, fellowships, or grants until the National Security Education Board (the Board) identifies critical countries and defines Program operating criteria. The 13-member Board is to be made up of 7 Federal Government representatives and 6 private sector members. The Board cannot achieve a quorum until the private sector members are confirmed by the Senate. Although the prospective private sector members have been selected, as of the time of this audit, none had been confirmed by the Senate.

Program officials also stated that no expenditures from the Fund are permitted until congressional approval is manifested in an appropriations act. That position is consistent with the language of the Act. However, the Act also requires that all expenditures necessary for the administration of the Program be paid from the Fund. Because the office of the Program Administrator was established before the Board could define priorities and operating criteria and before the Congress approved expenditures from the Fund, the Program has incurred administration expenses that are being paid by DIA, the ASD(C3I), and the Air Force.

Although the Congress intended for the Fund to be self-supporting, Program officials contend that the use of funds appropriated for other purposes to defray Program expenses is acceptable because the Fund is still in a developmental, or preoperational, stage. Office of the Secretary of Defense (OSD) General Counsel notified us that there is legal precedent for funding preoperational expenses from other sources. However, decision makers and organizations that provide oversight need to know the true cost of the programs for which they are responsible. Even though preoperational expenses may not be categorized as liabilities of the Program, they are a Program cost. Until such time as the Congress permits disbursements from the Fund, preoperational expenses should be recorded in the appropriate accounting records to facilitate management of the Program and should be reported in the Notes to the Financial Statements to apprise the users of those statements of the actual cost of the Program.

Conclusion

Except for establishing controls to ensure that all preoperational expenses are recorded in the Fund's accounting records, we believe there is reasonable assurance that the control structure meets the internal control objectives. Furthermore, disclosing "preoperational" expenses in the Notes to the Financial Statements will enhance their usefulness to management and oversight activities.

Recommendation, Management Comments, and Audit Response

We recommend that the Administrator, National Security Education Program:

1. Establish a system of controls to record obligations and liabilities in the accounting records of the National Security Education Trust Fund.

2. Disclose incurred preoperational expense, if any, in the Notes to the Financial Statements for FY 1993 and future years.

Management Comments. The Program Administrator nonconcurred with the finding, stating that the auditors assumed the office is conducting a program and incurring expenses that should be allocated against the Fund. A legal opinion rendered by OSD General Counsel on December 3, 1992, determined that the Fund cannot take on an operational status until an authorization and a provision in an appropriations act are enacted. That opinion reinforced the course of action that the DIA took in supporting the initial setup process, that is, it is appropriate to assist in setting up a program without designated funds for the program and without reimbursement if a related and functional interest exists. Regarding the Fund, the legislation specifically identified an administrative relationship to the Defense Intelligence College, an activity within the DIA.

Audit Response. The opinion expressed by the OSD General Counsel in the December 3, 1992, memorandum states that administrative expenses of the Fund are to be paid from the Fund. Furthermore, no expenditures could be made from the Fund until authorized by an appropriations act. As of the close of FY 1992 and the time of our audit, the required enactments had not occurred. Rather than exceed the level of authority established, the expenses were categorized by management as preoperational. In view of that decision and OSD General Counsel's opinion that legal precedent exists for funding necessary preoperational expenses from other sources, we have modified the report to acknowledge the positions espoused by Program officials and by OSD General Counsel.

Management Comments. The Program Administrator concurred with Recommendation 1. to establish a system of controls to record obligations and liabilities in the accounting records of the Fund.

Audit Response. We consider management's comments to be partially responsive to the recommendation. The comments did not indicate how the recommendation would be implemented or when the controls would be established. We request that the Program Administrator describe the control system to be established and the expected completion date in response to this final report.

Management Comments. The Program Administrator nonconcurred with Recommendation 2. to revise the FY 1992 financial statements to show the administration expenses as liabilities of the Fund. The comments stated that obligations could not be made against the Fund; therefore, expenses incurred were categorized as preoperational expenses and were funded from other sources.

Audit Response. Based on management's comments and OSD General Counsel's advice that a legal precedent exists for funding preoperational expenses from other sources, we have revised Recommendation 2. to require disclosure of preoperational expenses in the Notes to future financial statements. We request that management comment on the revised recommendation in responding to this final report.

Part III - Additional Information

Appendix A. Preoperational Expenses

Preoperational (administration) Expenses for the National Security Education Program for FY 1992 totaled $418,487.

Expense	DIA	ASD(C3I) [1]	USAF [2]	Total
Civilian Salaries	$255,441	--	--	$255,441
Military Salaries	--	--	$65,159	65,159
Accrued Leave	24,231	--	--	24,231
Federal Insurance Contributions Act	5,911	--	--	5,911
Federal Employees Group Life Insurance	1,395	--	--	1,395
Health Benefits	9,181	--	--	9,181
Retirement Benefits	13,933	--	--	13,933
Travel Costs	1,224	$11,105	--	12,329
Lease	21,780	--	--	21,780
Purchase Requests	5,339	--	--	5,339
Postage	--	3,000	--	3,000
Supplies	788	--	--	788
Totals	$339,223	$14,105	$65,159	$418,487

[1] Assistant Secretary of Defense (Command, Control, Communications and Intelligence)

[2] U.S. Air Force

Appendix B. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Type of Benefit
1. and 2.	Internal Control and Compliance. Ensure compliance with the David L. Boren National Security Education Act and facilitate the accurate and timely reimbursement to the activities that funded "preoperational" expenses of the Program. Provide managers accurate data to use in their decision-making process by full disclosure of unique accounting procedures in financial statements.	Nonmonetary.

Appendix C. Activities Visited or Contacted

Office of the Secretary of Defense

Assistant Secretary of Defense (Command, Control, Communications and Intelligence)
Administrator, National Security Education Program, Washington, DC

Defense Agencies

Headquarters, Defense Intelligence Agency, Washington, DC
Headquarters, Defense Information Systems Agency, Arlington, VA
Defense Finance and Accounting Service, Defense Accounting Office-Cleveland Center, Arlington, VA

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Policy)
  Administrator, National Security Education Program
Assistant Secretary of Defense for Command, Control,
  Communications and Intelligence
Comptroller of the Department of Defense
Assistant to the Secretary of Defense for Public Affairs

Department of the Army

Auditor General, Army Audit Agency

Department of the Navy

Auditor General, Naval Audit Service

Department of the Air Force

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

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Intelligence Agency
Director, Defense Information Systems Agency
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

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

Non-Defense Federal Organizations (Cont'd)

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

Senate Appropriations Committee
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Select Committee on Intelligence
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations
House Permanent Select Committee on Intelligence
House Subcommittee on Oversight and Evaluation, Permanent Select Committee on Intelligence

Part IV - Management Comments

Administrator, National Security Education Program

Final Report Reference

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, D.C 20301-2000

8 JUN 1993

POLICY

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT

SUBJECT: Draft Audit Report on the National Security Education Trust Fund Financial Statements for FY 1992 (Project No. 3RF-2005)

I have reviewed the draft DoDIG audit report for the National Security Education Trust Fund for FY 1992 Financial Statements and nonconcur on the findings. I do however, concur with your recommendation to establish a system of controls to record obligations and liabilities in the accounting records of the National Security Education Trust Fund.

Our noncurrence is based on the DoDIG report containing inaccurate statements, selective analysis and use of data unrelated to the FY 1992 review of financial statements. The following analysis is offered to correct the draft audit:

a. the DoDIG makes the assumption that the office is conducting a program and incurring expenses which should be allocated against the Trust Fund. A legal opinion rendered by the OSD/GC on 3 December 1992, determined that this office cannot take on an operational status until an authorization and a provision in an appropriations act are enacted. This determination reinforced the course of action that the Defense Intelligence Agency established for supporting the initial setup process i.e. it is appropriate to assist in the setting up of a program, absent designated funds for the program, without reimbursement if there is a related and functional interest. In this case, the legislation specifically identified an administrative relationship to the Defense Intelligence College, an activity in the Defense Intelligence Agency organization.

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b. based on background information in para. 2a, it is inappropriate to identify support assistance rendered by DIA and ASD/C3I to adjust the financial statements of the NSETF. There was no request by DoD components or legislative requirement that setup costs were to be identified as operational costs associated with conducting a program.

c. since the Program held official status with the ASD/C3I, support was temporarily created by personnel detailed from DIA. There were no funds available to purchase software necessary to independently record and maintain costs customarily incurred by DIA personnel. DIA Accounting and Finance did, however, maintain records of those costs. In addition, procedures were established

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to record expenditures to the NSEP as evidenced by existing MOAs among DFAS, DIA and the NSEP and between DISA and the NSEP.

d. other areas of the report found to reflect inaccurate data are:

-page 2. para. 5, there was not a provision in the FY 1992 legislation that would allow the Trust Fund to accept gifts; that provision is included in the legislative package for the FY1994 Budget request. deleted

-page 3. para. 1, states that $35 million remains available until expended. These funds have not been available, as indicated by a 3 December 1992 GC opinion which states that there was required an authorization and a provision in an appropriations act to incur obligations from the Trust Fund. 3

-page 7. para. 2, it is the position of the current administration that the four Board nominations made this past January be replaced with six new nominations. They have not been made to date. 7

-page 7. para. 3, notwithstanding what the Act has called for, it is the position of DIA that operational administrative costs have not been incurred and that those costs accrued to date are not incompatible with normal and customary expenses incurred by its personnel. 8

If you have questions or require further information, please contact Mr. Gary G. Dettman at (703)693-7717.

for Gary G. Dettman

R. Charlene King
Acting Administrator
National Security
Education Program

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