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**R** *eport*

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE  
NAVAL AUDIT SERVICE AUDIT OF THE FY 2000 NAVY  
WORKING CAPITAL FUND FINANCIAL STATEMENTS

Report No. D-2001-057

February 21, 2001

Office of the Inspector General  
Department of Defense

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### **Acronym**

NAS

Naval Audit Service



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

February 21, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING  
SERVICE**

**SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Naval Audit Service Audit of the FY 2000 Navy Working Capital Fund Financial Statements (Report No. D-2001-057)**

We are providing this report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Naval Audit Service disclaimer of opinion on the FY 2000 Navy Working Capital Fund financial statements, along with excerpts from the Naval Audit Service report, "Fiscal Year 2000 Department of the Navy Working Capital Fund Principal Statements," February 7, 2001. An audit of the Navy Working Capital Fund financial statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Because this report contains no findings or recommendations, written comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Joel K. Chaney at (216) 522-6091, extension 235 (DSN 580-6091) (jchaney@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink that reads "David K. Steensma".

David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. D-2001-057

February 21, 2001

(Project No. D2000FC-0279.001)

### Inspector General, DoD, Oversight of the Naval Audit Service Audit of the FY 2000 Navy Working Capital Fund Financial Statements

#### Executive Summary

**Introduction.** Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD to prepare annual audited Navy Working Capital Fund financial statements. Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, establishes the minimum requirements for audits of these financial statements. This Bulletin requires the Inspector General, DoD, to express an opinion on the DoD financial statements and to report on the adequacy of internal controls and compliance with laws and regulations. We delegated the audit of the FY 2000 Navy Working Capital Fund financial statements to the Naval Audit Service. This report is the second in a series of reports and discusses the work performed on the oversight of the Naval Audit Service audit of the FY 2000 Navy Working Capital Fund financial statements.

**Objectives.** Our objectives were to oversee the Naval Audit Service audit of the FY 2000 Navy Working Capital Fund financial statements and to determine the reliability and effectiveness of processes and procedures used to prepare those statements. This report focuses on the oversight objective. The objective for determining the reliability and effectiveness of processes and procedures used to prepare financial statements will be addressed in a subsequent report. See Appendix A for a discussion of the audit process.

**Results.** The Naval Audit Service report, “Fiscal Year 2000 Department of the Navy Working Capital Fund Principal Statements,” February 7, 2001, states that the auditors were unable to express an opinion on the FY 2000 Navy Working Capital Fund financial statements. We concur with the Naval Audit Service disclaimer of opinion; our endorsement of that disclaimer is Exhibit 1. Excerpts of the Naval Audit Service report are included in Exhibit 2 and provide the reasons for the disclaimer of opinion and identify the material weaknesses and reportable conditions associated with the internal controls and compliance with laws and regulations. The complete Naval Audit Service report can be accessed on the Internet at <http://www.hq.navy.mil/NavalAudit>. The FY 2000 Navy Working Capital Fund Principal Statements can be accessed on the Internet at [www.dtic.mil/comptroller](http://www.dtic.mil/comptroller).

# Table of Contents

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<b>Executive Summary</b>	i
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## **Appendixes**

A. Audit Process	
Scope and Methodology	1
Prior Coverage	2
B. Report Distribution	3

## **Exhibits**

1. Inspector General, DoD, Endorsement Memorandum
2. Excerpts from Naval Audit Service Report “Fiscal Year 2000  
Department of the Navy Working Capital Fund Principal Statements”

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# Appendix A. Audit Process

## Scope and Methodology

**Audit Work Performed.** To fulfill our responsibilities under Public Law 101-576, the “Chief Financial Officers Act of 1990,” as amended by Public Law 101-356, the “Federal Financial Management Act of 1994,” and Office of Management and Budget Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, we performed oversight of the independent audit conducted by the Naval Audit Service (NAS) of the FY 2000 Navy Working Capital Fund financial statements. We reviewed the NAS audit approach and monitored audit progress at key points.

**Reviewing the NAS Audit Approach.** We used the “Federal Financial Statement Audit Manual,” January 1993, issued by the President’s Council on Integrity and Efficiency, and the “Financial Audit Manual,” December 12, 1997, issued by the General Accounting Office, as criteria for reviewing the NAS audit approach. We reviewed the notification letter, formulation of strategy, entity profile, general risk analysis, cycle memorandums, and audit programs. In addition, we participated in NAS conferences on the Navy Working Capital Fund financial statements. The conferences covered the NAS planning and formulation of audit strategy and included presentations on issues that developed during the NAS work.

**Monitoring Audit Progress.** Through the DoD Financial Statement Audit Executive Steering Committee, and an integrated line-item oversight effort, we provided a forum for a centrally managed exchange of guidance and information. We reviewed and commented on the NAS audit opinion report, which included discussions of issues on internal controls and compliance with laws and regulations. We reviewed key work papers and summaries of NAS audit results and conclusions.

**DoD-Wide Corporate-Level Government Performance and Results Act Goals.** In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following corporate-level goal, subordinate performance goal, and performance measure.

**FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-02)**

**FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**

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**FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01–DoD-2.5.2)**

**DoD Functional Area Reform Objectives and Goals.** Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

**Financial Management Area. Objective:** Strengthen internal controls.  
**Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the DoD Financial Management high-risk area.

**Audit Type, Period, and Standards.** We performed this financial statement audit from August 23, 2000, through February 7, 2001, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data to conduct oversight of the Naval Audit Service audit of the FY 2000 Navy Working Capital Fund financial statements.

**Contacts During the Audit.** We visited or contacted individuals and organizations in the DoD audit community. Further details are available on request.

## **Prior Coverage**

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil/audit/reports>.

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## **Appendix B. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
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

### **Other Defense Organization**

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Director, Defense Finance and Accounting Service Cleveland

### **Non-Defense Federal Organizations**

Office of Management and Budget  
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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

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Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
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House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform  
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

**Exhibit 1. Inspector General, DoD,  
Endorsement Memorandum**



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

February 7, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING  
SERVICE**

**SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 2000  
Navy Working Capital Fund Financial Statements  
(Project No. D2000FC-0279.001)**

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Naval Audit Service (NAS) the audit of the FY 2000 Navy Working Capital Fund financial statements. Summarized as follows are the NAS disclaimer of opinion on the FY 2000 Navy Working Capital Fund financial statements and the results of our review of the NAS audit. The information provided in this memorandum contains reasons for the NAS disclaimer. We endorse the disclaimer of opinion expressed by the NAS.

**Disclaimer of Opinion.** The NAS disclaimer of opinion on the FY 2000 Navy Working Capital Fund financial statements, dated February 7, 2001, states that NAS was unable to express an opinion on the financial statements. We concur with the NAS disclaimer of opinion. The NAS was unable to ascertain the reliability of amounts reported on the financial statements. The following deficiencies as reported in Department of the Navy Management Representation Letter, Annual Statement(s) of Assurance, and the notes to the financial statements preclude an audit opinion.

- The Navy Working Capital Fund did not have transaction-driven standard general ledger accounting systems that could accurately report the value of assets and liabilities.
- Financial accounting systems did not contain sufficient audit trails to enable transaction-level verification.
- Financial and non-financial feeder systems and processes were noncompliant and not integrated as required by statutory requirements and other regulations. In addition, internal controls for the financial management feeder systems were absent or unreliable, resulting in information that had a high risk of being inaccurate.
- The inventory valuation model used to compute inventory and cost of goods sold contained errors, and the policies and procedures used to revalue inventory to historic cost did not provide an accurate inventory valuation.

**Internal Controls.** The NAS determined that internal controls did not provide reasonable assurance that the FY 2000 Navy Working Capital Fund financial statements contained no material misstatements. The major internal control weakness, as reported in the management representation letter and FY 2000 Annual Statement(s) of Assurance, was the continued lack of an integrated transaction-driven general ledger accounting system. The NAS also reported that numerous control deficiencies in prior audit reports have not been remedied. For example, cash reconciliations for naval shipyards were not performed, nor was all supporting documentation retained; operating procedures for naval shipyard financial accounting were not consistent or complete; wholesale inventory for the Marine Corps was not reported nor valued correctly because an integrated transaction-driven accounting system was lacking; and personal property was not accurately reported because assets were capitalized using an incorrectly placed in-service date and because property was depreciated after disposal.

**Compliance with Laws and Regulations.** The NAS identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996, the NAS audit work disclosed that the Navy Working Capital Fund used financial management and accounting systems, including feeder systems, which were error prone and did not substantially comply with Federal financial management systems requirements and Federal accounting standards. Also, journal vouchers used by the Defense Finance and Accounting Service Norfolk to adjust the financial statements for naval shipyards lacked required documentation, were incomplete, or inaccurate. In addition, inventory in the custody of the Defense Logistics Agency was adjusted without performing required causative research and property loss investigations.

**Review of Naval Audit Service Work.** To fulfill our responsibilities for determining the accuracy and completeness of the independent audit work that NAS conducted, we reviewed the audit approach and planning and monitored progress at key points. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the NAS work on the FY 2000 Navy Working Capital Fund financial statements from April 19, 2000, through February 7, 2001, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the NAS disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.

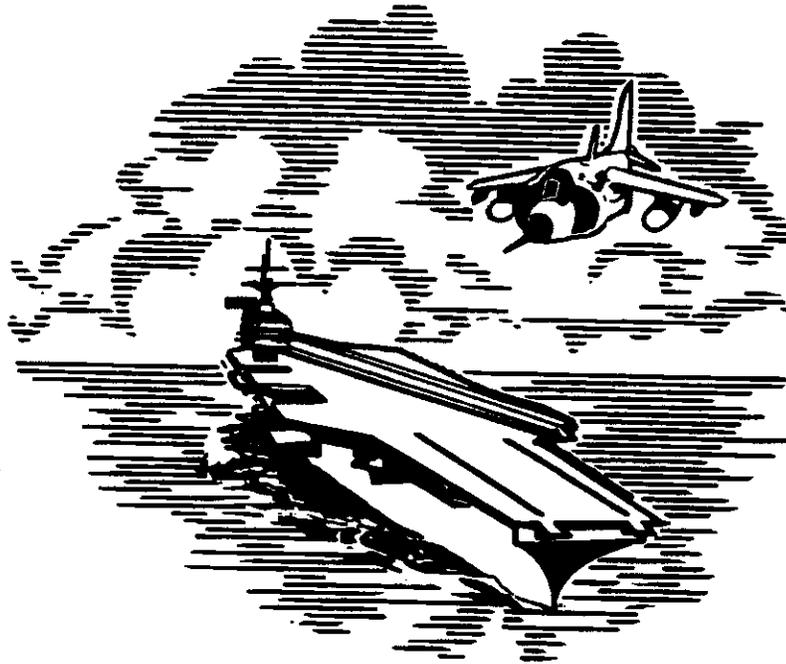


David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

**Exhibit 2. Excerpts from Naval Audit  
Service Report “Fiscal Year  
2000 Department of the Navy  
Working Capital Fund  
Principal Statements”**



# Audit Report



## Fiscal Year 2000 Department of the Navy Working Capital Fund Principal Statements

N2001-0013

7 February 2001

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Plans, Policy, and Resources  
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1006 Beatty Place SE  
Washington Navy Yard, DC 20374-5005

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# **Section A**

## **Introduction**

### **Background**

#### ***Audit Requirement***

In support of the Inspector General, Department of Defense, we performed audit work relative to the Department of the Navy Working Capital Fund Principal Statements for the fiscal year ended 30 September 2000. Financial statement audits are required by the Chief Financial Officers Act (Public Law 101-576), as amended by the Government Management Reform Act of 1994 (Public Law 103-356). The Acts were passed to improve financial management practices within the Federal Government and make Government operations more efficient and effective. The Acts require that financial statements be audited by the Inspector General, Department of Defense or by an independent external auditor designated by the Inspector General, Department of Defense.

#### ***Department of the Navy Working Capital Fund***

The basic principle of the Department of the Navy Working Capital Fund is to capture all costs of operating activity groups and to reflect the total cost of doing business in stabilized rates charged to customers. For Fiscal Year 2000, the Defense Finance and Accounting Service, with assistance from the Assistant Secretary of the Navy (Financial Management and Comptroller), prepared principal statements (see Section F) for the Department of the Navy Working Capital Fund and financial statements for each reporting entity. Principal statements that were produced for reporting purposes included:

- Balance Sheet
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Budgetary Resources
- Statement of Financing

The Department of the Navy Working Capital Fund consists of nine primary activity groups:

**Shipyards.** Functions include providing logistic support for ships and service craft; performing construction, overhaul, repair, alteration, dry-docking and outfitting ships and craft; performing design, manufacturing, refit and restoration; and providing services and material to other activities and units as required.

**Aviation.** Functions include providing responsive worldwide maintenance, engineering, and logistics support to the Fleet and ensuring a core industrial resource base essential for mobilization; repairing aircraft, engines, and components and manufacturing parts and assemblies; providing engineering services in the development of hardware design changes; and furnishing technical and other professional services on maintenance and logistics problems.

**Other (Marine Corps).** Functions include providing quality and responsive maintenance, and maintenance-related products and services to the Fleet Marine Force and other customers while maintaining a core industrial base to support mobilization and surge requirements.

**Ordnance.** This primary activity group was functionally transferred from the Navy Working Capital Fund to the Navy General Fund in November 1998. Because residual accounting remains in the Navy Working Capital Fund, each Ordnance activity prepared financial statements and related notes for Fiscal Year 2000.

**Transportation.** The mission of the Military Sealift Command is to provide efficient sea transportation, combat-ready logistics forces, and reliable special mission ships for the Department of Defense in peace and war.

**Base Support.** This primary activity group consists of two sub-activity groups that provide worldwide infrastructure needed to ensure the Department of the Navy maintains full operational capabilities.

**Information Services.** This primary activity group consists of three sub-activity groups which provide communications and information services needed to support the Department of the Navy and other customers world-wide through design, development, maintenance, and environmental support of world class communications and information systems.

**Research and Development.** This primary activity group consists of five sub-activity groups that develop technologically advanced warfare tools and technology for naval forces deployed on land, sea, and air.

**Supply Management.** This primary activity group consists of two sub-activity groups which provide our naval forces with quality supplies and services that meet customer demands for consumable and repairable items while maintaining appropriate levels of inventory.

## **Objectives**

The objectives of this audit were to:

- Determine whether we could perform an audit of the Department of the Navy Working Capital Fund Principal Statements for Fiscal Year 2000. An audit, if completed, would determine whether the principal statements fairly presented the financial position and results of operations for Fiscal Year 2000, in all material respects.
- Assess the adequacy of internal controls to detect or prevent errors and misstatements that could have a material effect on the financial statement balances.
- Ascertain compliance with laws and regulations that could have a material effect on the financial statement balances.

## **Scope and Methodology**

Overall responsibility for auditing Department of Defense financial statements rests with the Inspector General, Department of Defense, as required by the Chief Financial Officers Act of 1990. Our audit of the Department of the Navy Working Capital Fund was accomplished in support of this requirement.

Our audit evaluated internal controls and presentation of selected accounts of the Fiscal Year 2000 Department of the Navy Working Capital Fund Principal Statements and related footnotes. We performed our audit work from 22 February 2000 to 7 February 2001 at Navy Working Capital Fund and Defense Finance and Accounting Service locations. A listing of the activities visited or contacted is in Section D.

Except for the scope limitations discussed in Section B, the audit work was conducted in accordance with generally accepted government auditing standards. At activities visited, we examined accounting records and reports; held discussions with officials; and performed various audit steps to enable us to evaluate internal control structures, Management Control Programs, and compliance with applicable laws and regulations. We coordinated the audit with the Inspector General, Department of Defense.

This report provides our disclaimer of opinion on the Department of the Navy Working Capital Fund Principal Statements for the fiscal year ended 30 September 2000, and contains our conclusions on internal controls and compliance with laws and regulations. Section F provides the Principal Statements, Notes to the Principal Statements, Supporting Consolidating Statements, and Required Supplementary Information.

# **Section B**

## **Results of Audit Work**

### **Part I - Report on Auditor's Opinion**

We performed audit work relative to the Department of the Navy Working Capital Fund Principal Statements as of 30 September 2000, in accordance with generally accepted government auditing standards. Our auditing procedures included an evaluation of related internal controls and compliance with laws and regulations. The Assistant Secretary of the Navy (Financial Management and Comptroller) is responsible for these financial statements, for establishing and maintaining internal controls, and for complying with laws and regulations applicable to Department of the Navy financial accounting and reporting.

**Disclaimer of Opinion.** We are unable to express an opinion on the Department of the Navy Working Capital Fund Principal Statements as of 30 September 2000. As reported in the management representation letter and annual Statements of Assurance, the following deficiencies preclude an audit opinion.

- The Department of the Navy Working Capital Fund did not have transaction-driven standard general ledger financial accounting systems that could accurately report the value of assets and liabilities.
- Financial accounting systems did not contain sufficient audit trails to enable transaction-level verification.
- Department of the Navy Working Capital Fund financial and non-financial feeder systems and processes were noncompliant and not integrated as required by statutory requirements and other regulations.
- Internal controls for financial management feeder systems used by the Department of the Navy Working Capital Fund activities were absent or unreliable, resulting in information that had a high risk of being inaccurate. These deficiencies increased the likelihood of fraud, errors, and material misstatements within the system and the resulting financial statements.
- The Inventory Valuation model used to compute an inventory value and a value for cost of goods sold contained errors. The reported inventory in the Department of the Navy Working Capital Fund financial statements was unreliable. The policies and procedures used to revalue inventory to historic cost did not provide an accurate inventory valuation.

As a result of deficiencies cited above, we were unable to ascertain the reliability of amounts reported on the financial statements.

**Internal Controls.** Limited tests found internal controls were not adequate to ensure that resources were properly managed and accounted for, that the Department of the Navy complied with applicable laws and regulations, and that the Department of the Navy Working Capital Fund Principal Statements were free of material misstatements. Internal controls did not ensure that assets and liabilities were properly accounted for and valued, and that accounting transactions were accurate and properly supported.

A handwritten signature in black ink, appearing to read "Bill A. Roderick", is written over a horizontal line.

BILL A. RODERICK  
Assistant Auditor General  
Financial and Forces Management Audits  
Naval Audit Service

7 February 2001

## Part II - Report on Internal Controls

As part of our review to determine whether we could perform an audit of the Department of the Navy Working Capital Fund Principal Statements (hereinafter referred to as "financial statements") as of and for the year ended 30 September 2000, we considered the internal controls over those financial statements. We obtained an understanding of the internal controls, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in the areas shown in Section E. The objective of our audit was not to provide assurance on internal controls. Consequently, we do not provide an opinion on internal controls.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters discussed in the following paragraphs involving internal controls and their operations that we consider to be reportable conditions and material weaknesses.

The major internal control weakness identified in the management representation letter and Statements of Assurance was the lack of an integrated transaction-driven general ledger accounting system. The Department of the Navy Working Capital Fund used financial management and accounting systems, including feeder systems, which were error prone and noncompliant. In addition, we identified major control procedural problems that contributed to internal control weaknesses in accumulating financial data.

The specific reportable internal control conditions are briefly described in Section E. They are broken out between those conditions being identified during this year and those conditions that were previously identified in prior audit reports. Details on these conditions are presented in separate supporting reports.



## **Part III - Report on Compliance With Laws and Regulations**

As part of our review of the Department of the Navy Working Capital Fund's Principal Statements (hereinafter referred to as "financial statements") as of and for the year ended 30 September 2000, we reviewed compliance with applicable laws and regulations.

The management of the Department of the Navy is responsible for complying with applicable laws and regulations. To determine whether we could perform an audit of the financial statements, we performed tests of compliance with certain provisions of laws and regulations. Noncompliance with those provisions of laws and regulations that we reviewed could have a direct and material effect on determining financial statement amounts. Also, we tested compliance with certain other laws and regulations specified in Office of Management and Budget Bulletin No. 01-02, including the requirement referred to in the Federal Financial Management Improvement Act of 1996. We limited our test of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Department of the Navy Working Capital Fund. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements and violations of prohibitions contained in laws or regulations that cause us to conclude that: (1) the aggregation of the misstatements resulting from those failures or violations is material to the Principal Statements of the Department of the Navy Working Capital Fund, or (2) the sensitivity of the matter would cause it to be perceived as significant by others. As reported in the management representation letter and annual Statements of Assurance, there were material instances of noncompliance with applicable laws and regulations.

The results of our tests of compliance with laws and regulations described in the preceding paragraph disclosed instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards and Office of Management and Budget Bulletin No. 01-02. Significant laws and regulations considered are listed in Section C. The specific material instances of noncompliance are briefly described in Section E. They are broken out between those conditions being identified during this year and those conditions that were previously identified in prior audit reports. Details on these instances are presented in separate supporting reports.



# **Section E**

## **Identified Conditions**

### **Fiscal Year 2000 Identified Conditions**

- Contrary to requirements, a compliant General Ledger Financial Management System for Naval Shipyard financial accounting had not been developed. This necessitated manual work-arounds and unnecessary duplication of transaction entries in order to prepare and report financial data; could result in errors in financial data; was an inefficient use of resources; and increased the risk for inaccurate Department of the Navy Working Capital Fund financial reports. (Federal Financial Management Improvement Act of 1996, Office of Management and Budget Circular No. A-127, Department of Defense Financial Management Regulation (DOD 7000.14-R), Volume 1, Chapter 2).
- Journal vouchers used by Defense Finance and Accounting Service Norfolk to adjust Naval Shipyard financial statements lacked required documentation. (DOD 7000.14-R, Volume 6, Chapter 2).
- Cash reconciliations for Naval Shipyard financial accounting were not performed nor was all supporting documentation retained as required. (DOD 7000.14-R, Volume 4, Chapter 1, paragraph 0103).
- Naval Shipyard financial accounting operating procedures were not consistent, complete, and/or had not been established as required at Defense Finance and Accounting Service Norfolk. (Standards for Internal Control in the Federal Government GAO/AIMD-0021.3.1).
- Valid Memorandums of Agreement, including supporting Concept of Operations, which detailed roles and responsibilities did not exist between Defense Finance and Accounting Service Norfolk and the Naval Shipyards as required. (Department of Defense Instruction 4000.19).
- Marine Corps inventory reported was not accurate because of the following:
  - Inventory in the custody of the Defense Logistics Agency was adjusted without performing the required causative research and property loss investigation. This occurred because the contractors managing the inventory were not aware of the requirements. (Material Standard Transaction Reporting and Accounting Procedures (MILSTRAP), DOD 4000.25-2-M).

- Wholesale inventory balances were not reported and valued correctly on the financial statements because a transaction based integrated accounting system was lacking. (DOD 7000.14-R, Volume 11B, Chapter 55).
  - Internal controls at Defense Distribution Depots Barstow, CA and Albany, GA did not prevent improper disposal of serviceable Marine Corps Inventory. This occurred because of management inattention to monitor and track assets being disposed. (Defense Material Disposition Manual, Chapter 3, paragraph G, DOD 4160.21-M).
  - Marine Corps inventory security controls were not adequate to safeguard inventory from loss or possible theft because of insufficient resources and management inattention. (DOD 7000.14-R, Volume 1, Chapter 3, Addendum, Key Accounting Requirement 2).
- Personal property inventory was not accurately reported because assets were capitalized using an incorrect placed in-service date, and assets depreciated after disposal. (DOD 7000.14-R, Volume 11B, Chapter 58 and Volume 6B, Chapter 1).

### **Previously Reported Conditions**

- Accounts Receivable, Net, Federal subsidiary accounts were not reconciled to the general ledger because there was a lack of management policy and procedures in performing and posting adjustments to the general ledger. (DOD 7000.14-R, Volume 4, Chapter 3, paragraph 030202).
- Inventory and Related Property, Net was not accurately reported due to the following conditions:
  - The Inventory Valuation model contained material misstatements because of weaknesses in the Standard Operating Procedures and allowance treatment of accounts that were period gains and losses. (DOD 7000.14-R, Volume 11B, Chapter 55, Addendum 2, paragraph C.6.a; and Office of Management and Budget Statement of Federal Financial Accounting Standards Number 3, paragraphs 42, 43, and 44).
  - Operating Materials and Supplies held for use at industrial activities had not been revalued to historical cost because of a lack of policy and procedures. (Office of Management and Budget Statement of Federal Financial Accounting Standards Number 3, paragraphs 42, 43, and 44).
  - Security controls were not adequate to safeguard inventory from loss or possible theft because of insufficient resources and management inattention. (DOD 7000.14-R, Volume 1, Chapter 3, Addendum, Key Accounting Requirement 2).

- Cash reconciliations between the Centralized Expenditure/Reimbursement Processing System and activity general ledgers were not performed nor was all supporting documentation retained as required because of management inattention and lack of training. (DOD 7000.14-R, Volume 11B, Chapter 54, paragraph a.4).
- Cash was being recognized prior to collection or clearing Treasury at activities using Defense Industrial Fund Management System because no programming change had been made to correct the condition. (DOD 7000.14-R, Volume 11B, Chapter 54, paragraph A.2.a).
- Accounts Receivable, Net, Federal and Non-Federal for Supply Management were not based on individual transactions because summary information was included in the reported account balance. (DOD 7000.14-R, Volume 11B, Chapter 54, paragraph C.4).
- Accounts Receivable, Net, Federal and Non-Federal audit trails were lacking because supporting documentation was not retained as required and subsidiary ledgers were incomplete due to management inattention, lack of training, and unexplained inconsistencies between accounting systems. (DOD 7000.14-R, Volume 11B, Chapter 54, paragraph C.4. and Volume 1, Chapter 3, Key Accounting Requirement Numbers 5 and 8).
- Accounts Receivable, Net, Federal and Non-Federal internal controls did not identify irregular and noncompliant reporting practices and systems because of management inattention, lack of resources, and lack of training. (DOD 7000.14-R, Volume 1, Chapter 1, paragraph 010101 and Volume 4, Chapter 7, paragraph 0703).
- General Property, Plant, and Equipment, Net Acquisitions, disposals, and capital improvements internal controls were not adequate to detect or prevent errors because of management inattention, insufficient staffing, and lack of training. (DOD 7000.14-R, Volume 1, Chapter 1, paragraph 010101 and Volume 4, Chapter 7, paragraph 0703).
- General Property, Plant and Equipment, Net asset values reported for Supply Management were not transaction-based because no wall-to-wall inventory had been performed to provide values for each item. (DOD 7000.14-R, Volume 11B, Chapter 58, paragraphs D.6 and D.7; and Addendum 1, paragraph B.1).
- Assets Under Development were not transferred to General Property, Plant, and Equipment, Net in-use accounts and depreciation began in a timely manner because of management attention. (DOD 7000.14-R, Volume 11B, Chapter 58, paragraph D.7.b).

- Inventory and Related Property, Net reported values could not be relied on because no sound sampling plan for measuring the dollar accuracy of reported inventory stored at Government and contractor locations had been implemented. (DOD Regulation 4140.1-R and DOD Manual 4000.25-2-M).
- Inventory Valuation issues identified:
  - Inventory In-Transit from Customers, and Inventory for Agency Operations – Supplies and Material could not be verified because Department of the Navy Working Capital Fund logistics activities and Defense Finance and Accounting Service – Cleveland did not reconcile the General Ledger account balances to subsidiary records. (DOD 7000.14-R, Volume 6, Chapter 2, paragraph 020204).
  - Inventory at standard price did not match subsidiary records because a correctable error addressing the monthly execution of the valuation model was ignored pending revised guidance. (DOD 7000.14-R, Volume 11B, Chapter 55, paragraph E.2).
  - Inventory and Related Property, Net was not accurately reported because Net Operating Results for Supply Management was distorted because the cost of goods sold was computed without consideration for the stock funding of end use Depot Level Repairables that were returned from the Fleet without reimbursement. (DOD 7000.14-R, Volume 11B, Chapter 55, paragraph J.11 and Addendum 2, paragraph 3.11).
- Material Turned Into Stores inventory was not inducted in a timely or logical manner because of management inattention and a lack of resources. (DOD 7000.14-R, Volume 1, Chapter 3, Key Accounting Requirement Number 2).
- Sponsor owned material requirements were not supported or reviewed annually to determine appropriate retention levels and resulted in excess sponsor owned material being retained at Naval Sea Systems Command Working Capital Fund activities. This occurred because responsible managers were not aware of, or trained in, the application of sponsor owned material management guidance. (Sponsor Owned Material Management, Naval Sea Systems Command Instruction 4440.24C).
- Material returns were not processed within a timely manner, identified on inventory records, safeguarded to reduce the potential for theft or abuse, and protected from the elements as required. (DOD 4140.1R; Department of Defense Military Standard Requisitioning Accounting Procedures Manual, DOD 4000.25-M; Physical Security Program, Defense Logistics Agency DLA 5710.1; Material Turned Into Stores Manual, Naval Supply Systems Command Instruction 4440.157; and Ashore Supply, Naval Supply Systems Command Publication 485, Volume III).

- Accounts Payable, Federal and Non-Federal reconciliations between subsidiary and general ledgers were not performed nor was supporting documentation retained as required. (DOD 7000.14-R, Volume 4, Chapter 9, paragraph 090201).
- Eliminating entries for Supply Management Accounts Receivable could not be tested at the transaction level because summary data was included in the reported account value. (DOD 7000.14-R, Volume 6B, Chapter 10, paragraph 1023).
- Journal vouchers used by the Defense Finance and Accounting Service – Cleveland to adjust financial statement accounts lacked documentation and/or were incomplete or inaccurate. (DOD 7000.14-R, Volume 6, Chapter 2, paragraph 020207).
- Financial Management Systems internal control issues included:
  - The Department of the Navy does not have a single integrated approach to management of financial management feeder systems as required by law resulting in reduced control over financial management feeder systems; noncompliant financial management feeders system; an incomplete inventory of financial management feeder systems; and an incomplete Financial Management Improvement Plan. (Accounting Standardization Act of 1995.)
  - Access controls for financial management feeder systems were not adequate to prevent unauthorized access to financial information. (Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1.)
  - Systems documentation, documenting the functional user's accounting requirements, for financial management feeder systems was not maintained by Department of the Navy Working Capital Fund activities as required by the Department of Defense Financial Management Regulation. (DOD 7000.14-R, Volume 1, Chapter 3, Key Accounting Requirement Number 10.)

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